

# Armenia's Economic Growth Sustainability

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## Abstract

Armenia enjoyed 15 years of uninterrupted high economic growth prior to the global financial crisis in 2009. Investment, particularly in the mining and metallurgy sectors, played a key role as a driver of economic growth. Remittances, mostly from Russia, had an effect in sustaining consumption and boosting construction.

Armenia has shown some weaknesses in the external sector, due to demands for natural gas, mineral products, machinery, and equipment. Armenia's exports and FDI suffer from the embargo maintained by Turkey and Azerbaijan, in addition to the land-locked location. A political breakthrough would be necessary.

To sustain growth, Armenia may need a gradual creation of industrial systems that can facilitate more economic and export diversification. By overcoming challenges, exports can be developed to become a more important source of economic growth. Expansion in tourism can help the economy grow through the services sector.

**Key words:** Armenia, economic growth, FDI, investment climate, remittances

## 1 General background

As in Figure 1, Armenia had enjoyed 15 years of uninterrupted and remarkably high economic growth (about 11% on average during 2000-2008) before being hit hard by the global financial crisis in 2009, through such channels as external demand, commodity export prices, remittances, and private capital flows. Average income increased from below \$500 in 1994 to close to \$3,700 in 2008. Overall poverty rates dropped from over 50% of the population in the 1990s to less than 25% in 2008.

Armenia suffered a substantial drop in real GDP by 14.2% and a larger current account deficit (17.6% of GDP) in 2009. The economic decline was particularly noticed in the mining and processing sector. As a result of the crisis, the poverty rate increased from 23.5% in 2008 to 28.7% in 2009, implying the need to strengthen the social safety net.<sup>2</sup> Fiscal deficit, averaging 1.9% of GDP in 2001-2008, jumped up from the

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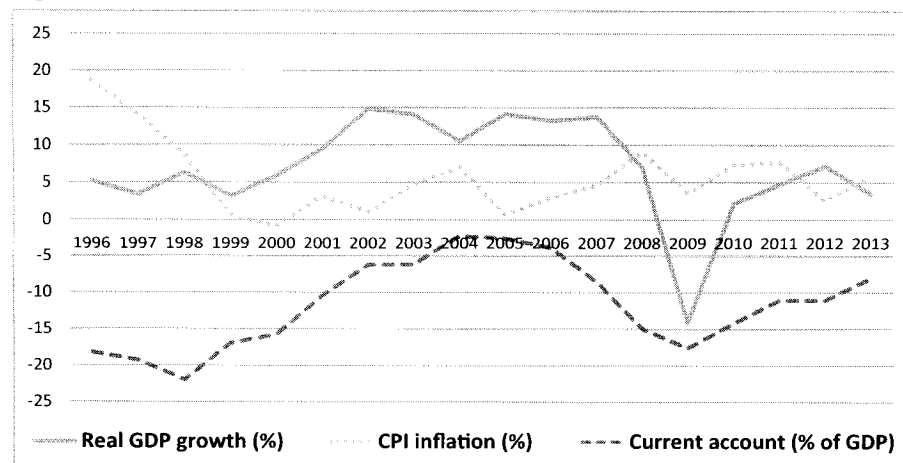
<sup>2</sup> See International Monetary Fund (2011).

only 0.7% in 2008 to 7.6% in 2009. Deficit was basically financed by borrowed funds from external sources, contributing to a rapid increase in external public debt from 13.6% of GDP in 2008 to 35.7% in 2009.

The economy later rebounded as the global market recovered, helped largely by the mining sector benefiting from an increase in metal prices. Services also rebounded due to an improvement in the external environment. However, the pace of recovery was rather slow due to a sharp fall in agricultural output caused by a violent storm. After growing by just 2.2% in 2010, real GDP grew more robustly by 4.7% in 2011, 7.1% in 2012, and 3.5% in 2013 on the back of recoveries in exports, foreign investment, and remittances. Over the medium-term, the critical issue regarding growth is whether Armenia continues to push further ahead with improving competitiveness. While Armenia maintains a highly liberal trade regime, it is a small landlocked country with high transportation costs. Thus, trade facilitation and investment in infrastructure are expected to benefit the Armenian economy. In order to sustain adequate economic growth contributing to poverty reduction, Armenia may need a new model of growth based on promotion of economic and export diversification and on economic transformation.

In this context, the purpose of this paper is to investigate the sustainability of economic growth for Armenia. Section 2 will provide a review on the status of and prospect for Armenia's growth performance. In Section 3, contribution of the main macroeconomic aggregates (consumption, total investment, export, and import) will be analyzed. Risks to sustaining economic growth will also be evaluated. Section 4 will go through changing parameters in exports, imports, and foreign direct investment (FDI), followed by the evaluation of risk factors to sustaining economic growth in the context of external sector. Then Section 5 will investigate and evaluate the growth performance of the key sectors: agriculture, industry, construction, and services. Section 6 will conclude the paper.

**Figure 1 Armenia's Growth, Inflation, and the Current Account**



Source: International Monetary Fund

## 2 Review on the status of and prospect for Armenia's growth performance

### 2.1 Macroeconomy at a glance

Armenia had enjoyed 15 years of uninterrupted and remarkably high economic growth (about 11% on average during 2000-2008) before being hit hard by the global financial crisis in 2009. In fact, as pointed out by OECD (2011), Eastern Europe and Southern Caucasus, including Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine, was one of the fastest-growing regions in the world, boosted partly by FDI inflows to the region.

The world economy experienced a steep downturn in 2009 due mainly to the economic decline in developed countries originated in the financial sector problem in the US. The global financial crisis had a considerable impact on the economy of Armenia. After continuing high growth rates for 15 years, Armenia recorded a 14.2% economic decline in 2009. Armenia's industrial sector tends to be affected by global prices for mining and metallurgy products.

External public sector debt increased following the global financial crisis. The current level of external public debt, 37.0% of GDP in 2013, is deemed manageable. IMF recommends that fiscal deficit be supported by concessional financing as much as possible to avoid a worsening of the debt dynamics.

### 2.2 External sector

Armenia was admitted to the World Trade Organization (WTO) in 2002 and maintains a liberal trade regime. However, the blockades by Turkey and Azerbaijan, as well as high transportation costs, continue to impede trade.

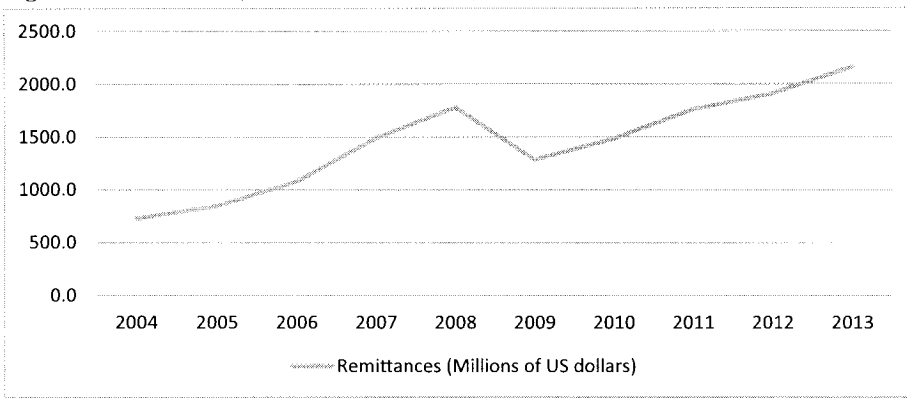
In 2010, principal exports consisted of base metals (33% of total), mineral products (27%), precious or semi-precious stones and metals (13%), and prepared foodstuffs (13%), according to Economist Intelligence Unit (2011). Russia remained Armenia's largest trading partner, accounting for 19.6% of exports and 20.0% of imports in 2012, according to Central Intelligence Agency (2014). Germany (10.7%), Bulgaria (9.1%), and Belgium (8.9%) also emerged as Armenia's important export markets.

Armenia constantly imports significantly more than it exports, mainly due to demands for natural gas, petroleum, mineral products, machinery, and equipment. Besides Russia, Germany (11%), Bulgaria (9%), Belgium (9%) were major import partners in 2012, as per Central Intelligence Agency (2014).

Russia is also Armenia's main investment partner and the main host for Armenian migrant workers. As such, favorable outlook for Russia helps stimulate Armenia's FDI and remittance inflows. Such structure of Armenia's external sector is thus subject to a risk, due to vulnerability to exogenous shocks *pertaining to* commodity prices and the Russian economic outlook.

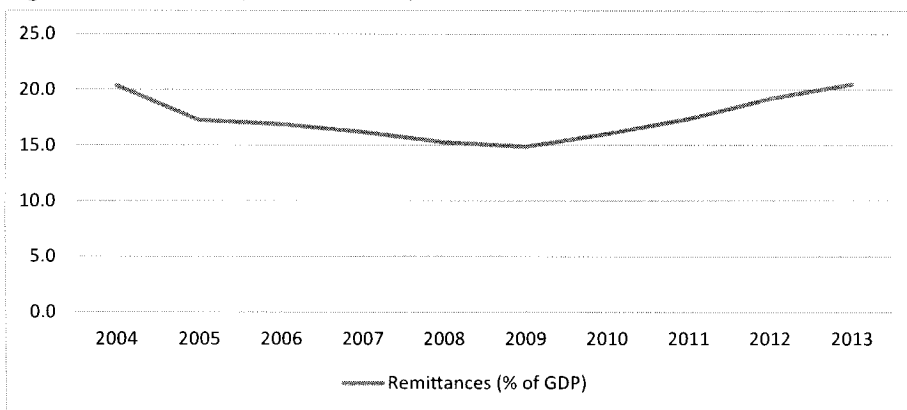
The share in GDP of exports of goods and services remain low, compared with other CIS (Commonwealth of Independent States) countries. Between 1999 and 2003 exports grew led by the diamond-processing sector. Due to disruptions to supply contracts and global competition, however, this sector has slumped since, while instead exports of base metals increased owing to new investment into the mining sector. As a result, the trade and current account deficits persist, although the latter is mitigated somewhat by inward remittances sent by Armenians working overseas as in Figures 2 and 3.

**Figure 2 Remittances (Millions of US dollars)**



Source: Central Bank of Armenia

**Figure 3 Remittances (Percent of GDP)**



Sources: Central Bank of Armenia; International Monetary Fund

### 2.3 Competitiveness

Weber and Yang (2011) argue that Armenia’s international competitiveness relative to the rest of the world declined during 2005-2008 although GDP grew by about 12% on average during this period. They show that the Armenian dram, undervalued between 2003 and late 2006, became overvalued sometime in 2007 and

has remained so through the March 2009 depreciation, contributing to a loss of external competitiveness in Armenia.<sup>3</sup>

World Bank (2013) reveals the difficulties of operating a business in Armenia, although starting a business is relatively easy. Armenia was favorably ranked 6 out of 189 economies in the “starting a business” index. However, Armenia’s position in the “trading across borders” and “enforcing contracts” indices remained lower at 117 and 112 respectively. As a result, Armenia’s overall ranking in the ease of doing business is 37.

While Armenia maintains a highly liberal trade regime as a WTO member country, it is a small landlocked country with high transportation costs. Thus, trade facilitation and investment in infrastructure are expected to benefit the Armenian economy. Armenia is located at the crossroads of several continents and comparatively well connected with the rest of the world, served by international airports. Local infrastructures are being upgraded through projects for land and air transport in Armenia.

## **2.4 Poverty and income distribution**

Armenia was severely hit by the global financial crisis in 2009, through such channels as external demand, commodity export prices, remittances, and private capital flows. The economic decline was particularly noticed in the mining and manufacturing industries. As a result, the poverty rate increased from 23.5% in 2008 to 28.7% in 2009, implying the need to strengthen the social safety net.

Strong economic growth prior to the global financial crisis was accompanied by rising real wages, contributing to an upturn in disposable income. Armenia’s regions have wide variations in development levels, depending on the degree to which investment has been attracted. According to Economist Intelligence Unit (2008), around 36% of the population lives in rural areas, many on extremely low incomes engaged in subsistence agriculture.

## **3 Economic growth of Armenia**

### **3.1 High economic growth**

Following the independence in 1991, Armenia suffered a severe economic contraction due to the collapse of the Soviet system, deteriorating terms of trade, and the economic blockade by Azerbaijan and Turkey. Since 1994 the economy had grown without interruption until Armenia was hit hard by the global financial crisis in 2009. As in Table 1 and Figure 4, between 2001 and 2007 the Armenian economy grew by an annual average of close to 13%, thanks to domestic and external developments. Investment by Russian and Western

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<sup>3</sup> The Armenian dram was allowed to depreciate by 22% against the US dollar in March 2009, following the Russian ruble depreciation.

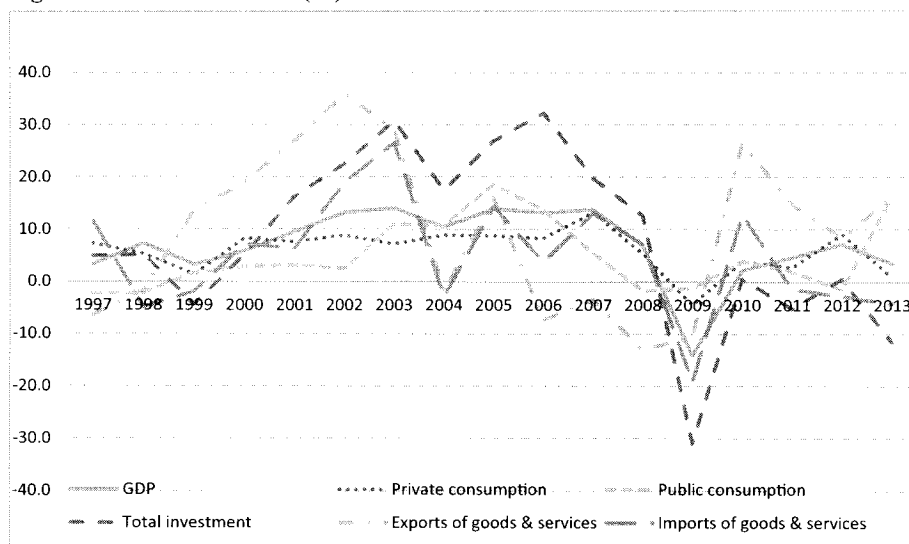
companies into the mining and metallurgy sectors supported growth in industry. Processing of precious stones and diamonds initially contributed to the acceleration in industrial output growth, but this subsector slumped later due to disruptions in supplies of raw diamonds and weak global demand. Instead, the energy, metallurgy, and food-processing sectors became the drivers of growth, as well as the construction sector and services sectors such as trade, transport and communication sectors boosted by growing tourism.

**Table 1 Real GDP Growth (%)**

1997	1998	1999	2000	2001	2002	2003	2004	2005
3.4	6.3	3.2	5.9	9.5	14.8	14.1	10.5	14.1
2006	2007	2008	2009	2010	2011	2012	2013	
13.2	13.7	6.9	-14.2	2.2	4.7	7.1	3.5	

Source: International Monetary Fund

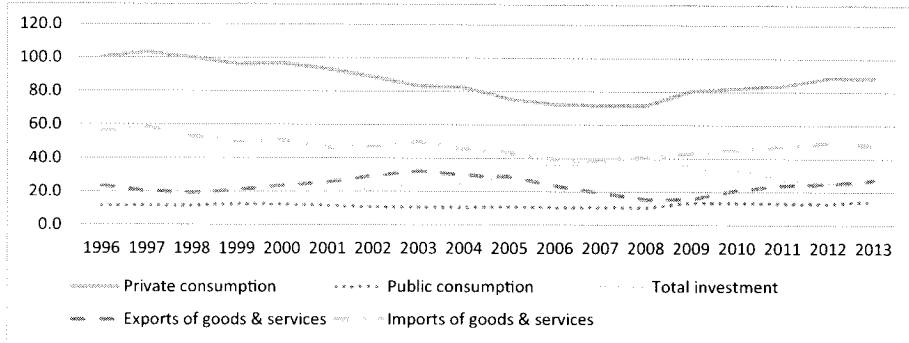
**Figure 4 Real Growth Rate (%)**



Source: Asian Development Bank

Since the independence, private consumption has been the most important among the components of aggregate demand, weighing over 70% of GDP although a declining trend was observed until 2008, as in Figure 5. Private consumption always contributed positively to economic growth until 2008, as seen in Figure 6.

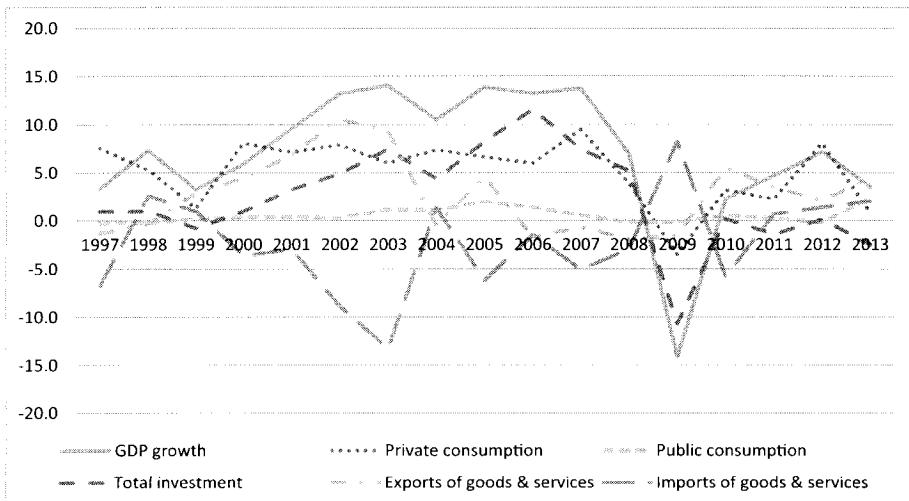
**Figure 5 Components as Percent of GDP**



Source: Asian Development Bank

The relative size of public consumption, on the other hand, had been fairly stable between 10% and 12% of GDP during 1996-2008. Public consumption was not a very important driver for growth. It can be seen in Figure 6 that the contribution to the economic growth by public consumption had been modest, turning negative in 2008, 2009, and 2012.

**Figure 6 Component Contribution to GDP Growth (%)**



Source: Asian Development Bank

Total investment remained about 20% of GDP until 2002, after which it increased, reaching the peak at 41% in 2008. Total investment served as an important engine for economic growth during 2001-2008, when its real growth rate was highly positive as seen in Figure 4. In this period the contribution to the economic growth by total investment was crucial, as observed in Figure 6.

The relative size of exports started to increase in 2000, peaking at 32% of GDP in 2003 as in Figure 5. Then exports began to decline well before the global financial crisis that affected world trade. Exports contributed strongly to economic growth during 2001-2003, but that performance turned out rather unsustainable, with the contribution turning negative in 2004 as shown in Figure 6. Subsequently, exports had not been a driver for economic growth until the recovery since 2010.

As seen in Figure 5, the relative size of imports had been constantly larger than that of exports, leading to persistent trade deficit. The contribution to economic growth by imports was negative during 2001-2003, offsetting the positive contribution by exports, as observed in Figure 6.

### **3.2 Global financial crisis**

As a result of the global financial and economic crisis in 2008-2009, the world economy experienced a steep downturn in 2009, mainly caused by the economic decline in developed countries. The crisis had a considerable impact on the economy of Armenia, which recorded a 14.2% decline in 2009, ending the continuous high growth rates of the previous 15 years. As pointed out by Mitra (2010), Armenia became the country hardest hit by the global financial crisis in the Caucasus and Central Asia.

The economic decline was especially noticeable in the mining and manufacturing industries. Lost employment and incomes abroad, especially due to the sharp downturn in Russia, decreased remittances toward Armenia. In 2009, Armenia's export and import volumes decreased by 33% and 25% respectively, according to the Ministry of Economy of the Republic of Armenia (2010). FDI also decreased in 2009.

While its relative size as percent of GDP increased, private consumption declined by 4.4% in real terms in 2009 (Figure 4), contributing to economic growth negatively as in Figure 6. The same is true with public consumption, whose relative share of GDP increased while decreasing by 1.2% in real terms in 2009 and thus contributing negatively to economic growth.

The relative size of total investment decreased significantly from 41% of GDP in 2008 to 35% in 2009, reflecting a decline by as much as 31% in real terms. This collapse of total investment was accountable for an important part of the acute decrease of real GDP by 14.2%.

Exports, whose relative size remained stably low in 2008 and 2009, decreased further by 10% in real terms in 2009, thereby contributing negatively to economic growth, as seen in Figure 6. Exports suffered from a steep fall in copper prices in the second half of 2008 and thus did not mitigate the crisis.

Imports decreased substantially by 19% in real terms in 2009, reversing its increasing trend recorded in 2007 and 2008. This had an effect of contributing to economic growth positively as seen in Figure 6.



### 3.3 Recovery since 2010

In 2010, the economy came back from its steep contraction of 2009, but only slowly due to a sharp fall in agricultural output. After growing by 2.2% in 2010, real GDP growth reached 4.7% in 2011, 7.1% in 2012, and 3.5% in 2013 on the back of recoveries in exports, foreign investment, and remittances. Industry and services remained to be a driving force, while construction and agriculture showed continued weakness. Recovery of economic growth in the main partner countries, especially in Russia, led to a robust expansion of workers' remittances.

Private consumption has increased in real terms since 2010, contributing positively to economic growth, notably in 2012, as observed in Figure 4 and Figure 6. As for public consumption, its sharp real increase contributed to growth in 2013.

Total investment increased only marginally in real terms in 2010 and has remained stagnant since. Total investment as percent of GDP, peaking at 41% in 2008, has declined steadily toward 22% in 2013.

Exports increased by 27% in real terms in 2009, reaching 21% of GDP as the relative size compared with 15% in 2008 and 2009. The increase in exports in 2010 played a key role for the economic recovery. Exports have maintained a dynamic trend since 2010.

However, imports also increased by 13% in real terms in 2010. Reflecting their higher relative size at 45% of GDP in 2010, this increase was translated into a negative contribution to economic growth, offsetting the positive contribution by the exports as seen in Figure 6. The real increase in imports has turned negative since 2011. Thus, declining imports contributed positively to economic growth during 2011-2013.

### 3.4 Risk factors to sustaining economic growth

Private consumption and public consumption have been relatively stable over time, but the relative size of private consumption as percent of GDP used to be much higher during the second half of the 1990s, prior to the strong economic boom accompanied by a solid growth of private consumption during 2000-2008. In the crisis year of 2009, however, private consumption fell by 4.4%, implying a decline in living standards. Toward the future, private consumption is to remain significant in terms of its relative share and can be a relatively stable factor to sustain economic growth.

Public consumption has been stably small in terms of its relative size and is not expected to be an important driver for economic growth in the future. There was a sharp real increase in public consumption in 2013. Fiscal policy shifted from restrictive to expansionary stance in 2013, as evidenced by a 14% increase in state budget expenditures.

Summing up the behavior of each component since the 1990s, it is safe to argue that the strong increase in total investment was an important factor leading to a solid economic growth of Armenia from 2001 to

2008. Total investment collapsed in the crisis year of 2009. It is possible that the Armenian economy had been somehow overheated before the crisis. The level of total investment remained modest in 2010 at 33% of GDP, lower than 38% in 2007 and 41% in 2008. Furthermore, total investment as percent of GDP continued to decline to 22% of GDP in 2013. To judge Armenia's future growth sustainability, it is necessary to search for a sustainable level of total investment going forward.

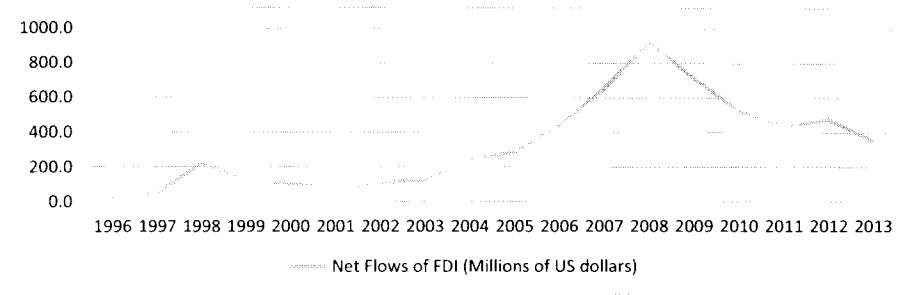
The exports picked up momentum in 2001-2003, contributing to economic growth, but this turned out unsustainable. The exports lost its dynamism and failed to contribute to growth in 2004 as well as 2006-2009. It follows that the 2009 crisis was not caused by the collapse of exports, as in many other countries. Rather, the collapse in total investment turned out more crucial. The export was not performing an important role as an engine of economic growth when Armenia was hit hard by the global financial crisis. The exports have recovered since 2010, contributing to economic growth. In order to sustain economic growth in the future, efforts need to be maintained to expand exports further.

As a net energy importer, Armenia has a relatively high propensity to import, whose size has been constantly far larger than that of export, leading to persistent trade deficit. The import has often played a role of negatively affecting economic growth, as observed in Figure 6. In 2009 the acute slowdown in imports was the only factor positively contributing to economic growth. The import growth in 2010 then had an effect of offsetting positive contribution by the export. The imports declined slightly in real terms during 2011-2013. If Armenia's propensity to import stays high, it can be a risk factor in achieving sustainable growth in the future. In other words, if the tendency in which contribution to economic growth by exports is offset by the imports drive persists, as experienced in 2001-2003, 2005, and 2010, that will present an important possibility that Armenia's future growth rate could be moderate.

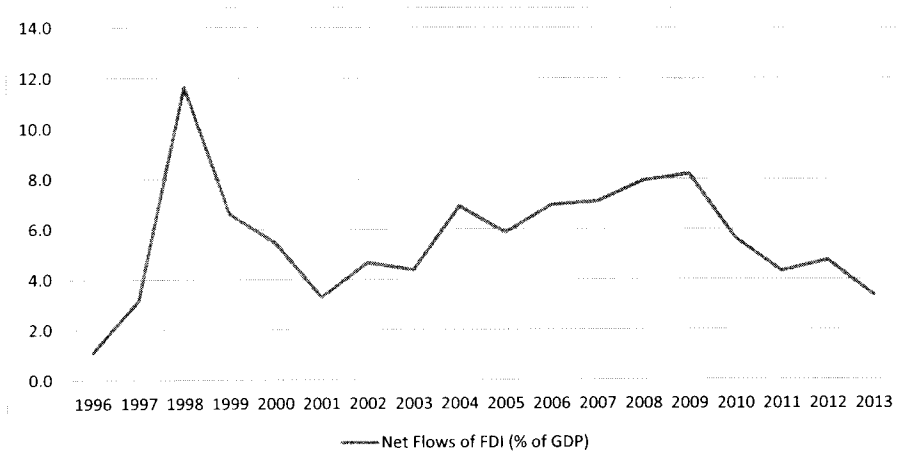
## **4 Analysis of changing parameters in foreign direct investment (FDI)**

### **4.1 Pre-crisis years**

The amount of net flows of foreign direct investment into Armenia remained relatively moderate until 1997. As in Figures 7 and 8, net flows of FDI jumped in 1998 to \$221 million, or 12% of GDP, boosted by a pickup in the privatization program particularly in the telecoms sector. Then FDI inflows as percent of GDP fell in 1999-2001 before picking up again.

**Figure 7 Net Flows of FDI (Millions of US dollars)**

Source: Asian Development Bank

**Figure 8 Net Flows of FDI (Percent of GDP)**

Source: Asian Development Bank

The communications sector, the mining and metallurgy industries, civil aviation, and the gas distribution network, among others, attracted foreign investment. Russia emerged as Armenia's leading foreign investor in such sectors as energy, metallurgy, and telecoms. Lebanon also invested in the expansion of mobile telephony networks. The construction of a new terminal of Yerevan's Zvartnots international airport was managed by an Argentinean company.

#### 4.2 Global financial crisis

It is noteworthy that FDI net flows remained relatively high in the crisis year of 2009. In fact FDI net inflows as percent of GDP increased from 7.9% in 2008 to 8.2% in 2009 as in Figure 8, since the amount of FDI decreased less than GDP. The major sources of investment consisted of Russia (communications; electricity, gas, heat and hot water production and distribution; inland transportation),

France (communications), Netherlands (electricity, gas, heat and hot water production and distribution), and Argentina (air transportation).<sup>4</sup>

#### **4.3 Recovery since 2010**

In 2010 the amount of net flows of FDI continued to decrease, possibly as a result of the 2009 crisis cooling foreign investors' minds in general. FDI inflows have remained relatively stagnant since 2010.

#### **4.4 Risk factors to sustaining economic growth**

The net flows of FDI started to increase notably after 2001. This helped total investment grow strongly, contributing to high economic growth that lasted until the 2009 crisis. The pickup of FDI was caused by Russia most significantly, followed by such countries as Lebanon, Argentina, France, and Netherlands, among others. The net flows of FDI did not fall substantially during the economic crisis in 2009, thanks to continued investment in communications and other key sectors.

The economic embargo maintained by Turkey and Azerbaijan has kept FDI inflows into Armenia significantly below those of its neighbors in the Southern Caucasus. In spite of improving investment climate, entry to the Armenian market remains relatively risky for foreign investors, because of weak implementation of business legislation, corruption, geopolitics, and possible earthquakes.

The relative weakness of FDI, as observed in 2010-2013, might in turn hold back the growth of exports and GDP. Toward the future, it is necessary for Armenia to step up its FDI promotion efforts and to upgrade local skills and supply capabilities, while maintaining its progress in such areas as transparency, disclosure, and corporate governance. In the context of investment climate, it is also necessary for Armenia to strengthen the alignment of infrastructure with a view to reducing transport and logistics costs.

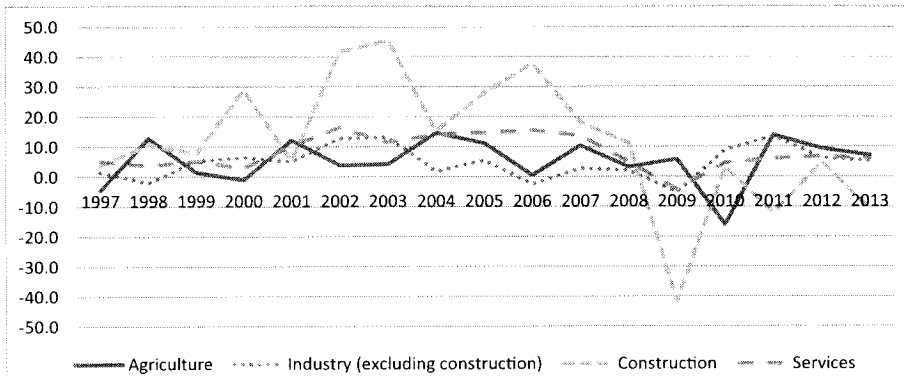
### **5 Growth performance of the key sectors**

Figure 9 shows the real growth rate by sectors: agriculture, industry (excluding construction), construction, and services.

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<sup>4</sup> See Ministry of Economy of the Republic of Armenia (2010).

**Figure 9 Sector Real Growth Rate (%)**



Source: Asian Development Bank

### 5.1 Agriculture

The growth rate of the agriculture sector tends to fluctuate, due to its direct dependence on weather conditions. During 2001-2009 the sector managed to maintain positive growth, playing a role of boosting economic growth. However, the steep drop due to poor weather in 2010 had an effect of making economic recovery weaker. Agriculture has regained its growth path since 2011, supported by an improvement in growing conditions, reflecting state assistance programs for productivity and efficiency.

### 5.2 Industry

The growth rate of the industry sector has not been very strong over time. FDI into the mining and metallurgy sectors supported growth in industry. The boom in 2002-2003 turned out to be rather short-lived. The diamond-processing sector grew and led to expanding exports, before falling into a slump.

The industry grew by 8.9% in 2010, contributing to the economic recovery. The industry benefited from higher global prices for mining and metallurgy products. The sector has maintained its strong performance since 2010.

### 5.3 Construction

The growth of the construction sector tends to fluctuate relatively more, compared with other sectors. Armenia experienced a construction boom during 2002-2008, which helped realize high economic growth. The growth of construction sector had been fueled by remittances. However, the boom was followed by a bust of 42% reduction in real terms in 2009, placing construction at the heart of economic slowdown. The construction sector has remained stagnant since the 2009 crisis, recording negative growth in 2011 and 2013.

#### 5.4 Services

The services sector posted double-digit growth during 2001-2007, contributing to high economic growth. The sector growth then slowed down in 2008 and suffered a negative growth in the crisis year of 2009. Then, the services sector has enjoyed stable growth since 2010.

The services sector contains tourism, based on cultural, historical, and natural attractions including such outdoor activities as skiing, hiking, and picnicking. As in Table 2, the number of arriving tourists reached 558,000 in 2008, more than twice the number recorded in 2004. In 2008, more than half of the tourists came from CIS countries, while Armenian passport holders accounted for 12%, according to the Ministry of Economy. Given the existence of a large number of Armenians residing outside of the country, the number of arrival, reaching 843,000 in 2012, is expected to increase further over time. The tourism sector has a potential of further expansion, contributing to economic growth through services.

**Table 2 Tourism Dynamics in Armenia, 2008-2012 (Thousands)**

	2008	2009	2010	2011	2012
Total: Arriving Tourists	558	575	683	758	843
Personal	369	378	453	523	582
Business and professional	189	197	230	235	261

Source: World Tourism Organization (2014)

#### 5.5 Risk factors to sustaining economic growth

By nature, the growth performance of the agriculture and construction sectors tends to fluctuate relatively more. The government can provide the agriculture sector with a further boost from rural infrastructure projects primarily financed by donors.

Efforts need to be made to help the industry and services sectors strengthen their performance and sustain growth. Going forward, economic recovery and development will mainly rely on these sectors. Prominent subsectors include tourism, IT (information technologies), and financial services.

### 6 Concluding remarks

This paper has investigated the sustainability of Armenia's economic growth. Having enjoyed 15 years of uninterrupted high economic growth, Armenia became recognized as one of the fastest-growing countries. Investment, especially in the mining and metallurgy sectors through FDI, played a key role as a driver of economic growth. Remittances sent by Armenian workers abroad, mainly in Russia, had an effect in sustaining consumption and boosting construction. Until 2008, construction contributed positively to strong

economic growth, as did FDI in key sectors.

Armenia has shown some weaknesses in the external sector. Armenia maintains a relatively liberal trade policy as a WTO member country, but the export failed to be a major driver of economic growth. Between 1999 and 2003 exports grew robustly on the back of the diamond-processing sector. However, this sector has slumped since, and instead exports of base metals increased due to new investment into the mining sector. Compared with its neighbors in the Southern Caucasus, Armenia's exports and FDI suffer from the economic embargo maintained by Turkey and Azerbaijan, in addition to the land-locked location. A political breakthrough would be necessary to strengthen Armenia's external sector. First, progress needs to be made in the unresolved territorial dispute with Azerbaijan, an important Turkish ally. This dispute has been an obstacle for attempts by Armenia and Turkey to restore diplomatic ties and reopen the border, which Turkey had closed in 1993 in support of Azerbaijan.

Armenia persistently imports significantly more than it exports, mainly due to demands for natural gas, mineral products, machinery, and equipment. As such, the positive contribution by exports to growth is usually offset by the negative contribution by imports.

The episode of Armenia's prolonged high growth period was abruptly and drastically ended by the global financial crisis in 2009. It is important to note that some weaknesses in the Armenian economy, such as a slump in exports, were already apparent before the crisis. The decreased construction activity and FDI reflected the major crisis in 2009.

To sustain Armenia's economic growth going forward, the country may need a gradual creation of industrial systems that can facilitate more economic and export diversification.<sup>5</sup> IT sector, for instance, could play a more important role in the near future. Armenia also needs to continue efforts to strengthen competitiveness, although Armenia's improving overall ranking in the ease of doing business as seen in World Bank (2013) is certainly respectable. It is relatively easy to start a business in Armenia, yet that alone may not be enough. A challenge lies in terms of how to promote further private sector development. Entry to the Armenian market remains relatively risky for foreign investors, because of such factors as weak implementation of business legislation, corruption, geopolitics, and possible earthquakes. To promote FDI, Armenia needs to retain necessary human capital. Brain drains through emigration have become an additional concern for Armenia's small open economy not endowed with rich natural resources. By overcoming challenges regarding external sector and by expanding tradable sector, exports can gradually be developed to become a more important source of economic growth.

The tourism sector has a potential to expand further, given the country's tourism resources and the existence of a large number of Armenians residing outside of the country. Growth in tourism can help the

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<sup>5</sup> See Ministry of Economy of the Republic of Armenia (2010).

economy grow through the services sector. Investment in necessary physical infrastructure such as airports and roads and in human capital is required for the tourism industry to become more competitive.

Going forward, gradual economic restructuring and transformation toward a more knowledge and technology-based economy are considered necessary in order to achieve a more sophisticated, innovative, and competitive production system ensuring high value added.

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