

Foreign Investments in Armenia: Influence of the Crisis and Other Peculiarities

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Abstract

The level of economic growth in the three South Caucasus countries correlates well with the amount of foreign direct investments in these countries. The Armenian government has been making efforts to diversify its economy, and in 2010, the inflow of investments, including foreign ones, increased to the food processing and tourism sectors, in addition to the traditionally-preferred mining, telecommunications and energy sectors.

Effectiveness of Foreign Investments in the Southern Caucasus

Despite the global economic crisis which hit Armenia in 2009, the amount of foreign direct investment flowing into the country has remained relatively stable in recent years. Figure 3 on p. 20 presents the level of foreign investment (FI) and foreign direct investment (FDI) as a percentage of GDP.¹ The GDP numbers differ from official sources because they are presented here in U.S. dollars. As the figure shows, the ratios of foreign investments/GDP and direct foreign investments/GDP have been fairly constant in Armenia in recent years—15–20% of GDP for FI and 8–9% of GDP for FDI. Although foreign investment inflows dropped during the crisis, they recovered in 2010. Foreign investments, and FDI in particular, play an important role in the country's economic life (though 2010 was an exception, as discussed below).

Figures 4 and 5 on p. 21 compare the size and efficiency of these investments in Azerbaijan and in Georgia with those of Armenia. For example, in Azerbaijan (Fig. 4) the ratio FI/GDP is close to the same value as in Armenia, 12%–20%, in 2007–2009². These data show that although the investments in Azerbaijan were much larger than in Armenia (US\$6–7 billion a year versus US\$1.5–2.0 billion in Armenia), these investments were not very effective (in terms of GDP stimu-

lation, at least in short perspective) compared to those in Armenia. Similar results can be seen for Georgia as well³ (Fig. 5) and they show that unlike Armenia and Azerbaijan, both FI and FDI in Georgia decreased both in 2009 and 2010. The numbers for 2010 are unexpected because Georgia's GDP grew in 2010 even as investment fell—in this case the correlation between the amount of foreign investment and economic growth did not hold constant. More important is the fact that many Western countries pledged to help Georgia after the August 2008 war, and much of that assistance was in fact provided. However, private investors were not enthusiastic about returning to Georgia. One reason for this decline was that in 2009 and 2010 the shock caused by the 2008 war continued to affect investors despite assurances provided by the Georgian government and its supporters. Another possible reason for the investment decline may be the fact that Russia had been a major source of investment for Georgia before 2008, and investors from that country were reluctant to go to Georgia in the immediate aftermath of the conflict.

Foreign Investments in Armenia

As for Armenia, FDI flows worth US\$700–800 million were typical in recent years and they were roughly half of total FI. The year 2009 was an exception and the Armenian government attracted significant quantities of loans from abroad (including US\$500 million as an intergovernmental loan from Russia) to counter the global financial and economic crisis. These loans partly replaced the shortage of FDI.

Figure 1 shows that during the crisis year of 2009, FI in Armenia decreased from US\$1.13 billion to US\$906 million dollars, but, GDP fell even more (in Armenian dram terms, it fell by 14%). However, the FDI/GDP ratio in that year was larger than in 2008. This was followed by an even deeper decrease in the amount of FDI (to US\$693 million in 2010) evidently caused by the

1 The usual definition of direct investment is: an investment which is sufficiently large to affect a company's subsequent decisions. In the methodology applied by the State Statistical Service of Armenia, an investor is named a direct investor if no less than 10% of the share capital of an Armenian company belongs to this investor. In some cases, the term "direct investment" is used as evidence that these funds were invested in the private sector, since there is no such criterion for investments in general. In particular, investment may include loans to public companies.

2 Source: Azerbaijan in Figures, available at <http://www.azstat.org/publications/azfigures/2010/en/020.shtml>, also data on Azerbaijan in 2010 available at: <http://www.azstat.org/macroeconomy/indexen.php>. Data for FDI in 2010 are not available and a tentative value is 12%. For Georgia, data are taken from: http://www.geostat.ge/index.php?action=page&p_id=119&lang=eng and http://www.geostat.ge/index.php?action=page&p_id=140&lang=eng

3 Data for Georgia and Azerbaijan are difficult to compare because the official data available on the sites of their respective statistical services are for FDI only for Georgia and total FI for Azerbaijan.

crisis. However, as one can see, earlier foreign investment played a role in restoring the economy after the “crisis” year of 2009.

Overall, Armenia has great difficulty attracting foreign investment. The country is not rich in natural resources, and therefore receives less attention from foreign investors than well endowed countries like Azerbaijan. In addition, like many other post-Soviet countries, Armenia has specific problems which make it less attractive to foreign investors. One major factor is the blockade of its communications imposed by Azerbaijan and supported by Turkey⁴. In fact, this factor makes investments in Armenia difficult because of the high transport tariffs for its cargoes. Accordingly, Armenia has to rely on Georgia for contact with the outside world because its fourth neighbor, Iran faces heavy Western sanctions of its own. These political issues make Armenia a bad partner compared not only to Azerbaijan (with its oil wealth) but also to Georgia.

Current foreign investments in Armenia focus on the mining industry, energy and telecommunications. Also the construction sphere has been growing rapidly in Armenia, but it was mainly fed by local rather than foreign investments. However, after the decline of 2009, the government has enhanced its efforts to diversify the economy, which, means, in particular, attracting more foreign investments in other spheres, too.

The Armenian government tries to make the investment climate favorable for both foreign and local investors. Since the early 2000s Armenia eliminated existing privileges for foreign investors and now treats foreign and local investors similarly. Eliminating such preferences for outsiders makes sense because the country has a large and unused potential for domestic investments. According to government estimates, Armenia has great development potential in tourism, medicine, the food industry and machinery. Accordingly in 2010, the food industry, tourism and science-intensive production became leading foreign investment magnets. The government also believes that Armenia’s IT sector has good perspectives for development; in the past, it attracted significant foreign investments (in particular, Synopsys, a prominent American chip maker, has a large software branch in Armenia). Nevertheless, in

recent years, this sector has not been a leader in attracting foreign investments.

The government has also used incentives to import innovation technologies. For example, it established tax privileges for investors who introduce technologies which are new for Armenia. Prime Minister Tigran Sargsyan (in office since April 2008) has also demonstrated readiness to create free economic zones in Armenia for the first time since the country gained independence 20 years ago. This government is also the first in independent Armenia to provide financial assistance to perspective Armenian companies as it did during the crisis of 2009. It continues to make the business climate in Armenia more attractive in 2011.

Russia, France and the Netherlands became the largest investors in Armenia’s economy in 2010 by investing US\$270.3 million, US\$146.8 million and US\$64.3 million, respectively. Their shares in the total foreign investment in Armenia were 38.5%, 20.9% and 9.2% in 2010. In 2010 Russia remained the largest investor in Armenia due to investments in energy, mining, transport, telecommunications and other spheres.

Investments and the Armenian Diaspora

Armenia’s large diaspora distinguishes it from many other countries and many Armenians abroad are successful business people. In practice, many people prefer to invest in Armenia simply because they are ethnic Armenians. There are no statistical data about the influence of ethnic origin on investment decisions, but it is known that the investments of diaspora Armenians are usually not large. They cannot compare with, say, the investments of Russia’s Gazprom in Armenia. There are exceptions, however. For example, in 2008, Argentina was the second-ranked investor in Armenia after Russia (and it was the fourth in 2010). This high status was due to the efforts of a single person, Eduardo Eurnekian, an Argentine businessman of Armenian origin. Eurnekian is the main shareholder in a consortium operating dozens of airports in Argentina and elsewhere. Under a 2001 agreement between the Armenian government and Eurnekian’s Corporacion America, it will modernize and manage operations at Zvartnots International Airport in Yerevan, Armenia’s main entry port by air. The deal was then worth US\$50 million, but the investor has since invested much more in Zvartnots. Besides the airport, Eurnekian has also invested in agriculture and banking.

This example shows the great potential of the Armenian diaspora for the economy of Armenia. However, it is not typical since the majority of the Armenians abroad work with medium-size businesses. The leaders of the country have made different efforts to use this resource

⁴ During a conference of the of the Asian Development bank on the investment problems of Armenia held on March 21, 2011, Prime Minister Tigran Sargsyan said: “The objective factor [which is not beneficial for the economy] is our geopolitical situation and those political risks facing the region in general.” <http://www.gov.am/en/news/item/5594/>. Regnum news agency goes further to quote him as saying (in Russian only): “The monopoly of Georgia on the Armenian transit is a constraining factor.” <http://www.regnum.ru/news/fd-abroad/armenia/721.03.2011>.

more effectively, starting with the so-called All-Armenian business meetings held in the early 1990s. The creation of a Ministry of Diaspora in 2008, under the presidency of Serzh Sargsyan, was another step in this direction. In April 2011, this Ministry made an attempt to create a worldwide network of Armenian business people. How effective this attempt will be remains to be seen. Currently, the diaspora's contribution to the economy of Armenia is not large but it is increasing.

Conclusion

Foreign direct investment is an important factor driving the economic growth of the South Caucasus countries. The blockade resulting from unsettled conflicts remains a major factor hindering investments in Armenia. Nevertheless, the current government is taking unprecedented measures to raise the attractiveness of the country for investors, both domestic and foreign.

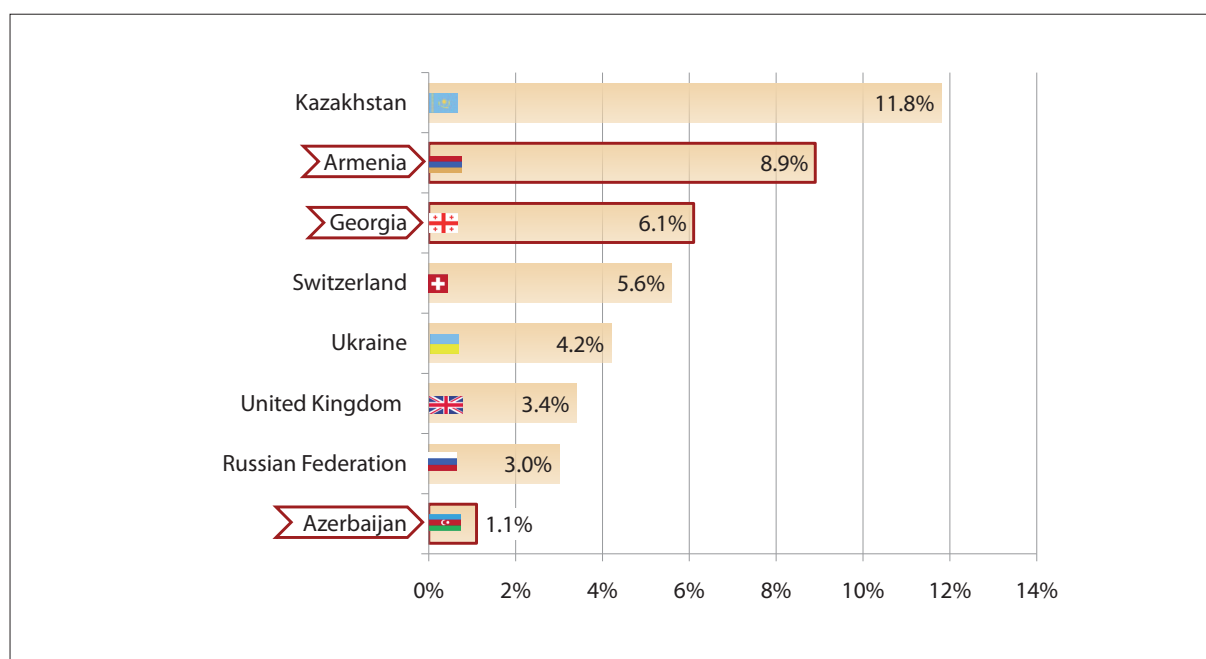
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STATISTICS

FDI and GDP

Figure 1: FDI in International Comparison (net inflows as percent of GDP, 2009)



Source: World Bank, World Development Indicators & Global Development Finance, <http://databank.worldbank.org/>