Armenia

In BEEPS V, the top three business environment obstacles identified by Armenian firms were access to finance; tax administration; and political instability (Chart 1). Young firms complained heavily about customs and trade regulations. In BEEPS IV, political instability, access to finance and the informal sector were the top obstacles.

Reliance on bank lending and inefficient customs regulations

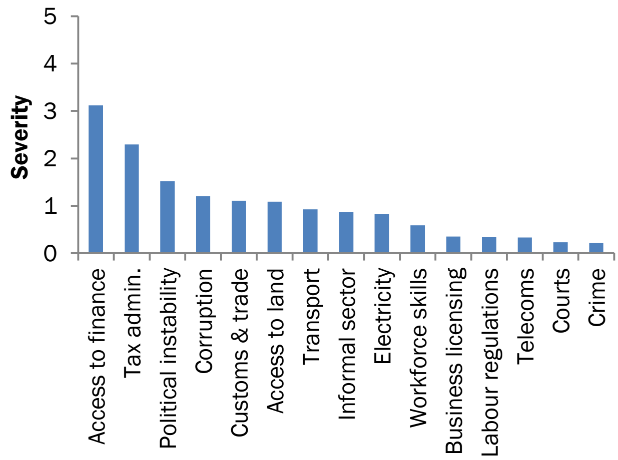
Access to finance emerged as the main constraint for Armenian firms. While the value of required collateral increased substantially, from 60% in BEEPS IV to over 200% in BEEPS V, this disproportionately affected SMEs and young firms, which were also more credit-constrained than large and old firms. Compared with their counterparts in eastern Europe and the Caucasus (EEC), Armenian firms depended less on internal funds to finance working capital, and instead relied on bank loans and other sources, such as moneylenders, friends and relatives. Just over a quarter of firms purchased fixed assets (compared with more than a half in BEEPS IV), and almost three-quarters of such purchases were financed using internal funds (compared with less than a half in BEEPS IV). Bank financing decreased from 21.7% to 9.5% and was below the EEC average, while other sources of financing were higher in Armenia than in other EEC countries (Chart 2).

Roughly three-quarters of firms were visited or inspected by tax officials in both rounds of BEEPS – nearly 18 percentage points above the EEC average in the latest round. This, together with the tendency of tax officers to impose at least one fine per visit even if no violation had been committed, could explain why **tax administration** emerged as the second biggest obstacle. However, the frequency of inspections by tax officials and the percentage of firms being asked for informal gifts or payments decreased since BEEPS IV. Inspections were more common among large firms – almost all of them were inspected – but tax officials were more likely to expect or request an informal payment from SMEs.

Political instability was the third major constraint. The unresolved conflict in Nagorno-Karabakh sustains a possible threat of military escalation and thus deters investment. In addition, the economic blockade imposed by Azerbaijan and Turkey, again due to unresolved conflict, increases costs for businesses. Firms may also be concerned about frequent amendments in policy and legislation.

It's not surprising to see **customs and trade regulations** amid the top obstacles for Armenian firms. On average, it took 8.6 days to clear customs for direct exports and 17.6 days for direct imports. Both figures exceeded the EEC and BEEPS V averages (Chart 3). This is particularly worrying given that Armenia is a small open economy whose business sector relies heavily on trade.

Chart 1. Business environment obstacles



Estimated for a hypothetical "average" firm. Higher values correspond to a weaker business environment.

Chart 2. Sources of financing of fixed asset purchases

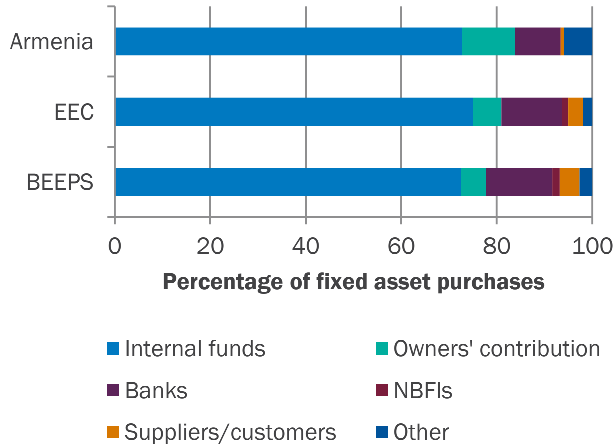
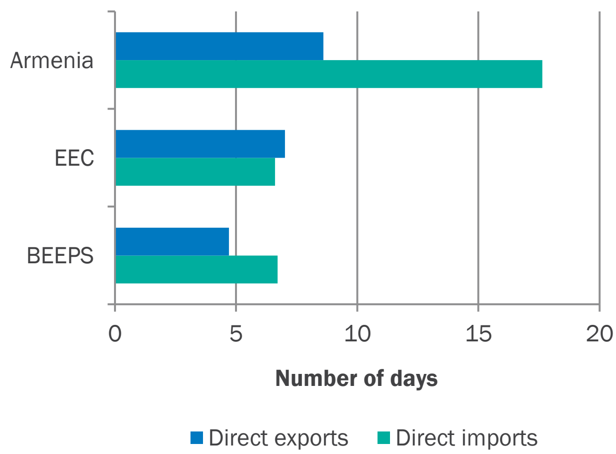


Chart 3. Customs clearance for direct exports and imports



Survey fieldwork period: November 2012 – July 2013. EEC: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Small and medium-sized enterprises (SMEs) have 5-99 employees. Young firms are less than 5 years old.