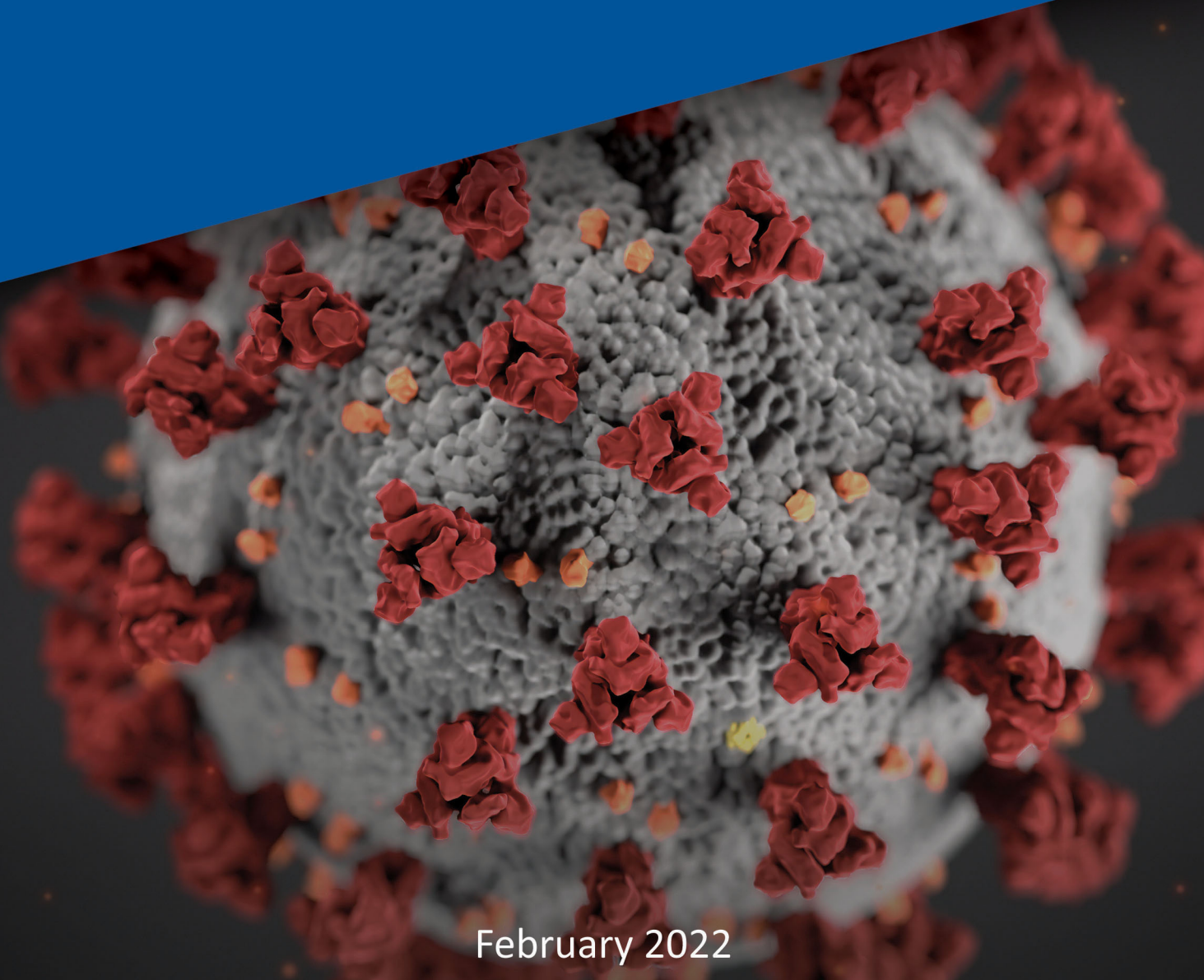




REPUBLICAN
UNION OF
EMPLOYERS
OF ARMENIA

COVID-19 IMPACT IN ARMENIA

POLICY PAPER



February 2022



REPUBLICAN UNION OF
EMPLOYERS OF ARMENIA

COVID-19 IMPACT IN ARMENIA

POLICY PAPER

Developed with the support of the International Labour Organization.

February 2022

Introduction

Armenia has been heavily battered by the Covid-19 pandemic. In 2020, between March and early September, the country experienced the second highest per capita infection level in the EU Eastern Partnership region. Cumulative Covid-19 cases in Armenia exceeded 8 000 infections per 100 000 people, far above the infection levels observed elsewhere in the region, and second only to Georgia. The country was dearly affected by the virus not only in regional comparison, but also relative to other countries in similar income brackets. The Armenian economy cratered as a result, leaving many small businesses under severe strain, and exacerbating an already high unemployment rate. In 2019, before the pandemic, the unemployment rate had reached 18.3%.

The Armenian economy will have experienced a near V-shaped recovery by 2022. The initial impact of Covid-19 led to a GDP contraction in 2020 of 7.4%, the sharpest decline amongst EU Eastern Partnership countries – influenced not only by the pandemic’s effects but also due to border conflict –, followed by a rebound in GDP which is expected to have reached 6.5% in 2021. Absent any unforeseen event, the pre-pandemic GDP peak level in Armenian will be toppled during 2022. Overall, real GDP growth in 2022 is expected to reach 4.5% and will likely plateau at an annual growth rate of 4% over the medium term. Yet it remains to be seen how resilient the Armenian economy has turned out to be in face of an extreme event such a global pandemic.

The structure of Armenia’s business fabric is built upon the trade sector. This sector represents 63% of the total number of Armenian businesses, of which 97% are micro enterprises with less than 10 employees. Compared to peer countries, the level of trade activities is much higher in Armenia. These activities have been more negatively affected by lockdowns, and they are mostly performed by smaller businesses. More than 60% of Armenian micro, small, and medium-sized enterprises (MSMEs) are said to have suffered a strongly negative impact from Covid-19, compared with only 44% amongst large-sized firms. With regards to fiscal support, as of May 2021, 45.6% of businesses had received wage subsidies and 55.3% cash transfers. Working hours lost to Covid-19 amounted to 16.8% of total in 2020 – the heaviest toll across peer countries.

People labouring in the informal sector have been disproportionately affected by Covid-19. According to 2019 ILO statistics, about 25% of workers in Armenia were employed outside the formal sector, and recent analysis has elevated that share to about 40%. Informal workers, representing a very large cohort, have thus been disadvantaged in accessing government support programmes. The government’s support has been delivered through subsidised lending, direct cash subsidies, lumpsum payments to the vulnerable, co-financing of innovation projects sector-wise, and others. Yet the size of support has been low in regional comparison, given Armenia’s fiscal pressures. Public debt reached 63.5% of GDP in 2020, and it increased further during 2021, in an economy that is heavily reliant on its capital region Yerevan.

Armenia’s Information and Communication Technologies (ICT) sector has remained steady despite the macroeconomic backdrop. In 2020, the ICT sector’s relative weight in overall GDP hovered around 5%, employing 7% of all Armenian workers. Average salaries in ICT jobs were the highest in the country, and the female labour participation rate in the sector was also high. Since the outbreak of Covid-19, there has been a drive towards greater business digitisation across other sectors in the economy. Yet in most indicators of enterprise innovation, Armenia still scores around the median level observed amongst the EU Partnership cohort, and in some

cases below. Only 11.2% of businesses spend on research and development expenditures (R&D), and 42,5% do not even have their own website. Additional improvement is needed.

Policy Proposals

Tracking the uneven nature of the recovery would allow for more targeted support. Armenia has been affected by a high Covid contagion rate, having suffered the worst decline in GDP within the EU Partnership region during 2020. Despite a vigorous recovery in 2021, numerous businesses, including self-account workers and people employed outside the formal sector, may still require special assistance. Policy efforts should thus be placed on tracking the economic recovery sector-by-sector, region-by-region, to better understand which sectors and regions would appreciate more targeted assistance. Sales revenues, employment data, and investment statistics should be monitored in granular manner at the business level. While some sectors might merit financial assistance, others might necessitate capacity building.

Support turnaround specialists. Across the Western hemisphere pre-insolvency and turnaround practice have become critical focal points in managing the negative externalities of firm failure. Ideally, business demise should be identified before the fact, yet sometimes that is not feasible. Turnaround specialists are usually finance or legal types, who move into a company to fix the root problem, leaving the company when mission is accomplished. In some countries, such as the United Kingdom, these professionals are organised through private organisations. In others, they are registered with state organisations. These are also the people that could act as caretaker managers whenever companies are subject to insolvency proceedings.

Redress corporate law to facilitate the financial restructuring of struggling businesses. Business turnaround in Armenia is made difficult thanks to an underdeveloped corporate law, which does not allow for the existence of convertible debt. Struggling businesses usually face two different viability tests. A first one, an economic test, to assess whether a firm's underlying working assumptions are reasonable or not. And a second, to assess a firm's financials. Swapping debt for equity is an initial step, albeit an insufficient one, towards a path of financial sustainability. Corporate law should not only allow debt-for-equity swaps, but indeed it should promote them. New financial instruments can also be introduced, like those with characteristics of both debt and equity instruments, such as preferred equity or participative loans.

Create an integrated support package for innovative start-ups. The number of start-ups had risen prior to the pandemic, by 8% between 2018 and 2019. Yet the pattern of new business creation mirrored the existing sectoral distribution of businesses, as most new businesses were created in trade activities. The Government could nudge business creation towards other sectors by financing innovation calls, or by establishing itself as a buyer of locally developed applications serving particular social needs. An integrated support package would thus include resources to assist in the development and transfer of knowledge, as well as dedicated financial instruments to support innovation such as conditional grants or venture debt.

Create a fintech regulatory sandbox. In Armenia, 91.5% of all businesses have a bank account. While this ratio is seemingly high, it is indeed the lowest level observed amongst peer countries,

which means that 8.5% of all enterprises remain unbanked. Value-to-loan ratios in Armenia, on the other hand, are amongst the highest in the region at above 200%, making it very expensive to pledge collateral assets. Alternatives to bank finance would thus contribute to democratising access to finance, alleviating the limitation that many businesses encounter when unencumbered assets are not available to fulfil collateral requirements, allowing MSMEs to diversify their funding sources. Countries around the world have set up regulatory sandboxes. Regulatory sandboxes are testbeds for new technologies monitored under real life conditions.

Establish a mutual-guarantee programme. In Armenia, about 70% of loans are covered by an existing collateral asset. This is one of the lowest ratios across the EU Partnership region, which suggests a limited availability of assets to meet collateral requirements. A mutual-guarantee scheme involves the mutualisation of risk and the existence of a public counter-guarantee mechanism to reinsure against mutualised risks (and sometimes also a third-level backstop). It provides for diversification of risk and limited involvement of taxpayer money, while enhancing access to credit for businesses. Public policy can tilt the use of such an instrument towards specific uses by aligning recourse to the counter-guarantee mechanism with policy objectives.

Provide digital vouchers to SMEs for capacity building. Worldwide, SMEs have accelerated their transition to e-commerce, and generally to digital platforms, following the outbreak of Covid-19. Yet in Armenia, data pertaining to the use of digital platforms by SMEs are patchy, and do not allow for a rigorous assessment regarding the direction of change. Digital check-ups of SMEs should thus be pursued as part of public policy, to make sure businesses are up to date with the digital technologies without which no such transition will be possible. Governments across Europe are now active promoters of voucher schemes, supplied in partnership with private sector actors, to facilitate SME acquisition of core digital competencies and related capabilities. These are usually offered by accredited partners at subsidised prices in areas such as accounting, human resource management, e-marketing, e-sales, cybersecurity, and digital work plans.

Support the development of skills for tomorrow. Armenia currently exhibits a mismatch in the supply of, and the demand for, labour skills in certain sectors. This mismatch is seemingly latent in sectors such as agriculture and tourism, but eventually in others as well. Public policy could support apprenticeship and internship programmes managed by private sector companies. These programmes could include varying degrees of public co-financing according to the size, and innovativeness, of qualifying businesses. In addition, governments in high-income countries are in some cases delving into (the somewhat speculative) business of anticipating the skills of the future. Others, on the other hand, are pursuing the revival of skills of the past, yet equipped with modern technology and adapted to the world of today.

Make the labour law up to date with a digitised, XXI century world. Armenia's labour code does not provide for a comprehensive homeworking framework. Homeworking, or remote working, will survive the Covid-19 pandemic. Yet most labour regulations are not yet adapted to current work-from-home arrangements. As the pandemic fades out, the Government and private sector organisations, such as the employer association, should strive to achieve common ground on issues such as: limits to online monitoring and privacy of employees; additional costs incurred by employees working from home; how to balance parenting and working commitments; the disavowing of discriminatory practices negatively impacting remote workers vis-à-vis office workers; performance assessments; and virtual time clocking for employees.

Create a centralised platform whereby job seekers and job providers can interact with each other. Technology is a very powerful tool allowing for the disintermediation of many activities,

including employment mandates. A jobs platform managed by the public sector could be useful by allowing engagement between parties, the automatic recognition of academic certificates, and a built-in indicator of median salaries offered across different categories of jobs, locations, and skills. Having such a mechanism in place would also allow policymakers to better manage educational offerings, both in the short run and the long run, perhaps even changing the way public universities might be funded. Businesses actively engaged within the platform, either as top jobs providers or providers of top jobs, could perhaps benefit from tax incentives.

Bullet Line Summary

- Tracking the uneven nature of the recovery would allow for more targeted support.
- Support turnaround specialists.
- Redress corporate law to facilitate the financial restructuring of struggling businesses.
- Create an integrated support package for innovative start-ups.
- Create a fintech regulatory sandbox.
- Establish a mutual-guarantee programme.
- Provide digital vouchers to SMEs for capacity building.
- Support the development of skills for tomorrow.
- Make the labour law up to date with a digitised, XXI century world.
- Create a centralised platform whereby job seekers and job providers can interact with each other.