 POLICY BRI E F

Public Debt Management in Armenia. Analysis of Recent Policy Decisions[[1]](#footnote-1).

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| Armenian public debt increased from 16.4 percent of GDP in 2008 to 43.6 percent of GDP in 2013. In absolute terms the debt increased from AMD 585 billion in 2008 to AMD 1861 billion in 2013. The external debt of the government of Armenia increased by 3.2 times while the domestic debt increased by 2.8 times. The government explained part of this increase by the economic crisis that struck Armenia in 2009. However, the need of large volume borrowings is highly questionable. |  |

The government claims that the debt is at sustainable and manageable level. Armenian legislation allows the government to borrow up to 50 percent of the GDP. However, one must remember that the government of Armenia already was faced with debt problems in the past (in early XXI century) and had to restructure part of the debt to Turkmenistan and carry out debt to equity swap transaction with Russia to reduce the debt burden. At the time the public debt of Armenia was not exceeding 47 percent of GDP. Thus the 50 percent threshold does not guarantee that the country may not face problems. Private debt of Armenian banks and enterprises also increased dramatically during the last couple of years. Economic turbulence abroad may have worse impact on Armenian economy at higher debt levels.

Economic theory envisages that the public debt must increase by the size of the public budget deficit (if we discard that the government may have free cash at the beginning of the year and may use the proceeds from privatization to cover part of the deficit). However, there are differences between the sizes of the Armenian budget deficit and increases in public debt. The state budget deficit may be lower if the government carries out large volume lending transactions (lending transaction reduce the deficit since they bear a negative sign). Lending is not regulated by the parliament.

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|  | The dramatic increase in public debt resulted also in substantial increase in interest payments. Interest expenses on public debt increased from AMD 11 billion in 2008 to AMD 46 billion in 2013 (4.3 percent of revenues). It is expected that as Armenia borrows more money on non-concessional terms the debt service will increase. Increasing debt service payments absorb resources that should have been used to finance other socially and economically important expenditures. |

The increase in public debt may impact not only the size of interest expenses but over the time will also affect the volume of funds that are necessary to repay the debt. Thus, if the annual amounts of debt repayments against external debt were in the range of USD 15-17 million in 2005-2008, they were equal to USD 69 million in 2012 and USD124 million in 2013 (without the USD500 million paid to redeem the loan from Russia). The volumes of external debt repayments will continue to be on high levels and will exceed USD700 million in 2020. Large redemptions will increase the refinancing, foreign currency and other risks.

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| The Armenian government heavily borrowed even though there was a huge balance on Treasury Single Account (TSA). In late 2008 the government had more than AMD100 billion on TSA and could have done by borrowing a smaller amount and using instead the balance on TSA. The fact that the government had huge balances at the end of 2009 and 2013 may indicate that the government did not have any program how to use the borrowed funds. |  |

Over the years the government declared that it intends to replace the external debt with domestic one in order to reduce the foreign currency and other risks and develop the domestic securities market. However, after debut issuance of international bonds the government reduced the plans for domestic financing and refused all the bids during several auctions of government securities. The reduction of the volume of government securities in circulation will delay the development of government securities and capital markets since large volumes of securities in circulation are one of the preconditions for development of secondary market of government securities.

The evidence collected suggests that public debt management in Armenia is exposed to political influence. Thus, although the Prime Minister declared that the government terminated the program to construct North-South road corridor (because of lack of capacity) the Minister of Finance signed a new USD100 million loan agreement with ADB to finance the project. In general the Armenian legislation is not very clear with regard to authority to borrow.

Based on above presented findings and analysis the paper makes the following recommendations:

1. Clarify the borrowing authority.
2. Authorize the parliament to approve the characteristics of the desirable debt portfolio for the end of each year and assign the Minister of Finance to carry out all debt management transactions in line with the specified characteristics.
3. Revise the debt sustainability assessment framework used at present taking into consideration Armenian experience from the past.
4. Clarify the goals of borrowing transactions.
5. Reduce the share of foreign currency loans in debt portfolio.
6. Regulate the lending transactions.
7. Introduce a golden rule according to which all borrowed funds must not be used for consumption.

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1. *Research has been conducted in the period from October 2013 through March 2014. Final version of the research paper will be published in May 2013 and will include latest data for 2013.* [↑](#footnote-ref-1)