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Assessment of investment requirements of the SME sector in Armenia

Gagik Torosyan and Varsenik Mnatsakanyan

Under macroeconomic framework of the Sustainable Development Program (SDP), value added of the SME[1] sector in Armenia should increase by USD 500-600 million each year to sustain the current levels of contribution to the GDP. In order to reach the 2006 level of SME Development Index of Central and Eastern European (CEE) countries by 2011 the average growth of the SME sector should amount to USD 869 million annually, i.e. additional USD 2.6 billion GDP should be generated by the SME sector compared to current levels. Investment absorption is a key factor to achieve these targets that can be only materialized through robust investments in Research and Development (R&D). In order to reach the average level of R&D investments to GDP in developing and developed countries (2%) USD 300-350 million will be required by 2011 from private and public sources.

Introduction

The state of development in the SME sector is considerably low in Armenia, as compared to CEE countries. Nevertheless, SME sector has huge potential and perspectives for development which can be realized only under appropriate and efficient policies. Investment promotion, especially in the field of R&D is crucial in case of this size of enterprises.

This analysis attempts to figure the level of investments necessary for the SME development with a special emphasis on R&D investments. However, the chosen methodology was heightened and limited by data constraints and resource availability problems.

Indicators that measure the role and significance of SMEs in the CEE economies were taken as targets. Accordingly, four development scenarios were worked out in the medium-term horizon. Economic growth projections under the Sustainable Development Program (SDP) for 2008-2011 were taken as a basis for our scenarios. The needs for investments in R&D to achieve the levels of more successful countries in this field were assessed separately.

The applied methodology, although quite simple, does allow concluding that the SME sector in Armenia have a huge potential for absorbing investments which, in turn, should be led by the R&D developments. According to our findings, intensive investments in R&D are required during the next three years.

SME perspectives and investment needs

Legislative regulation of SME sector, which emerged since 1990s, started by the adoption of the Law on State Support to SMEs passed in 2000. The mentioned law clearly defines entities that can be considered as SMEs and the methods to be used as part of the state support.

Currently, the private sector constitutes 84% of the economy, overwhelming majority of which – 98% - are SMEs. SMEs provide for about 30% of the Armenian GDP (40% of the GDP excluding agriculture and net indirect taxes[2]). Contribution of SMEs to the GDP is considerably high in trade, construction and services, with a slight increasing trend in the industrial sector. (*See Table 1*)

1 SME: Small and Medium-Sized Enterprises

2 For international comparison, the share of SMEs is usually calculated against the GDP without agriculture and net indirect taxes.

Table 1. The structure of GDP by main sectors of economy, 2006-2007

Sectors	Share of SMEs, %		Share of large enterprises, %	
	2006	2007	2006	2007
Industry	26.5	27.9	73.5	72.1
Construction	47.8	41.2	52.2	58.8
Trade	45.5	47.3	54.5	52.7
Transport and Communication	27.7	28.6	72.3	71.4
Services	41.9	42.3	58.1	57.7
GDP excluding agriculture and net indirect taxes	40.3	41.0	59.7	59.0
Total GDP	29.7	29.8	70.3	70.2

Source: SME Development National Center http://www.smednc.am/index.php/lo/101/

SME sector largely contributes to the creation of jobs. In 2006, overall employment in SME sector totaled 20.3 thousands. The role and significance of SMEs in the international practice are more comprehensively described by the SME Development Index developed by the United Nations (UN).[3] SME Development Index for Armenia equaled to USD 398.6 in 2007 which is significantly below the average of CEE countries. (*See Table 2*)

Table 2. SME Development Index in Armenia and Central and Eastern Europe, 2006

	Share of private sector in the economy %	**Share of SMEs in the GDP** %	**Share of those employed in SMEs** % in total employment	**GDP per capita** US dollar	**SME Development index** Per GDP per capita, US dollar
Slovenia	65	56.5	62.6	17,000	4,208.9
Estonia	80	73.7	55.6	10,230	3,353.6
Lithuania	75	63.0	70.0	7,647	2,529.2
Croatia	60	56.0	65.0	8,750	2,229.5
Slovakia	80	45.3	66.0	8,796	2,103.9
Latvia	70	58.2	69.3	6,869	1,939.0
Hungary	80	36.9	56.8	10,811	1,812.9
Cech Republic	80	32.7	56.7	12,097	1,794.3
Armenia[4]	***84***	***41.0***	***40.7***	***2,844***	***398.6***
Romania	70	55.0	21.0	4,544	367.4
Bulgaria	75	30.0	42.2	3,454	327.9

Source: EBRD Transition Report 2006, Businesses in Transition, UN ECE SME Development database, OECD Science, Technology and Industry Outlook 2006

Based on GDP projections in 2008-2011 under the SDP and the indicators describing the SME sector in Armenia for 2007, below we present several scenarios for the assessment of investment needs for expansion of SME sector. ***Scenario 1*** assumes that the share of SMEs in the GDP will remain the same. ***Scenario 2*** targets the SME development level of CEE countries in 2006, while ***Scenario 3*** and ***Scenario 4*** target the SME development levels of Latvia and Czech Republic in 2006, respectively.

3 SME Development Index represents the share of SMEs in a country's economy and bases on the following three economic factors: the share of the private sector in the economy, share of SMEs in the GDP, the share of employment in SMEs in the total employment in the economy. SME Development Index can be presented either in percents and/or in money terms – against GDP per capita.

4 Indices for Armenia are presented for 2007.

Scenario 1 – Based on Sustainable Development Program projections

Assuming that the share of SMEs in GDP (excluding agriculture and net indirect taxes) will remain unchanged until 2011 (41%) and the annual GDP growth will equal on average 9%[5], other things being equal, the SME Development Index will reach USD 775.4 providing that the employment in SMEs as share in total will grow by 1.8 percentage points.[6] Under such circumstances, GDP generated by SMEs will reach AMD 1,601.1 billion by 2011, which implies that it will grow on average by USD 548 million annually. However, this will not be sufficient to reach the 2006 development indices of Eastern-European countries by 2011.

Table 3. SME Development Index for Armenia, estimates under the SDP (Scenario 1)

	SME share in non-agricultural GDP	Private sector share	GDP	GDP excluding agriculture and indirect taxes	GDP generated by SMEs	Change from the previous year		Share of employees in SMEs in the total employment	Per capita GDP (according to SDP)	SME Development Index (per GDP per capita)
	%	%	AMD billion	AMD billion	AMD billion	AMD billion	USD million 1USD= 310 AMD	%	USD million	USD million
2007	41.0	84	3,148.7	2,264.8	928.6	-	-	40.7	2844.0	398.6
2008	41.0	84	3,671.7	2,661.7	1,091.3	162.7	524.9	42.5	3718.0	544.2
2009	41.0	84	4,169.3	3,038.6	1,245.8	154.5	498.5	44.3	4210.0	642.3
2010	41.0	84	4,703.2	3,454.1	1,416.2	170.4	549.5	46.1	4734.6	751.7
2011	41.0	84	5,280.7	3,905.0	1,601.1	184.9	596.4	47.9	5297.2	873.9

Source: own calculations

Scenario 2 – To reach the average of CEE countries in the share of SMEs in GDP[7]

In order to achieve the 2006 levels of SME share in GDPs of CEE countries[8] by 2011, while reaching 56% of the average employment in SMEs in the same countries, the SME employment in Armenia should increase in average by 3.8%[9] during 2008-2011. Meanwhile, the GDP generated by SMEs in absolute terms should increase by USD 869 million annually.

5 See PRSP-2, www.prsp.am

6 Calculations used the employment elasticity against economic growth indicators in 2002-2006, which equals 0.2%, i.e. 1% economic growth resulted in 0.2% increase in employment. Source: PRSP-2, www.prsp.am

7 For comparison, Slovenia, Estonia, Latvia, Lithuania, Croatia, Slovakia, Hungary, Czech Republic, Romania and Bulgaria were used.

8 For comparison, Slovenia, Estonia, Latvia, Lithuania, Croatia, Slovakia, Hungary, Czech Republic, Romania and Bulgaria were used.

9 Elasticity of employment in this case would equal 0.43. Source: EDRC estimates.

Table 4. SME Development Index for Armenia to reach the CEE average share of SMEs in the GDP and employment (Scenario 2)

	SME share in non-agricultural GDP	Private sector share	GDP	GDP excluding agriculture and indirect taxes	GDP generated by SMEs	Required change from the previous year		Share of employees in SMEs in the total employment	Per capita GDP (according to SDP)	SME Development Index (per GDP per capita)
	%	%	AMD billion	AMD billion	AMD billion	AMD billion	USD million 1USD= 310 AMD	%	USD million	USD million
2007	41.0	84	3,148.7	2,264.8	928.6	-	-	40.7	2844.0	398.6
2008	43.0	84	3,671.7	2,661.7	1,144.5	216.0	696.7	44.2	3718.0	593.6
2009	45.0	84	4,169.3	3,038.6	1,367.4	222.8	718.8	47.7	4210.0	759.1
2010	47.0	84	4,703.2	3,454.1	1,623.4	256.1	826.0	51.2	4734.6	957.0
2011	50.0	84	5,280.7	3,905.0	1,952.5	329.1	1,061.5	56.0	5297.2	1245.9

Source: own calculations

Scenario 3 - To reach the 2006 SME Development Index of Latvia

In order to achieve the SME Development Index of Latvia in 2006 (USD 1939) by 2011, it is necessary for Armenia to achieve the share of SMEs in the GDP equal 62.9% in 2011, thus growing by 5.5 percentage pointes each year, while SME employment reaching 69.3% of the total by 2011 (required annual increase is 7.2 percentage points[10]). As a result, under the projected annual GDP growth of 9% during 2008-2011, the contribution of SMEs to the GDP generation (in absolute terms) should increase on average by USD 1514 million. I.e. USD 762 million annually will be required in addition to the USD 548 million projected under the SDP, which implies a drastic investment requirement increase.

Table 5. SME Development Index for Armenia to reach the SME Development Index level of Latvia (Scenario 3)

	SME share in non-agricultural GDP	Private sector share	GDP	GDP excluding agriculture and indirect taxes	GDP generated by SMEs	Required change from the previous year		Share of employees in SMEs in the total employment	Per capita GDP (according to SDP)	SME Development Index (per GDP per capita)
	%	%	AMD billion	AMD billion	AMD billion	AMD billion	USD million 1USD= 310 AMD	%	USD million	USD million
2007	41.0	84	3,148.7	2,264.8	928.6	-	-	40.7	2844.0	398.6
2008	46.5	84	3,671.7	2,661.7	1,237.7	309.1	997.2	47.9	3718.0	694.9
2009	52.0	84	4,169.3	3,038.6	1,580.1	342.4	1,104.5	55.0	4210.0	1011.4
2010	57.5	84	4,703.2	3,454.1	1,986.1	406.0	1,309.8	62.2	4734.6	1421.3
2011	62.9	84	5,280.7	3,905.0	2,455.5	469.4	1,514.2	69.3	5297.2	1939.0

Source: own calculations

10 Elasticity of employment in this case would equal 0.79. Source: EDRC estimates.

Scenario 4 - To reach the 2006 SME Development Index of Czech Republic

If the target is taken to reach the 2006 development indicator of Czech Republic (USD 1794.0) by 2011, as well as to ensure 56.7% of total employment to come from SME sector, it is necessary to achieve the level of 71.1% of SME share in the GDP: that is - to increase by 7.5 percentage points each year and ensure annual growth of employment in the SME sector by 4.0 percentage points.[11] Thus, under the projected 9% of annual economic growth, the GDP generated by SMEs should increase on average by USD 1597 million.

Table 6. SME Development Index for Armenia to reach the SME Development Index level of the Czech Republic (Scenario 4)

	SME share in non-agricultural GDP	Private sector share	GDP	GDP excluding agriculture and indirect taxes	GDP generated by SMEs	Required change from the previous year		Share of employees in SMEs in the total employment	Per capita GDP (according to SDP)	SME Development Index (per GDP per capita)
	%	%	AMD billion	AMD billion	AMD billion	AMD billion	USD million 1USD= 310 AMD	%	USD million	USD million
2007	41.0	84	3,148.7	2,264.8	928.6	-	-	40.7	2844.0	398.6
2008	48.5	84	3,671.7	2,661.7	1,291.7	363.2	1,171.5	44.7	3718.0	677.5
2009	56.1	84	4,169.3	3,038.6	1,703.4	411.7	1,328.1	48.7	4210.0	965.5
2010	63.6	84	4,703.2	3,454.1	2,196.5	493.0	1,590.4	52.7	4734.6	1332.8
2011	71.1	84	5,280.7	3,905.0	2,776.7	580.3	1,871.9	56.7	5297.2	1794.0

Source: own calculations

Assessment of investment requirements in R&D

Innovation and new technologies are direct products of R&D: the latter can be viewed as a most important driving force for the economy. International experience shows that investments in R&D are one of the warrants for the progress of efficient market economies, thus ensuring quite large outputs and value added.

Investments in R&D in OECD countries in 2006[12] constituted USD 729 million or 2.26% of the GDP. Investments in R&D in Japan are as high as 3.13% of the GDP, followed by 2.68% in the US, 1.81% - in EU countries with some of them having about 3% of the GDP as investments in R&D. Sweden, Finland and Japan have the highest shares of R&D investments in the GDP: 3.8%, 3.4% and 3.13% respectively.

This indicator for Armenia, according to some estimates, falls within the narrow range of 0.25-0.3%.[13] However, it is worth noting that this indicator reflects mostly the government spending on state-owned scientific institutions, since the R&D investments of the private sector are almost none.

In order to increase the R&D investments in Armenia to the average level of developing and developed countries by 2011 – that is 2.0% of the GDP, it is necessary to have USD 340 million investments (*See Table Scenario 1*). If Armenia targets reaching the level of R&D investments in Israel (2006) by 2011, USD 760 million will be required.

11 Elasticity of employment in this case would equal 0.44. Source: EDRC estimates.

12 OECD Science, Technology and Industry Outlook 2006

13 The science, technology and innovation policy of the republic of Armenia, UNESCO Armenian STI Mission 2008

Table 7. R&D Investment Requirements to reach the average for developing and developed country averages

		Investments in R&D								
	GDP	Scenario 1 To reach the average for developed and developing countries			Scenario 2 To reach the investment level of Israel in 2006			Scenario 3 To reach the investment level of Ireland in 2006		
	AMD billion	As % of GDP	AMD billion	USD million 1USD= 310AMD	As % of GDP	AMD billion	USD million 1USD= 310AMD	As % of GDP	AMD billion	USD million 1USD= 310AMD
2007	3,148.7	0.25	7.9	25.4	0.25	7.9	25.4	0.25	7.9	25.4
2008	3,671.7	0.5	18.4	59.2	1.3	45.9	148.1	0.5	18.4	59.2
2009	4,169.3	1.0	41.7	134.5	2.3	93.8	302.6	0.8	31.3	100.9
2010	4,703.2	1.5	70.5	227.6	3.3	152.9	493.1	1.0	47.0	151.7
2011	5,280.7	2.0	105.6	340.7	4.5	235.5	759.7	1.2	63.9	206.1

Source: own calculations

As one can see, huge financial resources will be required to reach the level of developing and developed countries in terms of R&D investments as share of GDP. By ensuring the inflow of such resources it will be feasible to develop the R&D sector, which will identify new development perspectives and technologies for SMEs thus expanding the capacity of the SME sector to absorb investments.

Summary

Analyses showed that the SME sector is still largely underdeveloped in Armenia. In order to reach the average level of Eastern European countries by 2011 Armenia needs to invest heavily. To that end, investments in R&D become a crucial pre-requisite. Although accurate quantitative estimates require in-depth and thorough studies and analyses, the methodology applied in this paper outlines the investment requirements and absorption capacities thereof.

Table 8. Investment Requirements for SME development and R&D for 2009-2011

Scenarios	Targeting	2009	2010	2011	Annual average	Total
Annual GDP growth in SME sector (year-to-year), USD million						
Scenario 1	Under the SDP macro-economic framework	498.5	549.5	596.4	548	1644
Scenario 2	To reach the average levels of Eastern European countries in terms of share of SMEs in the GDP and share of SME employment in total	718.8	826.0	1061.5	869	2606
Scenario 3	To reach the 2006 SME Development Index of Latvia	1104.5	1309.8	1514.2	1310	3929
Scenario 4	To reach the 2006 SME Development Index of Czech Republic	1328.1	1590.4	1871.9	1597	4790
Required Investments in R&D, USD million						
Scenario 1	To reach the average for developed and developing countries	134.5	227.6	340.7	114	341
Scenario 2	To reach the 2006 investments in Israel	302.6	493.1	759.7	253	760
Scenario 3	To reach the 2006 investments in Ireland	100.9	151.7	206.1	69	206

Source: own calculations

Under the targeted economic development framework (SPD framework) the SME sector should be capable of ensuring annual USD 500-600 million additional GDP (See Table 9). Even under those circumstances, the SME Development Index for Armenia in 2011 will be lower than the average for Eastern European countries in 2006. In order to reach the 2006 level of these countries, the nominal GDP generated by SMEs in dollar terms should grow on average by USD 869, which totals to USD 2.6 billion during 2009-2011. Such an increase will require large investments, absorption of which is an issue. That can be achieved only through adequate investments in R&D. R&D investments in Armenia are very low as compared to the GDP: in order to reach the average level of developed and developing countries (2% of the GDP) by 2011 investments of USD 300-350 million is required (*See Table 8*).

Reform of the post-communist state of Georgia

Zakaria Kutsnashvili

This analysis gives short history of the reforms done in the post communist state of Georgia. The study touches the reforms achieved concerning restructuring public administration, decentralization, fighting corruption and protection of human rights from the declaration of independence to recent days, by evaluating the results and making recommendations.

Public administration reform or governance system changing

Transition of one party regime to multiparty democracy was constituted by the elections of Georgian Supreme Soviet (first Parliament) on 28 October 1990. As a result Georgia shifted to a multi party represented legislative body. Georgia has held 5 parliamentary elections since the political-economic transition, having elected two or more parties occasionally.

Special law on public administration entered into force, which directly prohibited to give more priority to the interests of parties' than that of the state, reaching separation of interests of different levels. This is especially clear in executive body's activities, cadres' policy and elections.

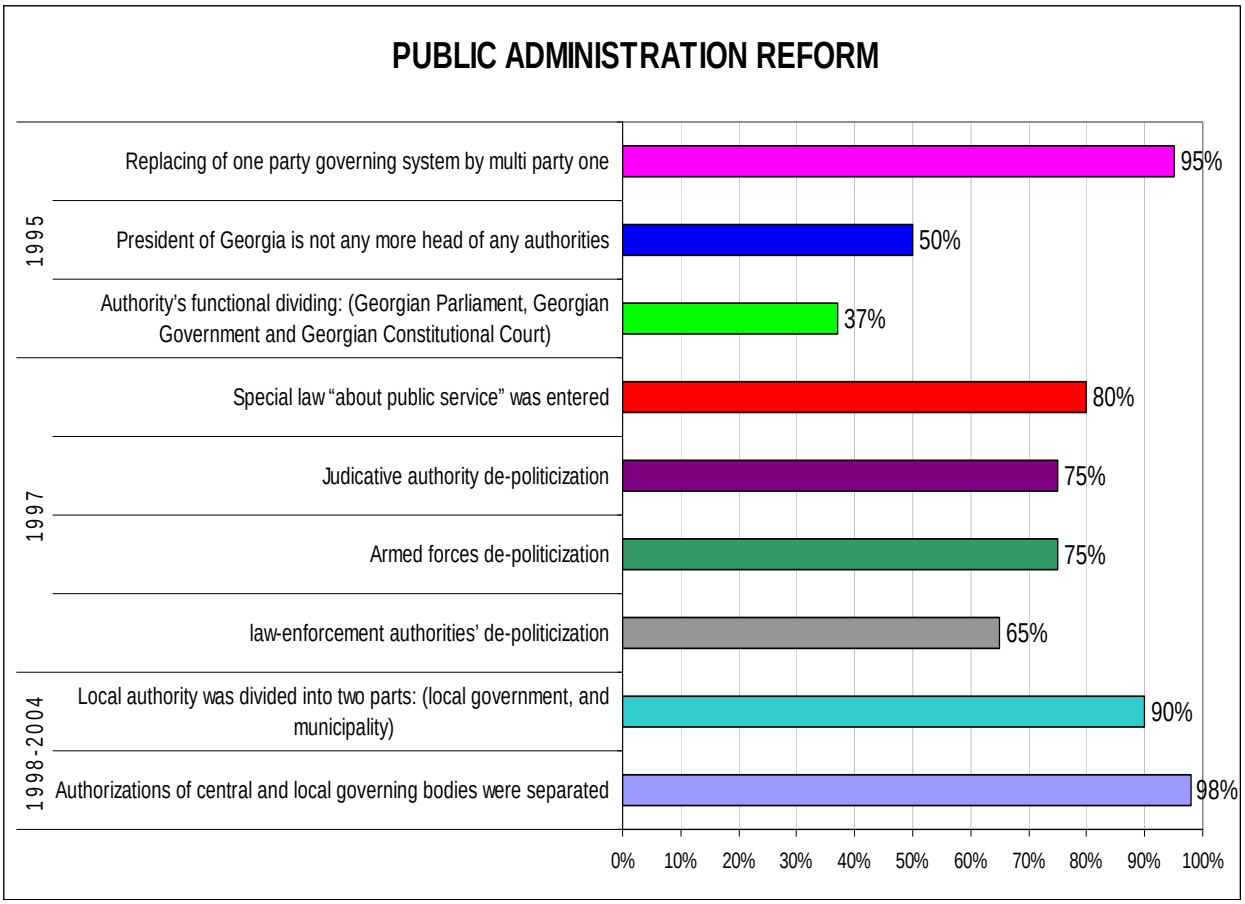
The de-politization of judiciaries, armed forces, right protection and law-enforcement authorities were introduced. Judges, public prosecutors, policemen and employees of the Ministry of Defense have no right of political activities and participation in demonstrations or meetings. The membership in political parties for former members of parties, who became the employees of above mentioned entities, was automatically stopped.

According to the Georgian Constitution legislated in 24 August 1995, from functional point of view, central authority was divided into three parts: the Georgian Parliament, the Georgian Government and the Georgian Constitutional Court, which is consisted of the system of courts and constitutional courts. President of Georgia cannot be the head of any authorities. According to the authorizations awarded by Georgian Constitution, he represents the State Governor and Executive Head of the Nation. He was also awarded by the rights to judge in disputes between authorities' branches.

According to the Georgian law on local public administration authorities local authorities were divided into two parts: local governments, with representative and legislative functions and municipality with executive functions. Authorizations of central and local governing bodies were separated. Central governing bodies were separated by territorial aspects.

Unfortunately during the governance system changing, the mechanism of checks and balances was violated. In post soviet Georgia the conflicts between government branches were fixed several times, however, it has resulted in different types of revolution and deficiencies in checks and balances and in the judicial system. Accordingly, the Georgian governance system needs cardinal change – in a civilized and peaceful way - to prevent further occurrence of crises.

Chart 1. Public administration reform



Source: Estimations belong to the author concerning the level of the accomplishment of each reform.

Decentralization

The country's administrational–territorial reform has not been introduced, and not because of the constitution act. According to this act the country's administrational–territorial arrangement is to be performed only after restoring country's territorial unity. Therefore, administrative units formed in communist Georgia, namely autonomies and regions still matter. There is an unsuccessful effort in the direction of changing the current administrative–territorial arrangement, as because of the lack of governing bodies own incomes. Georgia has governors, who completely depend on central government, they are not elected, supervised, and financing does not come from local population.

The competencies between central and local authorities are distributed in such a manner that all main rights (tax establishing, tax collection, protection of public order, privatization, creation of economic zones, permits issuance, labor relations) are accumulated into central government hand. Local authorities' exclusive rights are the maintenance of local roads, cemeteries, agricultural lands, The case of delegated rights from the central government to local authorities is very rare.

For self-government budget financing only one local tax is established, namely the property tax. All other taxes go to central budget. Because of the poverty of Georgian citizens and underdevelopment of business activities in the villages, property tax is not sufficient. Citizens are obliged to pay property tax only in case if the income of their family (a family includes all family members registered on the same address) exceeds GEL 40,000 per year. This means more than GEL 3,300 monthly income, what is the dreaming amount for most of the Georgian families. Thus, the aforementioned property tax can not be the financial source for the

local budget. All above mentioned results the dependence of local authorities on the central government. Central government allocates from the amount collected from taxes to towns and regions to finance their elementary and other needs.

Local authorities' activity control is implemented not by the way of juridical government but by the governor appointed by the central government. The law on local public administration authorities is country's anti-decentralization law. Because of the decentralization the principle of the separation of functions between the authorities is violated. Therefore, we might conclude that the State of Georgia keeps some characteristics of Georgia's communist regime. Georgia has to move towards the decentralization by taking administrative-territorial, as well as budgetary reforms.

Anti-corruption fight

Georgia has passed quite long way during the fighting against the corruption. A bureau analyzing and evaluating property and financial declarations was created. Law of "conflict of interests and corruption" was passed. In the law about "public administration services" the frames were established for different activities. In the law about "privatization" for opening the act of national identity, the public administration implementation mechanism was enforced. In course of last years the willingness to fight against corruption was expressed by some representatives of the government. Accordingly, Georgia achieved some results, the mass corruption was defeated.

But in the contrary to mass corruption, the high-level corruption reached quite high level. Up to date state procurement, strategic objects privatization, large enterprises owners' topics are closed. On March 2008 according the amendment made in the law about "manufacturers" it was directly prohibited to give any information to interested persons about companies' owners from manufacturers' register. Auditoria chamber as government entities and high position bodies activities financial control institute does not operating. In conclusion, Georgia achieved some results in fighting against mass corruption.

Human rights protection and justice accessibility

For today's condition institutes in charge with human rights protection are in crisis, but in the 17 years aged history of Georgian independence their passed quite successful way. In the Caucasus region Georgia was a top country in the progress of these kinds of organizations. Public protectors' apparatus was established. Non-governmental organizations' network, independent information means were created.

Administration of justice, as main guarantee in reaching the truth in human rights protection fight, is in quite complex state. The society looses the confidence and respect towards it. State fee is very increased, what forces many of citizens of Georgia to not use their rights. During criminal investigation, looking the priority is given to accuser's side. Massive violation of deadlines and decision-making process in disputes solving is in place. Accent is taken towards the repressive jurisdiction. In the population the hope of fair and independent court is loosen.

Georgians, as post – communistic state citizens, needed quite long time to acknowledge their rights protection by the way of court and other means. This is certified by the number of disputes entered in to Georgian common court. Each year number of disputes exceeds that of the number of the previous year. This means that in spite of low confidence to the court the citizens' are trying anyway to solve the problems by the civilized or court way. Beside, national institutes international mechanisms were also included in the process, what is expressed in collaboration with other rights protection organizations, like for instance the European court.

Human rights condition is the most right criteria for the measurement of the state of development. That is why government system changing priority is given to the progress of human rights.

Poverty phenomenon and its implications in the South Caucasus

Namig Tagiyev and Elvin Afandi

The article deals with the analysis and comparison of objective and subjective poverty rates in South Caucasus countries. Results argue that the poverty phenomenon can be differently interpreted in the region countries due to the different gauge of the well-being. Countries of the region are subjectively poorer than compared to the objective poverty measures. Moreover, there is totally inverse picture of poverty phenomenon for the countries of the region in terms of objective and subjective poverty measures.

Socio-economic background

Poverty appears as one of the most serious problems for countries of South Caucasus: Armenia, Azerbaijan, and Georgia. After the breakup of the Soviet Union (SSSR), South Caucasian countries face simultaneous challenges in building new states, democratic societies and market economies. South Caucasian countries had especially unfavorable conditions before transition began as compared with other republics of the former Soviet Union. Compared with other countries of the Union, South Caucasian countries had lower industrial output, weak labor productivity, low average monthly wages, higher unit labor costs, slower per capita growth, less developed infrastructure, low high qualified employment and less export opportunities.

As in other countries of the former SSSR, the transition led to economic decline also in the South Caucasus. The transitional processes in the South Caucasus have proved to be slower and more difficult than in other countries, with longer and deeper period of economic decline. In addition, these countries have suffered from ethnic conflicts and serious civil unrests. Overall, the process of transition turned to be more painful and also these states lagged behind in reforms.

Aforementioned tendencies caused serious poverty challenges. By the mid-1990s, up to half of the population of South Caucasian countries lived below the poverty line. Thus, based on international poverty standards, in 1999 more than 1 million people lived in extreme poverty in each country. (*See Table 9*).

Table 9. Poverty in the South Caucasus

	Year	Poverty rate (%)	Poverty gap (P1)	Severity of poverty (P2)
Armenia	1996	54.7	0.215	0.110
Azerbaijan	1995	68.1	0.276	0.144
Georgia	1999	23.2	0.074	0.035

Source: (Falkingham, J. (2005)." The End of the Rollercoaster? Growth, Inequality and Poverty in Central Asia and the Caucasus", Social Policy & Administration, Vol. 39, No. 4, pp. 340–360.)

Governments tried to meet this challenge, primarily with financial support and technical assistance from international financial institutions. Several programs were initiated for poverty reduction and economic developments in the framework of Poverty Reduction Strategy Papers (PRSP). By the 2000-2003, all countries have produced and adopted PRSPs in various forms: Armenia has Poverty Reduction Strategy, while Azerbaijan and Georgia possess State Program on Poverty Reduction and Economic Development.

Since the end of 1990s, the Caucasian economies entered in the phase of accelerated economic growth, achieving year-by-year impressive real GDP growth rates. In 2000-2007, these three economies all were

ranked among the top ten countries, with Azerbaijan leading the world growth figures by its 25.0%. Nevertheless, poverty is still an unsolved phenomenon.

Objective poverty

In order to show the difference between poverty situation of South Caucasian countries, objective poverty rates were calculated for year 2006 based on the survey conducted by Caucasus Research and Resource Center (CRRC). Poverty is measured as household total per capita expenditure adjusted by Purchasing Power Parity (PPP). We tested multiple poverty lines such as two international absolute poverty lines of USD PPP 2.15 and 4.30 per day expenditure and three relative poverty lines, namely, 40, 50, and 60 percent of median expenditures. (*See* T*able 10)*

Table 10. Poverty rates, 2006

Poverty lines	Poverty rate (%)		
	Armenia	Azerbaijan	Georgia
Absolute poverty (2.15 USD PPP per day)	17.7	0.8	24.8
Absolute poverty (4.30 USD PPP per day)	34.9	1.1	42.6
Relative poverty (40% of median expenditure)	13.8	1.8	14.8
Relative poverty (50% of median expenditure)	18.6	6.5	22.2
Relative poverty (60% of median expenditure)	23.9	13.7	30.5

Source: Author's calculations based on CRRC survey for 2006.

The results of calculation provide us two important insights. First, the results show that the poverty rate is the lowest in Azerbaijan. The highest poverty is observed in Georgia, while Armenia is situated in middle. These results are robust to selection of poverty line. Moreover, the major difference is between Azerbaijan on the one hand and Armenia and Georgia on the other hand.

This demonstrates that Azerbaijan is the leader of objective poverty reduction in the region followed by Armenia. Second, the results show that the poverty rates calculated based on absolute poverty lines have more differences as compared to poverty rates calculated based on relative poverty lines. Despite the relatively low level of objective poverty in the region, the subjective perception of living standards is pretty higher and more similar.

Subjective poverty

Attention of research on subjective poverty in countries which have experienced transition from a centrally-planned to a market economy has grown during last decade. A number of recent studies have evaluated subjective poverty in the transitional countries. To date studies on subjective poverty have focused almost exclusively on data from high or middle income countries in transition located in Central and Eastern Europe or in the western part of the former Soviet Union. Analysis on subjective poverty in South Caucasus countries is almost not available.

CRRC's survey questionnaire that asks the following question about subjective well-being: "How would you describe the current economic condition of your household?" provide us with subjective perception of living standards in the region. Due to this question we could estimate the subjective poverty rate in all three countries of the region.

Table 11. Subjective well-being in the countries of Caucasus (%)

Degree of well-being	Coding	Region	Armenia	Azerbaijan	Georgia
Very poor	1	14.62	13.61	14.15	15.92
Poor	2	32.17	25.81	35.66	34.54
Fair	3	48.37	53.03	45.25	47.14
Good	4	4.35	6.54	4.56	2.27
Very good	5	0.49	1.02	0.37	0.13
Total	-	100	100	100	100

Notes: Data are rounded up, Source: Author's calculations based on CRRC survey for 2006.

Analysis of well-being in the region as whole and in separate countries is shown in *Table 11*. Estimations show that the rate of subjective poverty for the South Caucasus is higher than objective poverty. In the region as a whole the majority of the people, approximately 48%, self-rate own well-being as fair. However, the significant number of people, approximately 32%, considers themselves poor. Furthermore, the considerable numbers of people, about 15%, consider themselves very poor. On the contrary, much smaller proportion of respondents, only 4%, perceive own well-being good and less than 1% very good. The same tendency in the proportions in distribution of well-being ranking can be observed in each country under investigation. In all countries the majority consider own well-being fair, followed by significant number of poor and very poor. The very small number of respondents evaluate own well-being as good or very good.

Cross country comparison reveals that Georgia leads with the number of very poor, followed by Azerbaijan and Armenia. By contrast, poor status is more common in Azerbaijan and Georgia – 36% and 35% respectively, than in Armenia – 25%. Likewise, Armenia has more respondents that rated own well-being as fair than Georgia and Azerbaijan – 53% vs. 47% and 45%. As well, Armenia has more people with good and very good subjective well-being followed by Azerbaijan and Georgia. Overall, it seems that subjective well-being in Armenia is more positive with more respondents identifying themselves as the fair, good and very good and less people identifying themselves as poor and very poor than in other countries of the region.

Conclusion

It is noteworthy, that the policy-makers are especially interested in the comparison with similar countries taken into account the perception of the citizens concerning with their living conditions. There is totally inverse picture of poverty phenomenon for the countries of the region in terms of the objective and subjective poverty measures. Although Azerbaijan maintains its leadership in objective poverty reduction, the significant portion of the population considers themselves poor. Furthermore, Georgia stays in back in terms of objective as well as subjective living standards. This kind of analyses should be signal for policy-makers in all three countries to compare the objective/actual poverty of their citizens with the subjective living standards satisfaction.

Unexploited trade and investment relations of Hungary and the CCA countries

Tamás Borkó

Countries of Caucasus and Central Asia (CCA)[14] intend to get involved much more in westward integration process, while the effective economic relations are mostly underdeveloped and distorted or one-sided. This is the case with business tights between Hungary and the CCA Region. The analysis investigates trade and investment relations among a new EU member and the given group of CIS countries. The potential is high in both areas.

Introduction

In the light of challenges Hungary and the CCA regions have to face because of global financial and economic turmoil, parallel with increasing strategic (economic and political) importance of the latter one, it is worth overview the potential room of expansion for trade and capital transactions.

In recent months this increasing attention to the topic is manifested in mutual visits of high-level politicians and top managers, discussing possible directions of cooperation.[15] It is fact, that the main rationale of these meetings is in connection with energy and energy security issues.[16] However, it is unavoidable to touch questions concerning economic relations of other sort.

Trade turnover

Based on 2007 data of *Hungarian Central Statistical Office (HCSO)*, only 0.3% of total Hungarian import (around USD 257 million) was originated from CCA countries, while 0.45% of total Hungarian exports (USD 385 million) went to the region.[17] This means that parallel with the overall trade balance surplus of Hungary, the balance with CCA countries is also positive for Hungary and exceeds USD 125 million. 2007 was the first year of Hungarian trade surplus, while the trade turnover felt as compared with 2006. (*See Chart 2*)

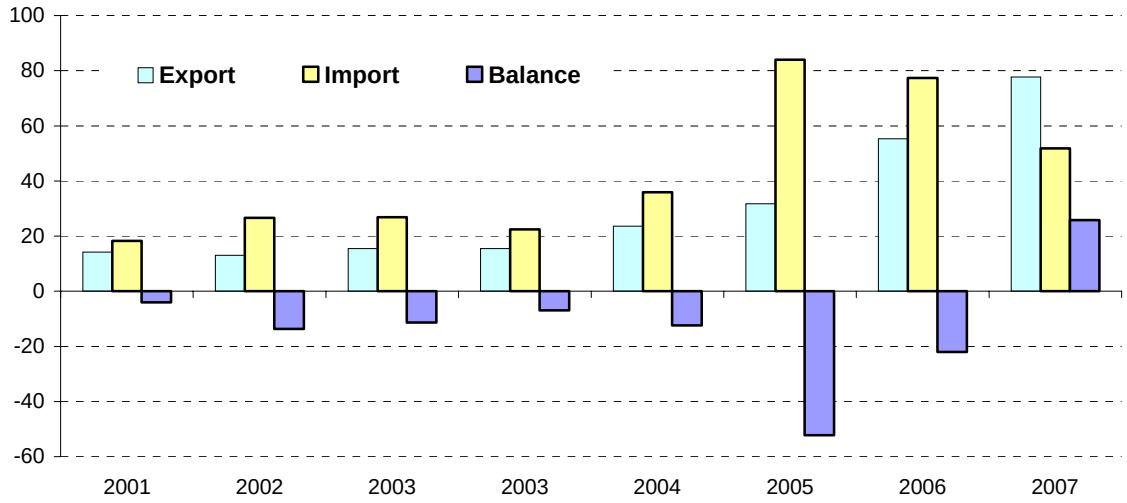
14 Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan

15 Main visits are Nursultan Nazarbajev Kazakh President's delegation last year, Ilham Aliyev Azerbaijani President this year, Ferenc Gyurcsány Hungarian Prime Minister to Azerbaijan and to Turkmenistan this year – only mentioning the highest level meetings.

16 Discussions on the Nabucco pipeline

17 Amount given in HUF are converted by the official exchange rate of the National Bank of Hungary on 27.11.2008: 201.89 HUF/USD.

Chart 2. International trade turnover of Hungary and CCA countries, 2001-2007 (HUF billion)



Source: Hungarian Central Statistical Office

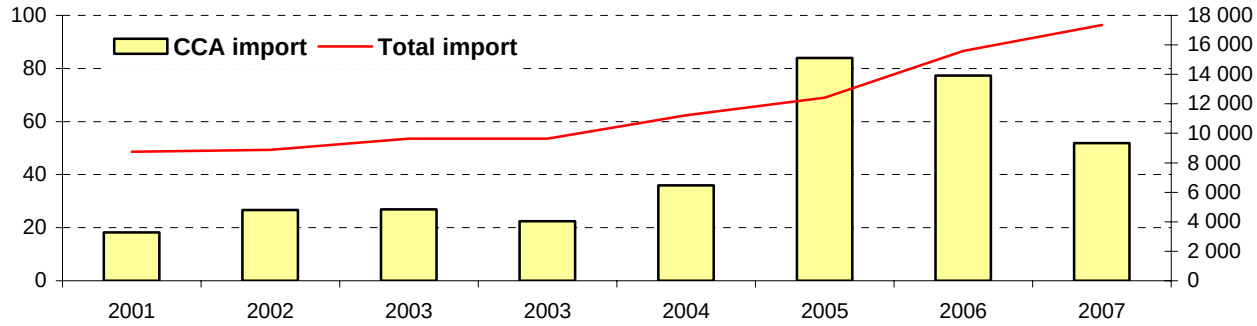
The reason of decreasing trade turnover is the falling CCA export to Hungary. In 2005-2007, it decreased by 35% to HUF 52 billion (USD 258 billion). The development of Hungarian export directed to CCA regions follows and rather exceeds the paces of total export's growth. Especially in the course of 2005-2007 it moved upwards dynamically. (*Chart 3*)

Chart 3. Total (left scale) and CCA (right scale) export, 2001-2007 (HUF billion)

Source: Hungarian Central Statistical Office

As concerning the import of Hungary, one can see that the pace of Hungarian CCA import growth lags behind the pace of growth regarding total import. And what is more, in 2005-2007, while total imports increased, imports originated from CCA countries decreased.

Chart 4. Total (left scale) and CCA (right scale) import, 2001-2007 (HUF billion)



Source: Hungarian Central Statistical Office

Structure of trade by countries and sub-regions

If investigating the structure of trade by individual countries of the CCA region, 97.8% of total Hungarian imports from CCA countries come from Uzbekistan (70.4%) and Kazakhstan (27.4%), that is, 99.8% of all Hungarian imports from the region is originated from Central Asia. Caucasian economies either are unable or unwilling to import to Hungary. (*See Table 1*)

Exports show different picture, as both regional, both individual distributions are more balanced. Caucasian countries welcome 20% of Hungarian export going to CCA countries, while the remaining 80% is directed to Central Asian states. The biggest target country is Kazakhstan (65.3%), followed by Azerbaijan (10.8%) and Georgia (7.6%), and then afterwards by closely similar shares of 2-5% the others. (*See Table 12*)

Table 12. The structure of Hungarian export and import related to the CCA countries by countries and country groups, 2007

Country	Balance, 2007	Export, 2007		Import, 2007	
	HUF million	HUF million	%	HUF million	%
Azerbaijan	8 335,4	8 365,4	10,77	30,0	0,06
Georgia	5 847,6	5 877,0	7,56	29,4	0,06
Armenia	2 093,0	2 129,0	2,74	36,0	0,07
Kazakhstan	36 570,8	50 763,8	65,34	14 193,0	27,37
Kyrgyzstan	1 626,2	1 636,4	2,11	10,2	0,02
Tajikistan	674,0	1 633,8	2,10	959,8	1,85
Turkmenistan	3 075,0	3 146,7	4,05	71,7	0,14
Uzbekistan	-32 398,2	4 135,8	5,32	36 534,0	70,44
Caucasus	*16 276,0*	*16 371,4*	*21,07*	*95,4*	*0,18*
Central Asia	*9 547,8*	*61 316,5*	*78,93*	*51 768,7*	*99,82*
CCA	**25 823,8**	**77 687,9**	**100,00**	**51 864,1**	**100,00**

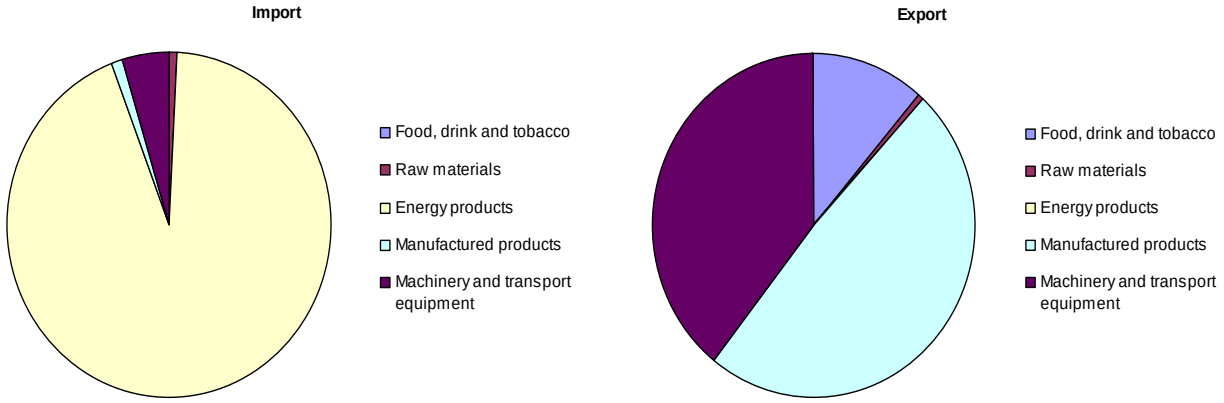
Source: Hungarian Central Statistical Office, own calculations

With exception of Uzbekistan, all countries of the region have trade deficit with Hungary. In 2007, Hungary realized HUF 25 billion (USD 124 million) trade surpluses, which is a small amount, while in relative terms reaches 30% of total exports to the region, or almost equivalent to total Hungarian trade surplus.

Structure of trade by product groups

The structure of trade turnover by product groups show also distorted picture. By the freshest available, 2006 data, countries of CCA in relation with Hungary are simple exporters of energy products, while importers of manufactured goods, machinery and transport equipment, food, drink and tobacco. (*See Chart 5*)

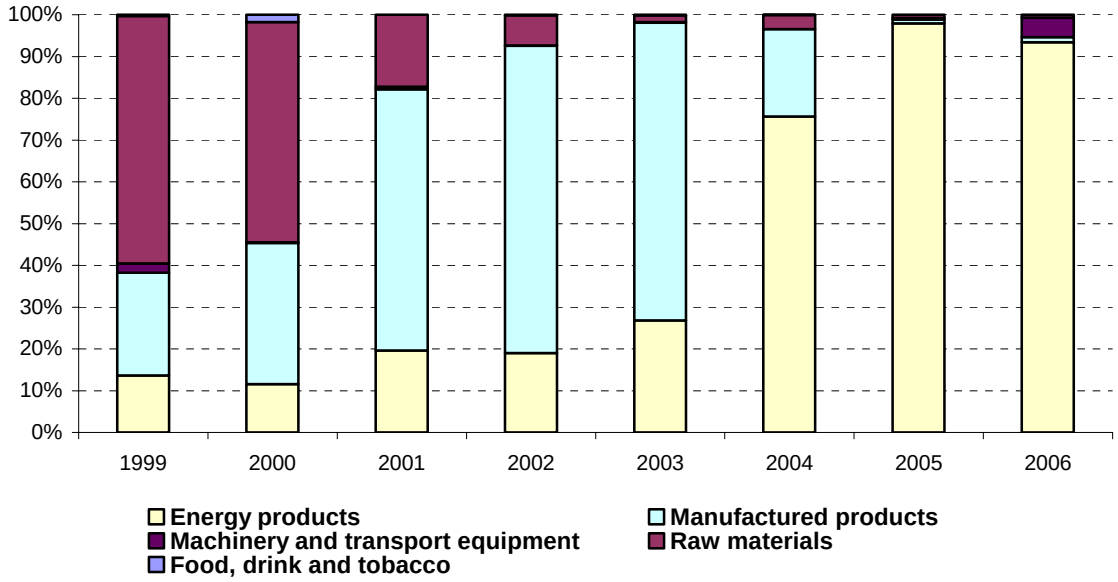
Chart 5. The structure of Hungarian export and import related to the CCA countries by main product groups, 2006 (%)



Source: Hungarian Central Statistical Office

Having a look on the time series of structural development of imports and exports gives us further aspects. Earlier, the considerable part of Hungarian import from CCA countries was covered by manufactured goods, and raw materials. While in 2001-2003 the manufactured goods took the lead, in 2004-2006 the energy products were absolutely dominant. This is clearly a sign of energy price increase. Other product groups lost momentum not only relatively, but in absolute terms as well. (*See Chart 6*)

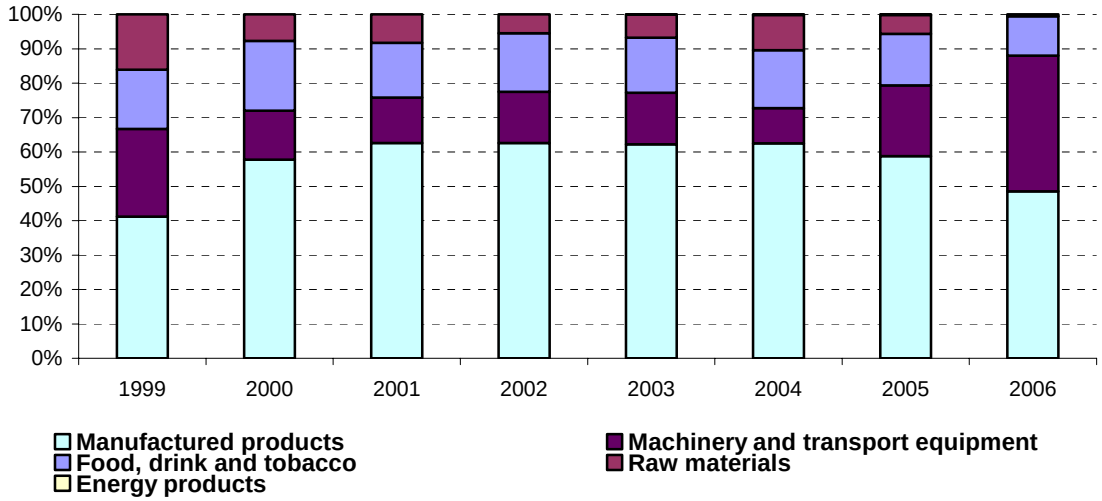
Chart 6. Structural change of Hungarian imports from CCA countries by main product groups, 2006 (%)



Source: Hungarian Central Statistical Office

As for the export, in 1999-2006 its structure has been more stable and sustainable. The share of food, drinks and tobacco products remained nearly the same, the importance of machinery and transport equipment products doubled, while the export of raw materials almost completely diminished. The overwhelming part of the exports to CCA region was based on manufactured products. (*See Chart 7*)

Chart 7. Structural change of Hungarian exports to CCA countries by main product groups, 2006 (%)



Source: Hungarian Central Statistical Office

Embryonary investment ties

Regarding investment relations, there is no statistically measurable Foreign Direct Investments (FDI) among these countries. The possible reasons of it from Hungarian point of view are: unstable political environment, inappropriate institutional frameworks, and low priority of the region. The main obstacles from CCA perspective are: underdeveloped industry and private sector, lack of competitive production, low priority of Hungary in external economic affairs.

Concluding remarks

Summarizing the trade and investment relations of the country, one can see very low intensity of economic ties based mainly on distorted trade structures and completely lacking investment activity. Concerning the trade development, from CCA countries' point of view there were two important factors that influenced considerably the structure and the volume of it. The entry of Hungary into the EU harmed the higher value added products' exports of CCA economies, while parallel the rise of energy prices and changing energy supply of Hungary boosted energy exports. Of course, these events and processes affected individual countries diversely.

From policy perspective, in order to boost trade and investment relations, both sides have to made steps to exploit the seemingly considerable potential. Hungary has to make steps within the EU to reach preferential conditions for these countries. Also Hungary owes knowledge of market and political transformation that could be shared with CCA countries. It is also important to build up the basic transmission institutions of economic relations, like embassies and consulates, as they are usually responsible for promote bilateral economic deals giving consultancy, information and personal local expertise.

But much more can be done by CCA countries. Beyond the importance of economic and political opening, it is crucial to start structural and institutional reforms mainly concentrating on improving business environment and ensuring the protection of property rights. But it is also crucial to treat high corruption level of these states. These are the basic preconditions of international trade and financial integration that gives floor for improving opportunities to get in touch with global markets.