

# **Implications of the World's Financial Crisis for Armenia's Economy**

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## **EXECUTIVE SUMMARY**

It has become clear by now that the ongoing financial crisis will have a deep and prolonged impact on a wide range of economies. This is also likely to be true for a peripheral economy like Armenia's, regardless of how isolated its relevant sectors are from the rest of the world. While in-depth research on the causes and consequences of the crisis is still in the pipeline and will become available as more facts are uncovered, economists around the world agree that there is ample evidence of a serious crisis in the making. A number of large economies have already come under strain and applied for emergency funding from the International Monetary Fund.

In this context, Armenia's economy is likely to be significantly affected. Recent developments in emerging markets suggest that the crisis-related deterioration of the economic outlook is likely to occur abruptly with little signs of early warning, making it important to have pre-emptive policy response in place before things get worse. Against this background, the report discusses the main channels through which Armenia's economy is likely to be affected as a result of the adverse global conditions and offers a set of specific policy recommendations summarized below that may help mitigate the impact of the ongoing global crisis on Armenia's economy.

## **Recommendations**

### **Addressing Capacity Issue**

- Establish a Crisis Prevention Team as a high-level policy advisory body reporting directly to the Prime Minister. It should consist of economists and financial sector professionals with strong reputation and experience in dealing with crisis countries and include Diaspora and possibly non-Armenian professionals.

### **Fiscal Policy Response**

- As signs of the crisis become more pronounced, undertake a review of the current budget envelope and reduce expenditures on items of secondary importance (excluding social spending) and waste during public procurement. Recourses that will have been freed in such a way—as well as any new external financing that could be secured for this purpose—should be used to provide exporter support and social assistance as part of the fiscal stimulus package.
- As a counter measure to possible shrinkage of the traditional tax base, broaden the tax base by ensuring that no privileged large company remains outside of the tax authorities' radar screens.

- Launch a guarantee facility to ensure uninterrupted trade financing, particularly for critical commodities.

### **Monetary and Exchange Rate Policy Response**

- Allow for much greater flexibility of the exchange rate by reducing to a minimum the Central Bank's interventions (i.e., sales of foreign exchange) on the foreign currency market.
- Gradually reduce policy interest rate and reserve requirements, and ease access to the Central Bank's credit and liquidity facilities, while carefully monitoring inflation developments. Prepare to adopt higher rates of credit expansion specifically targeting producers, especially exporters.

### **Structural Policy Response**

- Create a lending facility for Small and Medium Enterprises (SMEs) to provide targeted and easy-to-access loans to viable SMEs in need of emergency financing.
- Take measures to reduce the monopoly price-setting powers of key import companies.
- Undertake a review of barriers for business operations and make credible steps to eliminate some of those barriers in the near term.
- Enhance/expand the social safety net by: (1) undertaking a review of the poverty guidelines, and (2) targeting the next layer (i.e., currently on the margin) of socially vulnerable strata of population, and (3) making credible steps toward eliminating corruption from the existing system.
- Review and enhance existing unemployment insurance and provide assistance to employees that have lost jobs due to crisis-related closures and downsizings.