

Armenia's public budget for 2021: need for revision?

Nikolas Schmidt, Zareh Asatryan (contributor)

Berlin, April 2021

Outline

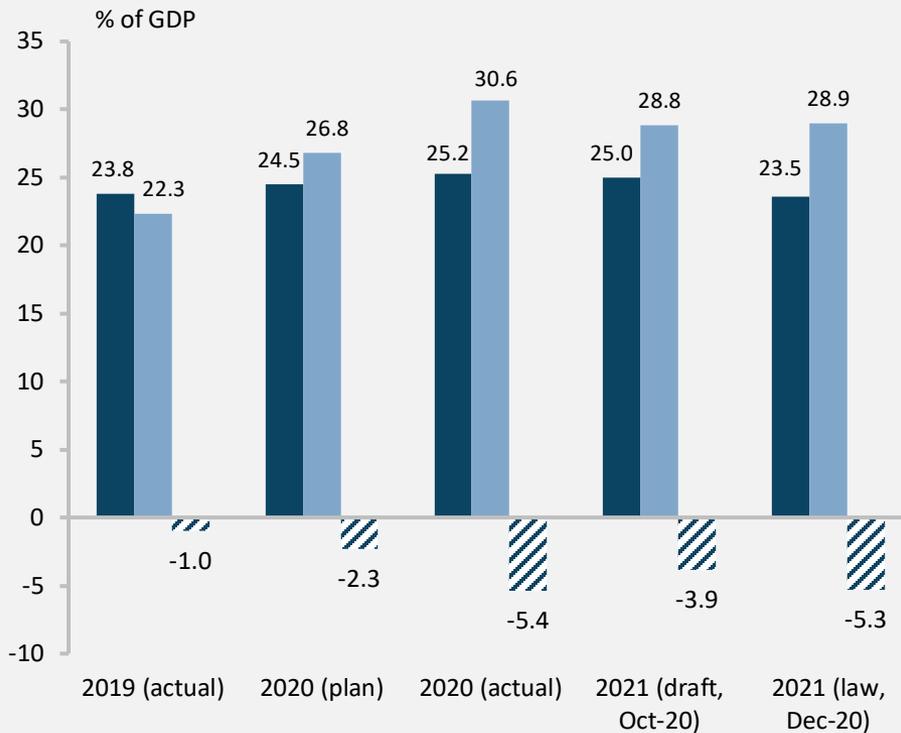
1. Introduction
2. Budget for 2021
3. Revenues in 2021
4. How realistic is the revenue plan?
5. Expenditure in 2021
6. Expected additional expenditures
7. Financing the budget deficit in 2021
8. Public and external debt in 2021
9. Conclusions

1. Introduction

- The Armenian government drafted an initial budget for 2021 in October 2020 and passed an amended budget law in December 2020
- However, the budget for 2021 does not seem to take into account the negative impact of the military conflict in 2020 on economic growth, revenues and expenditure
- Here: assessment on how realistic this budget is and whether a revision is likely

2. Budget for 2021

Central government budget



Source: Ministry of Finance, note: GDP figures for plans based on gov forecast

Budget for 2021

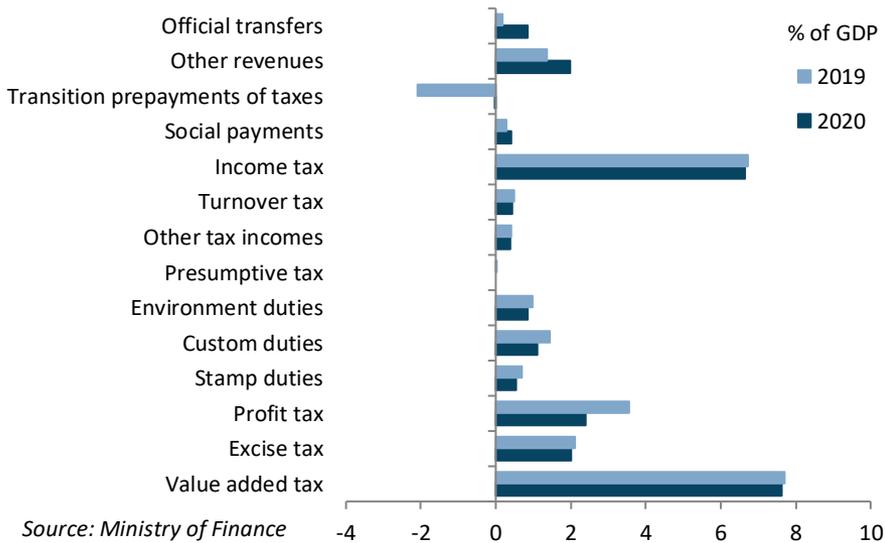
- Oct-2020: draft budget 2021 was passed
 - Dec-2020, i.e. after military conflict: slight changes of budget 2021
 - Lower revenues
 - Very small increase in expenditures
 - Increase of deficit by AMD 94 bn (approx. USD 180 m)
- **Fiscal costs of post-conflict measures and output effect not properly reflected**

Outlook

- Revision of the budget to be expected
- Expenditure to rise, revenue likely to be lower than expected due to suppressed growth

3. Revenues in 2021

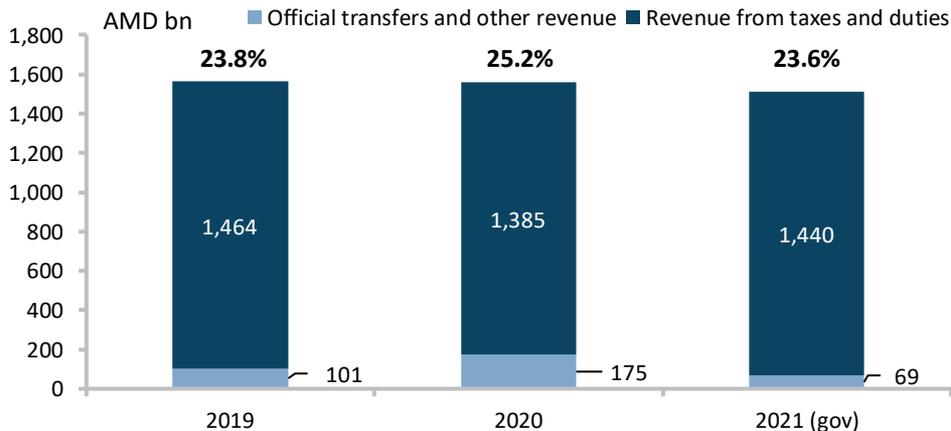
Budget revenues in 2019-2020



Revenue plan

- The 2021 budget expects revenues of AMD 1.5 trn (approx. USD 3.2 bn)
- This represents a 3% decrease from 2020
- But: mainly a base effect from higher non-tax revenues in 2020
- For tax revenue, the government foresees an increase, based on growth expectations and an ambitious tax reform plan

Change in budget revenue 2020-2021



Source: Ministry of Finance, Armstat, note: percentage are % of GDP

4. How realistic is the revenue plan?

Real GDP growth forecasts for 2021

Institution	MinFin ARM	World Bank	CBA	IMF
Date of forecast	Dec-20	Jan-21	Apr-21	Apr-21
Real GDP growth, %	3.2%	3.1%	1.4%	1%

Source: Respective institutions

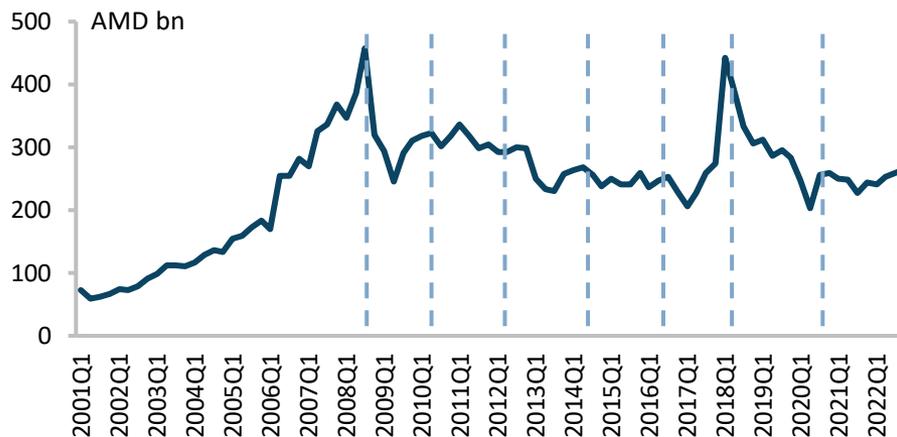
Underlying GDP forecast

- The revenue plan is based on a forecast of 3.2% real GDP growth
- Currently this seems rather optimistic
- Growth will likely remain subdued, esp. due to low investment as a consequence of political uncertainty and the aftermath of the military conflict

Growth outlook

- Other more recent GDP forecasts expect subdued growth
 - This is particularly due to dampened investment: conflict flare-ups have had negative effects on investment in ARM in the past
- **Revenues likely to be lower than planned by the government**

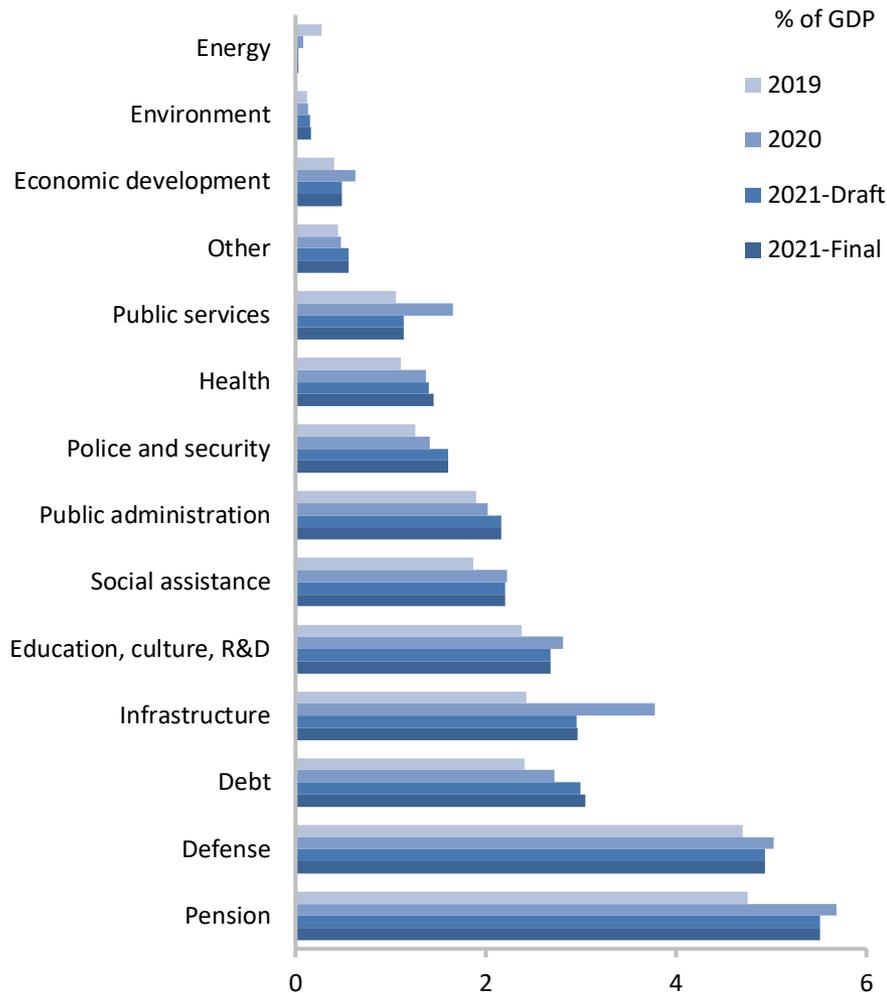
Reactions of investment to conflict flare-ups



Source: Armstat, GET calculation, note: real investment seasonally adjusted

5. Expenditure in 2021

Expenditure plan comparison from 2019 to 2021



Source: Ministry of Finance, GET calculation

Expenditure planning

- Overall planned expenditure has hardly changed from the ambitious 2020 plan – neither before nor after the conflict
 - Higher spending is planned mainly on debt service, public admin and health
 - Lower spending is planned for public services and infrastructure, but mainly because pre-COVID 2020 plan had foreseen relatively high spending
- It stands to reason that costs arising from the 2020 conflict may not properly reflected in the budget yet
- Additional expenditures are likely to be incurred for the following items
 - Social assistance: for families of fallen soldiers and support for refugees
 - (Re-)Building infrastructure in Nagorno-Karabakh and at the new border

6. Expected additional expenditures: social assistance

Estimated cost of compensation for army personnel

Fund finances after conflict 2020 (USD m, approx.)	One-time	Annually recurring for 20 years
Revenues	16	61
Expenses	100	30
Balance	-84	31

Source: 1000Plus/Insurance Foundation for Servicemen, GET estimate

Estimated cost of one-time support for refugees

Costs for refugees	Figures
Number of refugees in ARM	75,000
One-time support per person	USD 135
Total	USD 10 m

Source: Government of Armenia, GET estimate

Social assistance to soldiers

- Payments for disabled soldiers or families of deceased/missing from 1000-Plus Fund
- Revenues currently financed by „stamp duty“ on every employee; recent reform increased and changed from flat to progressive duty
- One time payments are lacking financial coverage in the short term
- Recurring payments are presumably covered with increased duty after reform
- Risk for state budget: decreasing revenue due to lower employment; change in duty revenue due to switch to progressive system

Refugee support

- One-time support to refugees from Nagorno-Karabakh to ARM: USD 135 per person pledged (though number of people receiving unclear)
- Risks for state budget: not all costs associated with refugees covered by one-time payment, such as education, housing, unemployment

6. Expected additional expenditures (II)

Infrastructure

- New external border of Armenia (southern part of Eastern border) to be secured
- In some cases new civil infrastructure/houses (where the new border divided villages, e.g. Shurnuk)
- Costs of necessary increased maintenance of Lachin corridor; unclear cost of new corridor AZE-Nakhichevan

Costs stemming from Nagorno-Karabakh

- Armenia supports Nagorno-Karabakh through budgetary transfers and has pledged another USD 200 m (approx. 1.7% of Armenian GDP) for 2021
- Thus, costs incurred there could have an impact of state budget of Armenia
- Costs include rebuilding civil infrastructure (e.g. new houses for 10,000 people)
- Costs associated with territorial loss such as agricultural land, hydropower output, mining output

7. Financing the budget deficit in 2021

Eurobonds placed by the government of Armenia

Year	2013	2015	2019	2021
Volume, USD m	700	500	500	750
Maturity, years	7	5	10	10
Yield to maturity at issue, %	6.25	7.50	4.2	3.88

Source: Ministry of Finance

Deficit financing plan for 2021 as of Dec-20

Gross financing needs	AMD 764 bn	USD 1,461 m
Budget deficit	AMD 341 bn	USD 653 m
Debt redemption	AMD 286 bn	USD 547 m
Net financial assets	AMD 137 bn	USD 261 m
Financing sources	AMD 764 bn	USD 1,461 m
Treasury bonds	AMD 370 bn	USD 708 m
Disbursement of external loans	AMD 152 bn	USD 290 m
Eurobonds	AMD 242 bn	USD 463 m

Source: Ministry of Finance, note: approximate values, USD values based on FX rate from 31.12.2020

Eurobond

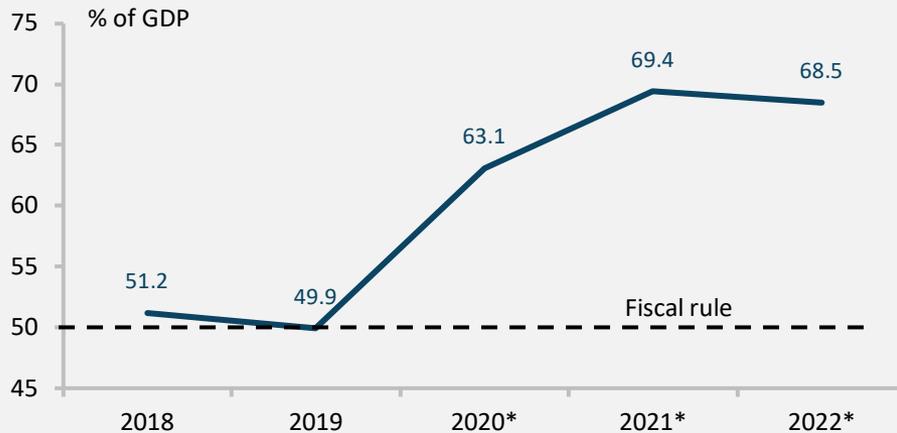
- In Jan-21, ARM issued a 10y Eurobond of USD 750 m, more than originally planned
- Good credit conditions are mainly a result of global liquidity provision

Usage of additional funds

- Decreasing domestic financing
- Additional spending for higher expenditure
- Replenishing reserves with the goal of securing external sustainability

8. Public and external debt in 2021

Public debt (central government)



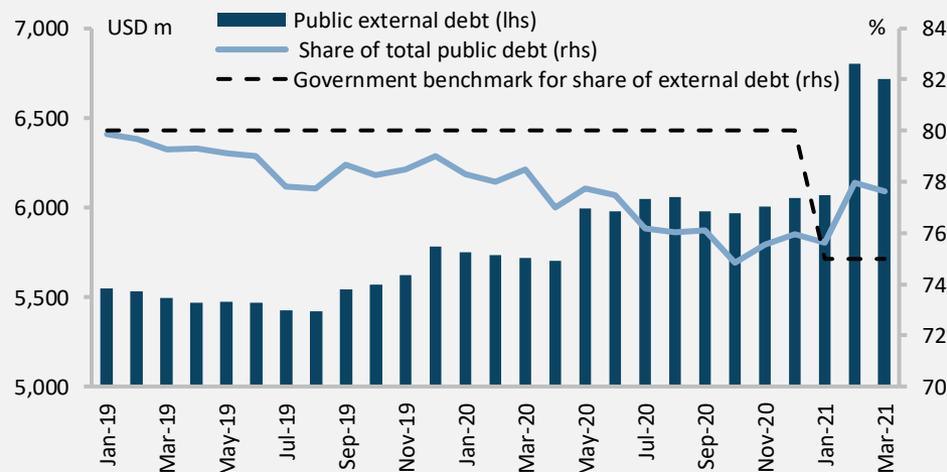
Source: IMF, *forecast/estimate, note: central government's public and publicly-guaranteed debt

Public debt (central government)

- Large increase of debt to GDP ratio from 49.9% in 2019 to 63.1% in 2020
- Technically violates the fiscal rule, but exception due to military conflict
- Public debt likely to grow in 2021 to 69%

➤ **For compliance with fiscal rule, consolidation efforts necessary**

Public external debt



Source: Ministry of Finance; note: incl. external debt of the Central Bank

External debt

- Public external debt has also grown in 2020, and especially 2021 (due to the Eurobond), rising above even the government's own adjusted benchmark
- Current good external financing conditions could be an opportunity to secure external sustainability

9. Conclusion

- The budget for 2021, passed in December 2020, now appears somewhat unrealistic
 - Revenue projections are based on overly optimistic growth expectations
 - Expenditure plans do not reflect the necessary spending resulting from the 2020 conflict, esp. social spending and infrastructure
-
- **Likely prospect of a budget revision with lower revenue and higher expenditure**
 - **However, fiscal and external sustainability to be watched when considering budget revision**

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economics has been commissioned with the implementation of the consultancy.

CONTACT

Nikolas Schmidt, Project Manager Armenia
schmidt@berlin-economics.com

German Economic Team
c/o BE Berlin Economics GmbH
Schillerstraße 59
10627 Berlin

Tel: +49 30 / 20 61 34 64 0
info@german-economic-team.com
www.german-economic-team.com

Implemented by

