ECONOMIC DEVELOPMENT OF COUNTRIES IN A STATE OF ARMED CONFLICT: AN ARMENIAN CASE-STUDY

Ashot MARKOSIAN

D.Sc. (Econ.), Professor at the University of Architecture and Construction (Erevan, Armenia)

Boris AVAKIAN

Ph.D. (Econ.), Deputy Director of the Territorial Administration of the Federal Agency for State Property Management (Rosimushchestvo) for the Leningrad Region (St. Petersburg, the Russian Federation)

Elianora MATEVOSIAN

Ph.D. (Econ.), Employee at the Center of Political Scientific, Legal, and Economic Research and Forecasting Noncommercial Organization (Erevan, Armenia)

A B S T R A C T

This article takes a look at the current state and dynamics of Armenia's economy over the past few years; the authors have studied several budget expenditure items, and also carried out a comparative analysis of Armenia's external trade indices with the countries of the region.

Involvement in any conflict, particularly one that is unresolved, has an impact on the country's economy and makes it unattractive to investors, who do not like vagueness and avoid risks; commerce strives to minimize transactional outlays, while closed borders lead to enclave development. This is precisely how Armenia's economy has been developing over the past two decades.

This situation is making the country's economy dependent on particular players, different factors, and so on, and is leading to monopolization of its main branches and underdevelopment of sectors that in other conditions could become a catalyst for economic progress.

An analysis of the economic growth trends in the Republic of Armenia (RA) shows that this growth is still having little influence on the standard of living of the country's population, since government budget expenditures are mainly oriented toward defense. At the same time, the main source of personal monetary income comes from private remittances.

Investment flows and Armenia's reciprocal trade with neighboring countries are

going against the overall economic integration trends. This is causing countries that are already in a state of conflict to move increasingly away from each other.

The authors of this article think that economic cooperation among all the countries of the Southern Caucasus should become an alternative to the continuing conflict.

KEYWORDS:　*Armenia, GDP, an armed conflict, the trends toward economic growth, defense spending.*

In Lieu of an Introduction.
The Economic Environment and Standard of Living

In the 2000s, the trend toward sustainable economic growth continued in the Republic of Armenia. However, it stands to reason that the world crisis had an impact on the republic's economy. At its first stage, Armenia managed to prevent a severe market landslide: the republic's low external debt before the crisis, rise in savings, and balanced and non-risk fiscal policy created a kind of safety net. According to another viewpoint, the main reasons Armenia was able to more or less cope with the first wave of the slump were its low integration into the global economic environment and the large volume of remittances sent home from workers abroad.

Beginning in the 4th quarter of 2008, the drop in overall external demand and decrease in capital flows took their toll. The volume of investments shrank considerably, while housing construction felt the main brunt of the abrupt change in the economic environment. The 2009 indices provided graphic evidence of the profound economic slump: the size of real GDP (in drams) decreased by 14.1%. This was followed by a slow economic revival: GDP growth rates reached 2.2% in 2010, 4.7% in 2011, and 7.2% in 2012.

The precrisis economic growth indices reached during the past decade have permitted Armenia to debut in the group of middle-income countries. The precrisis economic growth allowed for stable employment, a rise in real wages, and an increase in consolidated government budget spending for social programs. All of these factors, as well as the higher volume of remittances, have made a considerable contribution to reducing poverty.

Between 2004 and 2008, there was an increase in average economic growth rates in almost all sectors of the economy, which amounted to 11.6% and led to significant structural changes in GDP. The highest rates were achieved in construction; in 2008 they ensured 39.1% of GDP growth. In so doing, the share of construction in the GDP structure rose to 24.1%.

However, in 2009, the real reduction in GDP, as mentioned above, amounted to 14.1%. It was a significant decrease in construction volumes that caused such a reduction. The construction slump continued in subsequent years, and the year 2012 saw negative shifts in this branch of the economy: there was a drop in construction rates compared to 2008 and 2009 (19.0% and 11.7%, respectively).

In 2010, economic growth of 9.2% was registered in industry (compared with the 6.9% drop in 2009), which promoted an increase in GDP by 1.2 percentage points.

A relatively favorable situation was seen in the agrarian sector in 2009, but in 2010 there was a 16.0% drop caused by unfavorable climatic conditions, which also had a negative effect on GDP growth (of 2.7 percentage points).

The Armenian government took steps aimed at stimulating the supply of agricultural commodities, attracting investments into industrial enterprises and branches, de-bureaucratizing tax policy and alleviating the tax burden, offering benefits on deferred value added tax payments, and so on.

These measures encouraged significant changes in 2011 in the republic's GDP structure. In particular, as the result of a 113.7% increase in agriculture and 113.5% in industry in 2010, the specific percentage of these sectors of the economy in GDP rose (from 17.1% to 20.2% in agriculture and from 15.4% to 16.3% in industry). As in previous years, there was a 12.5% slump in construction.

Along with the slump, an increase was seen in end consumption in the economy compared with the size of GDP. For example, in 2009-2011, the average final consumption level amounted to 95% (in 2012 to 101.4%), while in 2008, this index was equal to only 81.8% of GDP.

During 2005-2008, the national currency strengthened compared to the U.S. dollar and other foreign currencies. The reason for this was, first, the increase in inflow of foreign currency in the form of private remittances, government grants, and foreign direct investments. In 2009-2012, due to the decrease in volumes of private remittances (in 2009) and foreign direct investments (in 2009-2012), Armenia's currency became devaluated.

In 2011, average annual inflation amounted to 7.7%, while in 2012 it was at a level of 2.6%.

The main indices of Armenia's socioeconomic development (in dollar equivalent) are presented in Table 1.

It is difficult to give a positive assessment of the economy when the level of gross income per capita is extremely low (in 2012 it amounted to $3,290), import is almost three times as high as export (2012), a third of the population lives below the poverty line, and the level of unemployment is very high. Moreover, since the economy does not have the necessary resource base, its dependence on external remittances is rising. If we add monopolization and technological backwardness of industry to the above, as well as a high external state debt that reaches almost 40% of GDP, it can be concluded that this kind of economy is unlikely to comply with the goals and priorities the country must aim for in present-day conditions.

The level of poverty is the most important indicator for measuring and assessing the population's wellbeing. Poverty is manifested in different forms and affects such spheres of public life as consumption, food safety, health care, education, rights (including the right to vote), and the quality of life. In so doing, one of the most important ways to overcome poverty is to find a decent job.

It should be noted that, in contrast to the previous two years, the poverty level stopped rising in 2011, amounting to 35.0%, which is a little lower than the index for 2010 (35.8%).

In 2009-2010, the rise in poverty level in Armenia was mainly caused by the 14.1% economic slump of 2009. In 2010, compared with the previous year, Armenia's economy grew by only 2.2%. In 2011, economic growth amounted to 4.7%, while in 2012, it was 7.2%. But initially the slump was so profound that further economic growth can be said to have had no effect on the standard of living. Moreover, there are doubts about whether the economic growth factors are being correctly calculated.

In the end, the profound economic slump, which was accompanied by an increase in unequal levels of personal income, promoted a decrease in consumption volume. The results of an all-encompassing study of the standard of living of Armenian households for 2011 shows that real average monthly consumption of the entire population compared with 2008 decreased by 6.1%. In so doing, the decrease in consumption volume affected all strata of the population.

Experts calculated that in order to eliminate poverty in 2011, Armenia would have to spend 111.5 billion Armenian drams, or 3% of GDP, in addition to those funds that had already been allotted to finance social support programs.[1] Moreover, social support must be properly targeted; otherwise financing meant for the poor strata of the population will be squandered on other needs and support of those who are not particularly in need of help.

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[1] See: *Picture of Poverty and Social Situation of Armenia*, Statistical Analytical Report, National Statistics Board of Armenia, Erevan, 2012, p. 46.

T a b l e 1

**Armenia's Main Socioeconomic Indices
in 2005-2012**

No.	Indices	2005	2006	2007	2008	2009	2010	2011	2012	2012 compared with 2005, %
1	2	3	4	5	6	7	8	9	10	11
1.	Average annual dram/dollar exchange rate	457.7	416.0	342.1	305.9	363.3	373.7	372.5	401.8	87.8
2.	Average monthly nominal workers' wage, $	113.7	149.7	216.9	285.7	264.3	274.7	290.2	302.1	265.7
3.	GDP (market value), $bn	4.90	6.38	9.21	11.66	8.65	9.26	10.14	9.95	203.1
4.	GDP per capita, $	1,523	1 982	2 853	3 606	2 666	2 844	3 363	3 290	216.0
5.	Final consumption expenditure, $bn	4.22	5.26	7.53	9.54	8.10	8.80	9.79	10.09	239.3
	% of GDP	86.0	82.3	81.8	81.8	93.7	95.1	96.6	101.4	15.4 percentage points
6.	Gross savings, $bn	1.49	1.57	3.48	4.77	3.00	3.04	2.83	2.37	159.1
	% of GDP	30.4	24.6	37.8	40.9	34.7	32.8	27.9	23.8	−6.6 percentage points
7.	Industrial production, $bn	1.42	1.55	2.09	2.42	1.84	2.21	2.68	2.79	196.5
	% of GDP	29.0	24.3	22.7	20.8	21.3	23.9	26.4	28.0	−1.0 percentage points
8.	Agricultural production, $bn	1.08	1.34	1.85	2.05	1.52	1.70	2.13	2.09	193.5

T a b l e   1   (c o n t i n u e d)

1	2	3	4	5	6	7	8	9	10	11
	% of GDP	22.0	21.0	20.1	17.6	17.6	18.4	21.0	21.0	−1.0 percentage points
9.	Construction volume, $bn	0.95	1.55	1.96	2.81	1.60	1.58	1.36	1.17	123.2
	% of GDP	19.4	24.2	21.3	24.1	18.5	17.0	13.4	11.7	−7.7 percentage points
10.	Goods turnover, $bn	1.87	1.97	4.16	5.48	4.33	4.84	5.50	5.46	292.0
	% of GDP	29.0	24.3	22.7	20.8	21.3	23.9	26.4	28.0	−1.0 percentage points
11.	Volume of services, $bn	0.79	1.20	1.67	2.28	2.03	2.12	2.32	2.42	306.3
	% of GDP	16.1	18.8	18.1	19.6	23.5	22.9	22.9	24.3	8.2 percentage points
12.	Revenue of consolidated budget, $bn	0.98	1.28	2.04	2.62	1.96	2.15	2.43	2.43	248.0
	% of GDP	20.0	20.1	22.2	22.5	22.7	23.2	24.0	24.4	4.4 percentage points
13.	Consolidated budget expenditure, $bn	1.09	1.36	2.18	2.71	2.61	2.61	2.72	2.58	236.7
	% of GDP	22.2	21.3	23.7	23.2	30.2	28.2	26.8	25.9	3.7 percentage points
14.	Provision of crediting, $bn	0.42	0.57	1.23	2.05	2.00	2.39	3.36	3.96	942.9

T a b l e 1 (c o n t i n u e d)

1	2	3	4	5	6	7	8	9	10	11
15.	External trade turnover, $m	2,775.6	3,176.7	4,420.1	5,483.3	4,031.3	4,790	5,479.6	5,694.9	205.2
	including:									
	Export	973.9	985.1	1,152.3	1,057.2	7,10.2	1,041.1	1,334.3	1,428.1	146.6
	including food products	—	—	—	199.7	134.8	170.15	237.1	323.2	
	Import	1,801.7	2,191.6	3,267.8	4,426.1	3,321.1	3,748.9	4,145.3	4,266.8	236.8
	including food products	—	—	—	–760.7	–612.0	–673.5	–781.2	–812.5	
16.	Consumer price index (compared to previous year, %)	100.6	102.9	104.4	109	103.4	108.2	107.7	102.6	102.0
17.	Current account of balance of payments, $m	–51.7	–117.1	–589.3	–1,381.8	–1,368.9	–1,373.2	–1,108.2	–1,056.4	2,043.3
	assets account	73.3	86.4	142.8	148.9	89.1	107.9	96.2	103.9	141.7
	financial account	–25.3	46.5	448.7	1,220.4	1,260.4	1,247.8	1,041.3	842.8	–3,331.2
18.	External trade balance of food products, $m	—	—	—	–560.9	–477.2	–503.0	–544.1	–489.3	—
19.	Deficit (–), surplus of government budget, % of GDP	–1.7	–1.3	–1.5	–0.7	–7.7	–5.0	–2.8	–1.5	0.2 percentage points
20.	External public debt, $m	1,099.2	1,205.6	1,448.9	1,577.1	2,966.7	3,299.0	3,568.2	3,737.8	340.0
	% of GDP	22.4	18.9	15.7	13.5	34.3	35.6	35.2	37.7	15.3 percentage points

S o u r c e s: *Statistical Yearbook of Armenia, 2010,* National Statistics Board of Armenia, Erevan, 2010, pp. 15, 18; *Statistical Yearbook of Armenia, 2012,* National Statistics Board of Armenia, Erevan, 2012, pp. 15, 18; *Socioeconomic State of Armenia in January-December 2012,* National Statistics Board of Armenia, Erevan, 2013, pp. 9, 78, 79, 127; *Socioeconomic State of Armenia in January-February 2013,* National Statistics Board of Armenia, Erevan, 2013, pp. 9-12.

Table 2 shows the expenditure items needed to eliminate poverty of the population.

According to the calculations, 3.9 billion Armenian drams are needed in order to eliminate extreme poverty, or another 0.1% of GDP in addition to the funds already allotted to social support.

T a b l e 2

**Monetary Value of Poverty Elimination
in Armenia in 2011**

	Extremely Poor Population	Poor Population
Average consumption of the poor population (***drams***, in the equivalent of one adult per month)	18,619	28,038
Poverty line (***drams***, in the equivalent of one adult per month)	21,306	36,158
Additional consumption required by the poor population (***drams***, in the equivalent of one adult per month)	2,687	8,120
Deficit—additional consumption required by the poor population compared with the poverty line (%)	12.6	22.5
GDP (*billion drams*)	3,776.4	3,776.4
Necessary budget (*billion drams*)	3.9*	111.5*
Necessary budget in relation to GDP (%)	0.1	3.0

   * This index is calculated as the product of the average annual size of the permanent population, level of poverty and amount of additional annual consumption required by the poor population.

S o u r c e s: The table was compiled on the basis of the results of a universal study of the standard of living of households in Armenia for 2011, National Statistics Board of Armenia; *Picture of Poverty and Social Situation of Armenia*, Statistical Analytical Report, National Statistics Board, Erevan, 2012, p. 47.

International experience shows that it is extremely difficult and almost impossible to ensure 100% targeted social support. The practice of other countries also shows that sometimes the number of poor is artificially inflated by those who want to acquire this status to receive large subsidies and social benefits. In this respect, it cannot be said for sure that Armenia will be able to avoid a similar situation. Keeping this factor in mind, the amount of financial funds that will actually be allotted to fighting poverty will most likely be much higher than the calculations we made. In order to ensure a high level of targeting social aid, the human resources activated in the programs to overcome poverty must also be doubled.

Private noncommercial remittances from people working abroad, mainly from Russia and the U.S., are having a significant impact on the standard of living of the Armenian population (see Table 3).

It follows from the data of Table 3 that during 2005-2012 the inflow of private noncommercial remittances rose by 224.1%, including from Russia by 266.9%, and from the U.S. by 80.5%. The outflow of remittances amounted to 154.0%, 197.0%, and 84.6%, respectively. The ratio of outflow of private noncommercial remittances to inflow amounted to 25.2% in 2005, 21.7% in 2006, 19.8% in 2007, 14.8% in 2008, 17.3% in 2009, 17.1% in 2010, 17.1% in 2011, and 17.3% in 2012.

Meanwhile, the net inflow of private noncommercial remittances received from individuals abroad during 2005-2012 increased by 247.8%; including from Russia by 279.7% and from the U.S.

T a b l e 3

**Private Noncommercial Remittances
from Individuals Received from Abroad and Sent Abroad
by Individuals through the Armenian Banking System
(data for 2005-2012, $Thous)**

Years	2005	2006	2007	2008	2009	2010	2011	2012
Inflow	752,819	960,926	1,319,479	1,635,307	1,124,119	1,293,736	1,546,959	1,687,263
including								
Russia	541,308	739,419	1,078,218	1,371,066	904,011	1,062,266	1,295,163	1,444,955
U.S.	82,628	94,491	76,571	60,958	59,288	67,789	74,380	66,554
Outflow	189,793	208,436	261,170	242,240	194,884	221,763	264,602	292,249
including								
Russia	83,537	107,835	129,126	122,759	99,524	116,950	141,352	164,588
U.S.	30,671	13,295	23,764	32,110	23,332	24,554	27,331	25,936
Net inflow	563,025	752,490	1,058,310	1,393,067	929,235	1,071,973	1,282,357	1,395,014
including								
Russia	457,771	631,584	949,092	1,248,307	804,487	945,316	1,153,811	1,280,367
U.S.	51,958	81,196	52,808	28,848	35,956	43,235	47,049	40,617

by 78.2%. In 2005, Russia's share in private noncommercial remittances amounted to 71.9%, while the U.S.'s was 11.0%. In 2006, these indices were equal to 76.9% and 9.8%, respectively, in 2007, 81.7% and 5.8%, in 2008, 83.8% and 3.7%, in 2009, 80.4% and 5.3%, in 2010, 82.1% and 5.2%, in 2011, 83.7% and 4.8%, and in 2012, 85.6% and 3.9%.

The above data show that in recent years, the share of Russia and the U.S. in the total amount of noncommercial private remittances reached around 90%. We hereby note that Russia's share increased and the U.S.'s, on the contrary, decreased.

We will note that whereas in 2008, the ratio of indices of Armenia's government budget expenditure ($2,649.2 million) to private remittances ($752.8 million) amounted to 1:0.62, in 2009, it was equal to 1:0.44, in 2010 to 1:0.51, in 2011 to 1:0.63, and in 2012 to 1:0.71. So after 2009, the share of private noncommercial remittances received from individuals living abroad rose by 0.27 percentage points, or by 38.0%. Calculations show that if we take Armenia's actual government budget expenditures as five units, during 2008-2012, private noncommercial remittances from abroad amounted to around three units; in natural terms, this number comprises a significant sum capable of boosting the prosperity of the Armenian population.

On the other hand, remittances are monetary resources that people earn abroad (since they cannot find a job in their homeland) and send to their family members.

The high percentage of private noncommercial remittances from individuals is one of the characteristic features of Armenia's development in 1990-the 2000s; most of them were sent to households. There is essentially no data about how much these monetary resources promoted savings, created other benefits, or boosted investment activity. The same situation has been continuing in the 2010s; in our opinion, this is one of those problems that requires more in-depth examination in terms of the impact remittances are having on the republic's economic development rate.

Budget Expenditures and Defense Spending

In 2008-2012, the amount of government budget resources spent on defense on average reached $384.12 million or 3.9% of GDP (or 15.3% of total budget expenditures). It is worth noting that in 2008-2012, expenditures (including reserve funds that do not relate to the main sections) on public order, security, judicial activity, economic development, housing construction, utilities, public health, recreation, culture, religion, and education dropped much more than spending on defense.

Moreover, whereas in 2012 compared to 2008 government budget expenditures decreased to 89.4%, with respect to spending on defense they only dropped to 96.1%.

It should be noted that defense expenditures are huge. For example, in 2012, almost as much was spent on defense ($380.5 million) as on public order, security, and judicial activity ($188.3 million), economic relations ($98.9 million), environmental protection ($9.5 million), housing construction and utilities ($15.3 million), and recreation, culture, and religion ($48.2 million) all together. To be more precise, $20.3 million more was spent on defense.

It follows from the above that the enormous expenditures on defense are allotted to the detriment of other items of the republic's government budget.

The data of Table 4 show that on average for 2008-2012, the amount of defense spending (15.3%) occupies second place after spending on social security of the population (27.3%).

Proceeding from the fact that countries do not always present complete data about spending on arms and defense, we made use of information from the World Bank that is published in the annual World Development Indicators reports and reflected in the data base on the organization's official

T a b l e   4

**Armenia's Government Budget Expenditures
in Terms of Their Functional Classification**

Groups of Expenditures		2008	2009	2010	2011	2012	2012 compared with 2008, %
Expenditures	1	2,649.2	2,557.6	2,554.0	2,455.7	2,368.9	89.4
	2	100.0	100.0	100.0	100.0	100.0	100.0
	3	22.7	29.6	27.6	24.2	23.9	25.6*
including:							
Overall public services	1	342.6	311.1	383.5	408.2	392.4	114.5
	2	12.9	12.2	15.0	16.6	16.6	14.7*
	3	2.9	3.6	4.1	4.0	4.0	3.7*
Defense	1	396	358.4	394.9	390.8	380.5	96.1
	2	14.9	14.0	15.5	15.9	16.1	15.3
	3	3.4	4.1	4.3	3.9	3.8	3.9
Public order, security, and judicial activity	1	201.7	191.2	180.5	188.7	188.3	93.4
	2	7.6	7.5	7.1	7.7	7.9	7.6
	3	1.7	2.2	1.9	1.9	1.9	1.9
Economic relations	1	292.3	368.4	300.9	93.8	98.9	33.8
	2	11.0	14.4	11.8	3.8	4.2	9.0
	3	2.5	4.3	3.2	0.9	1.0	2.4
Environmental protection	1	9.8	10.8	13.2	11.9	9.5	96.6
	2	0.4	0.4	0.5	0.5	0.4	0.4
	3	0.1	0.1	0.1	0.1	0.1	0.1
Housing construction, utilities	1	45.9	58.1	114.6	85.3	15.3	33.4
	2	1.7	2.3	4.5	3.5	0.6	2.5
	3	0.4	0.7	1.2	0.8	0.2	0.7
Public health	1	163.3	154.6	150.2	164.2	154.1	94.3
	2	6.2	6.0	5.9	6.7	6.5	6.3
	3	1.4	1.8	1.6	1.6	1.6	1.6
Recreation, culture, and religion	1	52.4	44.9	43.1	47.3	48.2	92.1
	2	2.0	1.8	1.7	1.9	2.0	1.9
	3	0.4	0.5	0.5	0.5	0.5	0.5

T a b l e 4 (c o n t i n u e d)

Groups of Expenditures		2008	2009	2010	2011	2012	2012 compared with 2008, %
Education	1	338.4	296.0	261.7	279.3	251.2	74.2
	2	12.8	11.6	10.2	11.4	10.6	11.3
	3	2.9	3.4	2.8	2.8	2.5	2.9
Social security	1	694.7	670.7	653.5	687.5	726.2	104.5
	2	26.2	26.2	25.6	28.0	30.7	27.3
	3	6	7.8	7.1	6.8	7.3	7.0
Reserve funds that do not belong to the main items	1	112.1	93.4	57.9	98.8	104.4	93.1
	2	4.2	3.7	2.3	4.0	4.4	3.7
	3	1	1.1	0.6	1.0	1.1	0.9

R e f e r e n c e:	2008	2009	2010	2011	2012
exchange rate	305.97	363.28	373.66	372.50	401.76
GDP, *million drams*	3,568,228	3,141,651	3,460,203	3,776,443	3,981,506.5

D e s i g n a t i o n s: 1. *$m*; 2. *% of total expenditures*; 3. *% of GDP*

* On average in 2008-2012.

S o u r c e s: Socioeconomic State of the Republic of Armenia in January-December 2012, National Statistics Board of Armenia, Erevan, 2013, pp. 105-106; *Statistical Yearbook of Armenia 2012,* National Statistics Board of Armenia, Erevan, 2012, pp. 385-386; *National Accounts for 2012,* National Statistics Board of Armenia, Erevan, 2012, p. 22.

website. By way of comparison, we took the data on arms and defense spending in the South Caucasian countries involved in conflicts after the collapse of the Soviet Union, the Baltic states, which used to belong to the Soviet Union and had more or less the same economy as the South Caucasian states but were not involved in conflicts after the Union's collapse, and three European states (Austria, Switzerland, and the Czech Republic), which have not participated in any military action for at least the past 40 years.

Based on our own calculations, we compiled Table 5, the data of which show that both Armenia and Azerbaijan spend much more on arms than any of the other countries studied.

The data in Table 5 also make it possible to present the following generalizations:

➢ Between 1992 and 2010 Azerbaijan spent 326.4% more on military requirements than Armenia;

➢ In 1992-2010, the highest defense spending index among the listed countries (in percentage of GDP) was registered in Armenia, while the lowest was in Azerbaijan. In the South Caucasian republics, these indices were distributed as follows; in Georgia—4.5% (the highest index), in Armenia—3.4%, and in Azerbaijan—3.0%. It is worth noting that during these years, Azerbaijan's military spending was $1,645.5 million higher than Armenia's ($2,523.4 million) and Georgian ($4,067.3 million) all together, which amounted to a total of $6,590.7;

T a b l e 5

Military Spending (Total for 1992-2010)

Country	GDP, $m	Military Spending, $m	Military Spending, % of GDP	Military Spending, % of Central Government Expenditures
Armenia	73,880.4	2,523.4	3.4	17.1*
Azerbaijan	276,865.4	8,236.1	3.0	1.2
Georgia	91,367.5	4,067.3	4.5	11.7
Estonia	192,784.1	3,329.7	1.7	4.4
Latvia	239,095.8	3,347.9	1.4	4.0
Lithuania	357,546.7	5,152.9	1.4	3.4
Austria	5,005,934.0	47,790.0	1.0	1.9
Switzerland	6,384,196.0	68,920.8	1.1	4.5
The Czech Republic	1,806,329.2	30,842.6	1.7	5.4

*Average statistics.

S o u r c e: The table is calculated on the basis of website data [data.worldbank.org/indicator/…], 2013-07-01.

> ➢ The ratio of military spending to GDP depends on the size of the latter. For example, between 1992-2010, Azerbaijan's GDP ($276.9 billion) was almost 1.7-fold higher than the total amount of Armenia's GDP ($73.9 billion) and Georgia's GDP ($91.4 billion); the matter concerns $165.3 billion;

> ➢ In the expenditures of the South Caucasian republic governments for 1992-2010, the percentage of military spending amounted to 1.2% in Azerbaijan, 11.7% in Georgia, and 17.1% in Armenia. In other words, all other things being equal (proceeding from the share of military spending in the structure of overall spending) during the entire period between 1992 and 2010, 14.25-fold (17.1:1.2) more was spent on military requirements in Armenia, and 9.75-fold (11.7:1.2) more in Georgia than in Azerbaijan;

> ➢ If we presume that the South Caucasian republics, following Austria's example (in this country the amount of military spending relative to GDP amounts to 1%), will reduce their military expenditures, Azerbaijan will be able to save $5.538 billion [$276.9 billion x (3.0% − 1.0%)/100% = $5.538 billion], Georgia — $3.199 billion [$91.4 billion x (4.5% − 1.0%)/100% = $3.199 billion], and Armenia — $1.774 billion [$73.9 billion x (3.4% − 1.0%)/100% = $1.774 billion], which comprises a total of $10.511 billion.

This enormous sum could have been used to develop the national economies, establish interregional good-neighborly relations, and support the formation of a common South Caucasian market. Spending such large amounts of money in the "proper" spheres would undoubtedly produce the best effect.

Moreover, if we keep in mind that military spending in the direct sense is detrimental to the wealth created by the labor of the entire society, in the economic respect it can be easily compared with the losses that are incurred as a result of earthquakes, flooding, or other natural disasters, for example.

Engage in Trade or Take Up Arms

We would do well to remember the words of one of the founders of the liberal economy Frédéric Bastiat (1801-1849), who said that when goods do not cross borders, armies will.

The impenetrability of borders leads to a decrease in economic growth and territorial contradictions—to a rise in transaction outlays in commerce or, worse still, to its cessation. In conditions of contemporary globalization, openness of the economy becomes extremely important (there are no limitations for specialization, cooperation, development of all types of business activity, nor is there any monopoly). Despite the openness of the Armenian economy, the republic's low level of goods turnover with neighbors is becoming the reason for the hike in price.

The data on export and import volumes of the South Caucasian countries over the past three years and the reciprocal trade between them presented in Table 6 can serve as confirmation of the above. As can be seen from the calculations we present, the volumes of Armenia's export and import are not very high. For example, the largest amounts of export and import the republic could achieve amounted to 5.7% of GDP (in 2012) and 6% (in 2011), respectively; no comment, as they say.

Another extremely important source of economic growth is investments. In January-December 2012, the inflow of foreign investments into the Armenian economy (including from state management agencies and banks) amounted to $1,587.0 million, which is 8.6% lower than in 2011. In so doing, in 2012, the inflow of foreign direct investments amounted to $656.7 million; this amount is 27.5% lower than 2011.

Other investments accounted for $928.9 million (which is 12.0% more than the index for 2011), while portfolio investments accounted for $1.4 million.

Throughout 2012, the outflow of monetary resources (not counting accrued interest, dividends, and debt servicing) amounted to $19.7 million; I am talking about resources exported by legal resident entities in the form of investments (see Table 7).

In January-December 2012, the amount of foreign investment flows into the real sector of the Armenian economy (not counting from state management agencies and banks) was equal to $751.8 million, which is 7.9% less than in 2011. The inflow of foreign direct investments into the real sector of the economy compared with 2011 decreased by 10.1% and amounted to $567.4 million.

In January-December 2012, 37.6% of the total volume of foreign investments in the real sector and 49.82% of the volume of foreign direct investments went to telecommunications. In so doing, it should be noted that in 2011 the most attractive branch in terms of investments was the production of base metals, which received 23.69% of the total volume of foreign investments in the real sector and 21.47% of direct foreign investments.[2]

In 2012, 9.6% of direct investments went to performing real estate operations and 6.37% to plant cultivation, animal husbandry, and hunting (including rendering services to related branches). In 2011, 21.97% of the total amount of direct investments went to telecommunications and 15.45% to branches related to the production and distribution of electricity, gas, steam, and conditioned air.

In our opinion, the presence or absence of a relation between foreign trade and investment activity of particular countries (both those receiving investments, and those providing them) poses a certain amount of interest. Research of data over the past few years shows that there is no direct dependence between Armenia's foreign trade with a particular country and the amount of investments coming into the republic from that country (see Table 8).

For example, in 2008-2011, Germany ranked 6th, 4th, 5th, 12th, 4th, and 3rd in terms of total investments, respectively. However, export volumes from Armenia to Germany occupied the top

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[2] See: *Socioeconomic State of the Republic of Armenia in January-February 2013*, National Statistics Board of Armenia, Erevan, 2013, pp. 83-98.

T a b l e 6

**Interregional Export and
Import of the South Caucasian Countries**

Countries	Export					Import				
	Total, $m	Southern Caucasus		Neighboring Countries		Total, $m	Southern Caucasus		Neighboring Countries	
		$m	% of GDP	$m	% of GDP		$m	% of GDP	$m	% of GDP
2010										
Armenia	973.6	48.2	5.0	88.5	9.1	3,606.9	49.7	1.4	478.0	13.3
Georgia	1,278.0	176.8	13.8	414.8	32.5	4,747.1	568.2	12.0	1,746.2	36.8
Azerbaijan	20,765.3	411.0	2.0	1,480.4	7.1	6,092.0	50.4	0.8	2,085.1	34.2
Iran	25,418.3	562.6	2.2	8,774.4	34.5	53,328.5	184.5	0.3	3,197.0	6.0
Turkey	109,670.1	2,320.7	2.1	13,365.1	12.2	185,523.7	1,158.3	0.6	15,205.4	8.2
Total	158,105.3	3,519.3	5.92	24,123.2	15.3	253,298.2	2,011.1	0.79	22,711.7	8.97
2011										
Армения	1,334.3	61.9	4.6	169.2	12.7	4,145.3	247.0	6.0	680.7	16.4
Грузия	1,990.8	282.0	14.2	533.3	26.8	6,389.0	711.0	11.1	2,306.8	36.1
Азербайджан	26,480.2	535.3	2.0	2,323.3	8.8	9,732.9	89.5	0.9	3,193.5	32.8

T a b l e 6 (c o n t i n u e d)

Countries	Export					Import				
	Total, $m	Southern Caucasus $m	Southern Caucasus % of GDP	Neighboring Countries $m	Neighboring Countries % of GDP	Total, $m	Southern Caucasus $m	Southern Caucasus % of GDP	Neighboring Countries $m	Neighboring Countries % of GDP
Iran	112,645.6	440.9	0.4	13,142.8	11.7	5,9421.6	255.0	0.4	3,982.1	6.7
Turkey	134,915.3	3,156.8	2.3	19,845.9	14.7	240,838.9	576.7	0.2	18,505.6	7.7
Total	277,366.2	4,476.9	1.6	36,014.5	13.0	320,527.7	1,879.2	0.6	28,668.7	8.9
2012										
Armenia	1,428.1	81.6	5.7	180.3	12.6	4,266.8	49.1	1.1	482.5	11.3
Georgia	1,674.4	310.1	18.5	466.2	27.8	7,184.8	741.8	10.3	2,511.4	35.0
Azerbaijan	23,827.2	570.7	2.4	2,217.9	9.3	9,641.7	129.9	1.3	3,205.2	33.2
Iran	—	—	—	—	—	—	—	—	—	—
Turkey	152,560.8	3,841.7	2.5	28,182.1	18.5	236,536.9	520.2	0.2	18,995.4	8.0
Total	179 490.5	4,804.1	2.7	31,046.5	17.3	257,630.2	1,441.0	0.6	25,194.5	9.8

N o t e: *Iran's* neighboring countries: Azerbaijan, Afghanistan, Turkey, Turkmenistan, Iraq, Pakistan, Syria, Armenia, and Kuwait;
Turkey's neighboring countries: Azerbaijan, Bulgaria, Iran, Cyprus, Armenia, Greece, Saudi Arabia, Syria, and Georgia;
Georgia's neighboring countries: the Russian Federation, Azerbaijan, Armenia, and Turkey;
Azerbaijan's neighboring countries: the Russian Federation, Georgia, Armenia, Turkey, and Iran.

T a b l e 7

Flows of Foreign Investments into Armenia in 2009-2012 by Type ($m)

	Investments in Armenia (liabilities)						Investments from Armenia in Other Countries (assets)					
	2009	2010	2011	2012	Absolute Change in 2012 Compared to 2011	Growth Rates, %	2009	2010	2011	2012	Absolute Change in 2012 Compared to 2011	Growth Rates, %
Total investments	2,555.4	1,555.8	1,735.9	1,587.0	–148.9	91.4	193.7	94.6	115.3	19.7	–95.6	17.1
Direct investments	906.2	706.9	906.3	656.7	–249.6	72.5	52.7	8.3	78.0	15.8	–62.2	20.3
Portfolio investments	11.0	12.23	—	1.4	—	—	10.6	1.5	—	1.1	—	—
Other investments*	1,638.2	836.7	829.6	928.9	99.3	112.0	130.4	84.8	37.3	3.3	–34.0	8.8
Commercial loans	49.9	26.6	39.5	84.4	44.9	213.7	8.8	12.5	16.0	0.1	–15.9	0.6
Short-term	31.2	5.9	4.2	4.4	0.2	104.8	8.8	12.5	16.0	0.1	–15.9	0.6
Long-term	18.7	20.7	35.3	80.0	44.7	2.3 раза	—	—	—	—	—	—
Loans	1,588.3	810.1	790.1	844.5	54.4	106.9	121.6	72.3	21.3	1.7	–19.6	8.0
Short-term	—	49.4	106.4	—	—	—	120.0	62.6	—	—	—	—
Long-term	1,588.3	760.7	683.7	844.5	160.8	123.5	1.6	9.7	21.3	1.7	–19.6	8.0
Monetary regulation bodies	337.4	100.0	91.1	99.5	8.4	109.2	—	—	—	—	—	—
State management bodies	1,065.0	313.7	284.0	348.7	64.7	122.8	—	—	—	—	—	—
Banks	0	150.3	227.0	319.2	92.2	140.6	1.6	7.9	19.1	1.6	–17.5	8.4
Other sectors	186.2	196.6	81.6	77.1	–4.5	94.5	1.6	2.0	2.2	0.1	–2.1	4.5

* Without calculating cash monetary resources, deposits, and other liabilities (assets).

S o u r c e s: *Socioeconomic State of the Republic of Armenia in January-February 2011*, National Statistics Board of Armenia, Erevan, 2011, p. 70; *Socioeconomic State of the Republic of Armenia in January-February 2012*, National Statistics Board of Armenia, Erevan, 2012, p. 85; *Socioeconomic State of the Republic of Armenia in January-February 2013*, National Statistics Board of Armenia, Erevan, 2013, p. 83

T a b l e 8

Rankings of Armenia's Main Partner Countries in Terms of Foreign Trade and Investments in 2006-2011

Countries	Export Years						Import Years						Total Investments Years						Foreign Direct Investments Years					
	2006	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010	2011
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
Russian Federation	3	1	1	2	1	2	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Germany	1	2	2	1	3	2	4	4	5	5	4	3	6	4	5	12	4	3	2	3	5	8	4	5
U.S.	7	6	7	3	6	6	8	7	6	8	9	9	5	5	8	6	6	6	3	4	4	6	6	5
Bulgaria	31	8	6	4	2	3	16	14	12	11	8	10	—	—	—	—	—	—	—	—	—	—	—	—
The Netherlands	2	3	3	6	4	4	28	27	31	25	29	24	15	13	14	3	3	15	18	16	10	12	9	15
Belgium	4	4	4	7	7	8	5	11	14	15	14	16	22	27	17	20	15	24	17	19	11	14	16	17
Georgia	8	5	5	5	8	10	18	17	17	19	17	18	—	21	12	16	—	—	—	—	—	—	—	—
Canada	14	21	12	8	10	9	29	35	26	30	30	26	9	—	—	—	10	9	6	—	—	—	—	—
Italy	10	10	9	15	20	23	11	12	10	9	7	7	25	15	—	7	16	20	21	21	—	4	11	13
Switzerland	6	7	13	10	11	11	23	25	35	7	15	13	18	26	15	14	13	11	19	15	9	10	7	11
Iran	9	10	10	9	5	5	6	8	7	6	6	6	—	—	16	19	18	25	—	—	9	—	15	—
China	41	17	31	11	9	13	7	5	2	2	2	2	21	—	—	—	—	—	16	—	—	—	—	—

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1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
Ukraine	12	9	11	12	13	15	2	2	3	3	3	5	14	19	—	11	—	—	10	11	—	7	—	—
Austria	20	22	19	13	23	29	15	10	9	16	16	21	17	22	13	15	—	22	—	18	14	—	—	—
Spain	11	14	14	14	12	7	30	28	24	29	28	23	24	—	—	—	—	—	—	—	—	—	—	—
France	18	15	15	17	16	18	13	6	11	13	12	12	8	8	2	2	2	2	8	5	3	2	2	2
UAE	17	20	16	18	15	17	22	29	25	22	23	20	—	—	—	—	—	—	—	—	—	—	—	—
United Kingdom	16	27	8	27	46	50	21	18	19	23	22	22	14	3	3	8	11	4	12	10	12	—	14	9
Republic of Korea	37	45	41	16	25	14	20	16	15	10	13	19	—	—	—	—	—	—	—	—	—	—	—	—
Thailand	28	29	22	22	28	25	36	33	33	31	32	34	—	—	—	—	—	—	—	—	—	—	—	—
India	40	24	28	24	18	27	19	25	18	18	20	15	—	—	—	—	—	—	—	—	—	—	—	—
Kazakhstan	19	18	25	25	26	24	3	33	36	50	37	31	2	7	8	10	12	14	—	11	11	—	—	—
Moldova	34	32	32	31	36	48	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Belarus	22	31	27	20	22	20	24	24	29	28	24	28	—	—	—	—	—	—	—	—	—	—	—	—
Turkmenistan	27	30	21	23	14	22	27	40	22	33	27	30	—	—	—	—	—	—	—	—	—	—	—	—
Uzbekistan	33	37	24	28	31	33	54	36	40	51	50	63	—	—	—	—	—	—	—	—	—	—	—	—
The Czech Republic	46	33	34	29	35	31	33	32	32	32	31	33	27	—	21	—	—	—	—	—	—	—	—	—
Sweden	49	50	39	30	41	38	37	22	20	27	21	35	—	—	—	—	—	—	—	—	—	—	—	—

T a b l e   8   (c o n t i n u e d)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
Turkey	24	26	30	32	34	37	9	9	4	4	5	4	—	—	—	—	—	—	—	—	—	—	—	—
Latvia	31	39	36	34	32	35	65	67	43	67	62	64	13	6	9	9	—	5	13	14	—	—	—	8
Poland	15	19	18	36	29	40	31	30	27	20	25	25	—	—	—	—	—	—	—	—	—	—	—	—
Israel	5	12	20	38	24	28	10	20	30	37	35	29	20	—	—	—	—	—	15	—	—	—	—	—
Hungary	62	42	55	40	47	46	34	23	28	34	33	32	—	—	—	—	—	—	—	—	—	—	—	—
Japan	45	23	45	42	55	51	17	13	8	12	11	14	—	—	—	—	—	—	—	—	—	—	—	—
Luxemburg	27	36	35	43	—	44	59	77	92	78	81	87	16	11	10	17	7	7	11	10	8	10	10	12
Lithuania	56	52	43	44	37	39	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Cyprus	55	47	50	61	39	32	63	50	67	65	66	60	11	12	7	13	8	13	9	8	6	9	3	7
Estonia	34	44	40	67	40	63	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Rumania	60	41	53	62	51	47	12	15	13	14	10	9	—	—	—	—	—	—	—	—	—	—	—	—
Finland	21	16	49	64	57	86	39	34	37	24	39	39	10	18	—	—	17	19	7	17	—	—	12	—
The Virgin Islands	35	13	77	—	54	69	—	—	—	—	—	—	19	24	—	—	—	8	14	13	—	—	—	3
Belize	13	34	29	—	21	16	38	41	34	38	46	41	—	—	—	—	—	—	—	—	—	—	—	—
Slovakia	—	—	—	—	—	—	49	53	54	57	56	54	—	23	19	—	—	—	—	—	—	—	—	—
Ireland	—	—	—	—	—	—	—	—	—	48	53	56	—	—	—	—	—	—	—	—	12	7	—	18
Singapore	—	—	—	—	—	—	52	51	55	48	53	56	—	—	—	—	—	—	—	—	—	—	—	—

T a b l e 8 (c o n t i n u e d)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
Greece	—	—	—	—	—	—	14	19	21	21	19	17	7	25	13	—	22	17	4	—	—	—	—	—
Denmark	—	—	—	—	—	—	48	54	51	43	48	48	—	—	—	—	20	—	—	—	—	—	—	19
Slovenia	—	—	—	—	—	—	40	45	44	39	45	45	—	—	—	—	—	—	—	—	—	—	—	—
Brazil	—	—	—	—	—	—	26	20	16	17	18	11	—	—	—	—	—	—	—	—	—	—	—	—
Indonesia	—	—	—	—	—	—	26	30	23	26	26	27	—	—	—	—	—	—	—	—	—	—	—	—
Malaysia	—	—	—	—	—	—	32	39	38	36	34	36	—	—	—	—	—	—	—	—	—	—	—	—
Argentina	—	—	—	—	—	—	—	—	—	—	—	—	4	9	4	5	9	12	5	6	2	3	4	10
Australia	—	—	—	—	—	—	—	—	—	—	—	—	—	10	20	—	—	—	—	7	—	—	—	—
The Cayman Islands	—	—	—	—	—	—	—	—	—	—	—	—	23	16	—	—	19	18	20	20	—	—	13	—
Lebanon	—	—	—	—	—	—	—	—	—	—	—	—	3	2	5	4	5	10	17	2	7	5	8	6
Lichtenstein	—	—	—	—	—	—	—	—	—	—	—	—	28	17	11	18	23	16	—	—	—	13	14	—
The Virgin Islands (U.S.)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	9	—	—	—	—
Syria	—	—	—	—	—	—	—	—	—	—	—	—	—	20	18	—	—	23	—	—	—	—	—	14
Panama	—	—	—	—	—	—	—	—	—	—	—	—	12	—	—	—	—	—	—	—	—	—	—	—
The Bahamas	—	—	—	—	—	—	—	—	—	—	—	—	26	—	—	—	—	—	—	—	—	—	—	—
UAR	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	21	—	—	—	—	—	—	—	—

S o u r c e: The table was compiled on the basis of data from the *Statistical Yearbook of Armenia, 2010*, National Statistics Board of the Republic of Armenia, Erevan, 2010, pp. 482-488 and *Statistical Yearbook of Armenia, 2012*, National Statistics Board of the Republic of Armenia, Erevan, 2012, pp. 471-474.

three positions on the list of other countries. We can look at another example: UAE did not invest in the Armenian economy in 2006-2011, but in terms of export from Armenia this country ranked 17th, 20th, 16th, 1st, 15th, and 17th, respectively. As for Armenia's import indices, the UAE ranked 22nd, 29th, 25th, 22nd, 23rd, and 20th.

In Table 8, we present the ranking of Armenia's main partner countries in foreign trade and in terms of investment volumes for 2008 through 2011. The data on export, import, and investment volumes for the countries occupying the first three positions (the Russian Federation, Germany, and the U.S.) demonstrate, if not a direct, at least a very obvious interdependence.

It can be concluded in this context that when a country opens up to foreign trade, it becomes more attractive and transparent for investors.

C o n c l u s i o n

The interstate conflicts in the Southern Caucasus are hindering the development of the transition economies of the region's countries. As a result of the government budget deficit and underdevelopment of market institutions (including social security mechanisms), they cannot fully carry out economic and social policy, nor are they in a state to permit themselves to spend large amounts on arms.

Cooperation among the regional states can be activated, primarily by means of economic reconciliation of the sides. If we proceed from this position, we can also examine the question of creating free economic areas with special features in the region.

For example, we can discuss a 10-year program of joint economic development of the region still in the grips of unsettled conflicts. In so doing, particular attention should be given to how much investment will be made over the entire planned period, as well as to maintaining parity (we will call this "parity of investments") in those branches of the economy they go to. The aim of this proposal is to observe the interests of economic activity agents, which will help to prevent an exodus of capital.

Launching economic cooperation and trade among the South Caucasian countries could help to open up new prospects for their interaction both in terms of ensuring peace in the region, and in terms of establishing mutually beneficial business relations.