

Orakarg economic daily newspaper to Guillermo Tolosa, IMF Resident Representative in Armenia

In your assessment, what would be the impact of current shocks in the global economy and the potential second dip on the Armenia's economy?

At this stage, we don't think there will be a double dip in the global economy. Global growth is expected to moderate in 2011-12, but should remain around 4 percent. That said, the current shocks to the global economy have made us recently reduce our growth forecasts for many advanced and emerging countries (including Russia). Growth is particularly slow in advanced countries, and downside risks have increased considerably.

We still expect that the effect of this moderation of global growth in Armenia will be mild. On the back of strong macroeconomic policies, we continue to see Armenia's economy to grow above 4 percent this year, in line with our expectations earlier in the year. However, it is also true for Armenia that there are considerably higher downside risks than six months ago.

What measures should be taken by the Government to reduce potential risks?

In light of increasingly uncertain prospects, the government should be cautious. This implies that it should not increase spending above past inflation, it should strengthen its revenue, and it should not embark in further borrowing beyond what was already scheduled. Against this backdrop, we very much welcomed the government recent announcement of a strong tax package and cautious spending for next year.

At the same time, the Central Bank should continue with policy of exchange rate flexibility and avoid interventions that could hurt much needed reserve buffers in the event of a global downturn.

Also, the Central Bank should continue to supervise the banking system very effectively and closely, in particular regarding the increasing foreign currency lending, as this type of lending can become a source of problems should the environment deteriorate.

More deeply, the government should be increasingly aware that the global economy will not make it easy for Armenia to grow for some time to come. The country cannot rely on external tailwinds: the only way to go forward fast and in a sustainable way will be through decisive economic reforms (like taking necessary steps to ensure fair competition and further reducing the cost of doing business).

The IMF has recommended the Government to increase tax rates on a number of goods as part of tax reforms. How appropriate do you find that measure in light of the significantly low taxes-to-GDP ratio in Armenia?

We think tax rates are reasonable in Armenia. Our preferred approach would be not to increase them, as there are other more promising opportunities to increase tax collection. For example, there are certain goods in which fixed tax payments (or "excise taxes") have been eroded significantly over time by inflation and need to be rapidly brought up to the prevailing levels in real terms of some years ago. We also think that there are some tax exemptions and loopholes in the legislation that should be reviewed. Those reforms, together with decisive action regarding the reduction of the shadow economy, should yield the expected results regarding the need of increased collections. However, we also understand the merits of increasing selected tax rates, like personal income tax for those in the very top of the income distribution on the basis of egalitarian pursuits.

Wouldn't increased tax rates lead to a further deepening of the shadow economy?

There is always a risk that increased taxation lowers the incentive to pay taxes. However, increased tax payments (“excises”) on certain specific goods will only take them back to preexisting levels. Also, if the authorities decide to increase selected tax rates we understand the increase may be moderate, and in many cases below tax rates in comparator countries. Also, it has recently become considerably easier to pay taxes, which operates as an offsetting force that should increase the incentive to pay. For example, taxes are expected to be paid with lower frequencies, filings can be done electronically, the taxpayer can recur to state-of-the-art tax service centers, he or she can recur to new publicly available clarifications of the tax law, and the taxpayer can apply to an independent appeals committee if he or she perceives unfairness from the SRC. In addition to this, the risk should be further diminished by the government renewed and decisive efforts regarding reducing the size of the shadow economy.

How much Armenia's foreign debt risks would increase with a more challenging situation in the global economy and Armenia?

We think that foreign debt in Armenia is manageable, even under further deterioration of the global environment. Not only the Armenia's debt level is considered acceptable for developing countries, but the composition of the debt (highly concessional and medium to long term duration) makes it particularly safe. However, as expressed earlier it is critical that the government is very conservative with new borrowing.

The IMF's July report indicates that dram is overvalued. How much is it overvalued? Is the CBA's FX policy aimed at adjustment of exchange rate adjustment?

Yes, our analysis suggests that the dram is overvalued. There is a range of instruments that one could use to assess the amount of the overvaluation, our preferred tools yield that the Armenian dram may be overvalued around 15 percent respect to its fundamental driving forces. We don't think the overvaluation is now a consequence of CBA action, which has mostly let the value of the dram be determined by market forces. It is actually normal that in all markets prices can deviate from its fundamentals for prolonged periods of time, and the analysis does not imply a prediction of currency movements in the near future. As a matter of fact, in the context of the floating nature of the Armenian dram, this means that the currency can appreciate before it depreciates, or it may not depreciate at all if underlying forces change in the proximate future.