

Economic Uncertainty Internationally and the Economy of Armenia



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Human
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Since 2018 Global Economic Policy Uncertainty (GEPU) index has been increasing. In parallel, the index of the prevailing direction of economic trends in the manufacturing and service sectors, Managers' Index (PMI), is decreasing. The world talks of economic uncertainty. Has Armenia joined the conversation?

Economic uncertainty has been discussed in the documents of the Central Bank pertaining to economic forecasts. It is referred to in the Government's programme of 2019: "The excessive system of State administration, with its unjustified scope of visible and invisible bodies, overlaps in functions and fields, ineffectiveness caused thereby, uncertainty [emphasis added] of liability of mechanisms, is an unjustified burden for taxpayers and most serious obstacle to raising competitiveness of Armenia. We need a cost-efficient, dynamic, flexible and competitive State administration system."

Perhaps this is a unique case when uncertainty features in official documents, but look at the very nature of this uncertainty! It is a signal to warn of the efficiency and effectiveness of the whole public administration system. How should a businessperson assess her/his business future in such policy environment? It is certainly commendable that there is readiness to acknowledge the issues, but what are the proposed solutions?

State budget as the main hindrance to economy

Since the third quarter of 2018 the state budget has been sending negative impulse to the economy. Revenue is collected, but the planned expenses have not incurred. This shrinks the total demand, sending a negative impulse to the economy. This certainly has an explanation, and it has to do with the need for quality changes in the expenses, and the incentive to increase effectiveness of these expenses. Returning to the mentioned government programme, it should be noted that one of the solutions to address uncertainty, aka efficiency of expenses, has become a priority, whereas the other three, specifically dynamic, flexible and competitive state governance system, are yet to be addressed.

Which is right, when you don't know where to go? Pause? Or perhaps walk and think while walking? Unfortunately, economy cannot pause and wait for the reforms in state governance system to take hold, for the development vector to be defined and for strategies to be developed. We pay dearly for this pause. In any case, the economy does not pause and continues to grow. Let's see why.

The monetary incentive

Observing the negative impulse from the state budget, the Central Bank lowered interest rates to enlarge the total demand. This policy certainly worked, but where did the additional resources go? The banking indicators show that in the recent two years mortgage and consumer loans have almost doubled. 200% increase!

The macro-economic reason for the current economic growth is hidden here. Is this quality growth? This is a very comprehensive question, and the answer includes both positive and negative aspects. The negative implies that economic growth is not conditioned by investments, and it should be noted that in a long-term perspective this approach is doomed. On the other hand, economic growth without investment means one thing only: increased productivity. This is of course positive, and growth in the service sector is rather impressive. The other positive factor is people's response to



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the change in interest rates. If people take consumer loans, they expect to have adequate income in the future. It can be inferred that people have positive expectations of the future.

“Macro”-summary

In the light of uncertainties in state governance a number of practical actions can be undertaken to reduce economic uncertainties. However, before venturing into such actions, it is important to identify the significant economic limitations, and specifically the dilemma of short- and long-term economic impacts. The government has resolved to return the additional 57 billion from tax revenues, which will send a positive impulse to the economy. However, this is also pregnant with uncertainties. For instance, is this the total sum? Will it be returned on time? Will this create new problems? It is impossible to restore trust of business people towards state institutions in a day. And this is only an episode. It is time to appreciate the fact that economy is a less important indicator of good governance, and it restricts rather than supports the activities of the state. Otherwise, having no state would have been the most low-cost efficient policy. Instead, there are alternatives:

- to promote economy through taxation policy: In a short-term perspective it contributes to development, but in a long-term perspective it negatively influences prosperity, because it leaves the burden of paying the interests to the next generations;
- contribute to the economy through expansive monetary policy: what is happening today balances the total demand in a short-term perspective, but in a long term, we will be paying again and most probably in the form of high prices;
- changes in sectoral policy or the structure of the economy: in a short term these changes are painful because of potential shocks in the labour market, but these will ensure long-term prosperity;
- investment policy: it is not painful in a short term and ensures a long-term result.

From this inventory all Armenian governments have always preferred the last one, in order to bring together both short- and long-term benefits, with the exception of 1990s. However, it should be noted that such policy will keep Armenia’s growth in the group of middle-income countries, as large perspectives in a long term become unrealistic. Even the absence of such policy, i.e. leaving investment to the regulation of market competition, will ensure economic, but never exponential growth.

The best solution is the combination of all the mentioned alternatives, but in order to do so, it is necessary to have reliable, “flexible, dynamic and competitive” state institutions that leave no room for uncertainties. It is time to walk the talk.

The policy brief has been elaborated based on the opinions exchanged by the participants of the off-the-record discussion “Current developments in monetary and fiscal policies”, organized on 17 October, 2019 within the project “Improving communication strategy in the monetary-fiscal and financial sectors”.