

Macro Dev

Armenia: Democratic impulse, economic growth and the challenges of transformation for an economy under pressure

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Summary: Armenia's external accounts and public finances have strengthened as a result of strong economic growth in 2022 and 2023 (12.6% and 8.3%, respectively), supported by the influx of Russian migrants, combined with improvements in the macro-fiscal framework, driven by the ongoing Stand-by Arrangement with the IMF. Since 2024, growth has eased slightly (5.9%, projected at 4.5% in 2025) and the country remains vulnerable to an economic downturn. Since the political transition initiated in 2018 with the assumption of office by Prime Minister Nikol Pashinyan, the country has also made significant progress in strengthening its governance framework. On the geopolitical level, the resurgence of tensions with Azerbaijan in 2020 and 2023 continues to place a strain on the security environment, although Yerevan and Baku say they are willing to move forward with the signature of a peace agreement. In this fragile context, Armenia has set out to strengthen its resilience by extending its partnerships to new geographical areas. These developments have been commended by the rating agencies, with Fitch and S&P upgrading the sovereign rating from B+ to BB- in the summer of 2023. The normalization of economic growth and growing global uncertainty make it essential to continue the consolidation efforts in order to preserve the recent gains. Indeed, the country remains marked by structural demographic, socioeconomic and geographical vulnerabilities. The transformation of its economy also poses many challenges: the development and diversification of its industrial and productive fabric, improvements in the business climate, and the development of human capital will all be key drivers for ensuring sustainable and inclusive growth in the medium term.

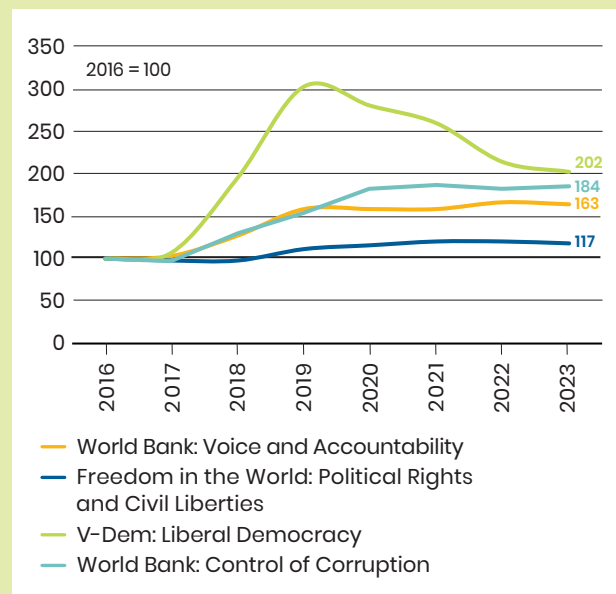
Thematic area: **Macroeconomics**

Geographical area: **Armenia**

1. Armenia experienced a major political transition in 2018 and remains marked by an uncertain geopolitical environment

Prior to 2018, the country was characterized by an oligarchic regime and democratic space was confined by vested interests. The Velvet Revolution of 2018, along with the victory of the opposition led by Nikol Pashinyan in the early parliamentary elections of 2018 on an anti-corruption program, marked a turning point towards a system of liberal democracy. The electoral and democratic system has been strengthened, as evidenced by the improvement in the V-Dem indicators (Liberal Democracy Index) (see Graph 1). This has been achieved through the political transition which started in 2018 and the implementation of major reforms promoting transparency in public life. They include strengthening controls on political party financing, the declaration of assets for elected officials, and the systematic publication of vacant public administration positions on an official portal. The last early parliamentary elections of 2021 were described as relatively “free and fair” by local and international observers. The next parliamentary elections are scheduled for June 2026. Ambitious reforms have been carried out to tackle corruption: adoption of a dedicated strategy and creation of an anti-corruption committee, establishment of a specialized court, strengthening of the Commission for the Protection of Competition, support for whistleblowers, and creation of a register of gifts for public officials. This has led to a significant improvement in the perception of corruption (62nd place in the Transparency International Corruption Index in 2023, against 105th in 2018). The Strategy for Judicial and Legal Reforms (2022–2026) has strengthened the rule of law (World Bank’s World Governance Indicators). However, the indicators on government effectiveness and regulatory quality are no longer showing improvement, due to the failure to implement sufficient reforms covering the quality of public services (political short-termism, low institutional capacity, budgetary constraints, lack of data).

Graph 1: The Velvet Revolution marked a change in the political regime



Source: World Bank (WGI),
Varieties of Democracy, Freedom House.

In terms of civil and political liberties, Armenia has again made significant progress. However, progress in the liberalization of the economy has stalled, with the oligarchy in power until 2018 retaining significant economic weight due to its historical presence in strategic sectors (energy, transport, telecommunications, banking). However, their access to public procurement has declined, and in early July, the Parliament declared that it was in favor of a phased nationalization of the country’s power company, Electric Networks of Armenia (ENA), which is currently privately-owned.

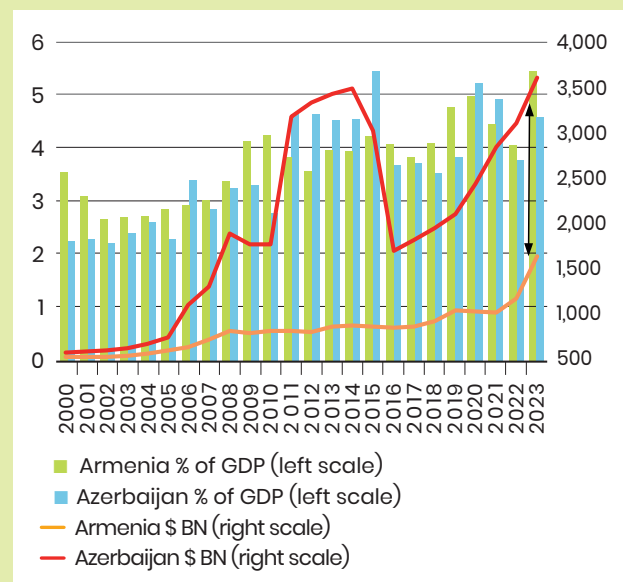
This momentum for institutional reforms experienced a marked slowdown in 2021 due to a succession of external crises (Covid-19, clashes with Azerbaijan in 2020, 2022 and 2023). In a climate of continuing uncertainty, the government’s priorities remain focused on external security issues, which slows down social and economic reforms.

Armenia is one of the most isolated countries in the world due to its topography (no coastline, very mountainous relief and deep valleys), the lack of modern transport infrastructure and, especially, its regional geopolitical integration, as two of its four borders are closed (with Türkiye and Azerbaijan). The century-long dispute with Azerbaijan over the Nagorno-Karabakh region, an enclave in western Azerbaijan which had been populated by separatist Armenians since its declaration of independence in 1991 and is not recognized by the international community, crystallizes the geopolitical tensions in the region. The escalation of military tensions with Azerbaijan came to a head with the deadly 44-day war in 2020, which enabled Baku to regain control of all the buffer regions surrounding Nagorno-Karabakh, then in September 2023, with the flash offensive by Azerbaijan when it regained control over the disputed territory. The ongoing talks between Armenia and Azerbaijan have resulted in a draft peace agreement, announced in March 2025, which Armenia would like to sign in the near future.

The risk of a further escalation of tensions, in particular over the thorny issue of the Zangezur corridor, cannot be ruled out. Armenia is in a position of military inferiority (see Graph 2), while the border delineation process is still ongoing. In this fragile and changing geopolitical game, Armenia is reassessing its defense strategy and the architecture of the security system in which it evolves: the suspension of its participation in the Collective Security Treaty Organization (CSTO) in early 2024, the establishment of an EU monitoring mission in 2022 (extended until 2027) at the borders with Azerbaijan, the signing of a Strategic Partnership Charter with the U.S. in early 2025, and the signing of military cooperation agreements between France and Armenia in the summer

of 2023 also illustrate this deepening of strategic and military links with European and Western partners. The country's political rapprochement with the European Union is gathering pace: the initiation of an EU accession process is being considered, following the Armenian Parliament's first reading approval of the EU membership application and a civil society petition advocating accession. These developments reflect a growing pro-European sentiment among the population and suggest the potential for a future referendum on the matter.

Graph 2: Military spending rising, but increasingly uneven

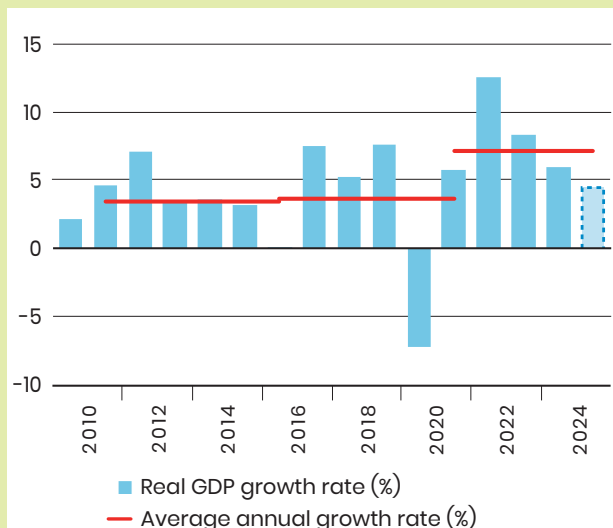


Source: World Bank (WDI).

2. A marked economic upturn since 2022 on the back of a stronger macroeconomic framework

The growth regime is characterized by a high exposure to the economic environment of trade partners and external shocks, due to the small size of its economy and its high degree of openness. The volatility of the Armenian cycle is in particular highly correlated with the economic cycles of its Russian neighbor, due to the important volume of trade, investment flows and remittances from labor migration (Russia is the leading destination for Armenian workers). **The country has benefited from a very favorable economic momentum since 2022**, with an exceptional peak in economic growth at 12.6% in the same year, as a result of the economic activity generated by the 65,000 new Russian migrants, combined with remittances (+200% between 2021 and 2023), which has boosted domestic consumption. The economy posted solid growth in 2023 (+8.3%) and 2024 (+6%), buoyed by increased private investment, with momentum now easing toward normalization.

Graph 3: Strong growth, which is tending to slow and converge towards its potential

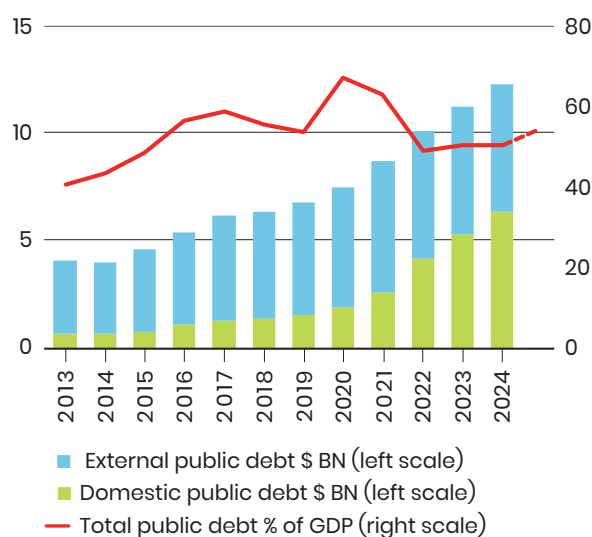


Source: IMF (WEO), AFD calculations.

This strong growth has led to a significant improvement in the metrics of fiscal and external sustainability.

In the space of 25 years, Armenia has initiated a remarkable transition, reducing its dependence on Official Development Assistance, which financed half of its investment expenditure in the early 2000s. This has resulted in an increased mobilization of non-concessional resources. In 2022, concessional financing only accounted for 7% of the total. This transition has been coupled with a continuous improvement in investor perception, as demonstrated by the gradual reduction in the Armenian spread on international markets.

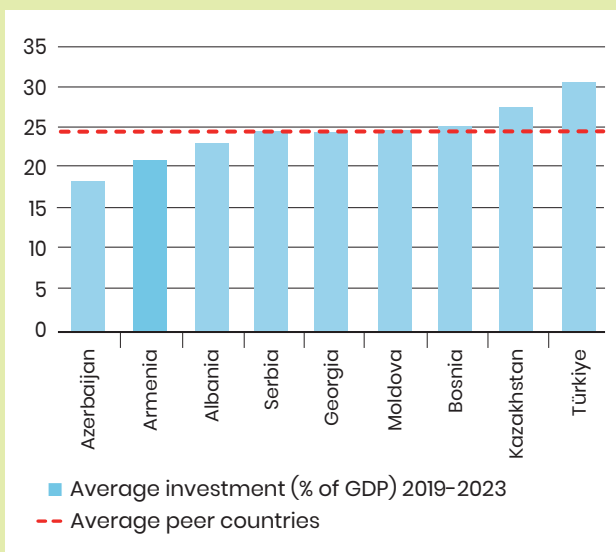
Graph 4:
The debt ratio is under control



Source: IMF (WEO), AFD calculations.

The reforms undertaken in public finance management, in particular in the context of the program with the IMF (Stand-by Arrangement), coupled with strong growth in nominal GDP, have enabled Armenia to significantly reduce its public debt-to-GDP ratio and therefore improve the sustainability of its public debt. The debt ratio fell from 67.4% in 2020, at the height of the health and political crises, to 50.3% in 2024. This virtuous path has contributed to the improvement in the country's sovereign rating: the agencies Fitch and S&P upgraded the rating from B+ to BB- in the summer of 2023. This fiscal consolidation has enabled Armenia to create the fiscal space needed to absorb major shocks, in particular the humanitarian and socioeconomic assistance to 100,000 refugees from Nagorno-Karabakh.

Graph 5: The level of investment is low by regional comparison



Source: IMF (WEO), ECO calculations.

However, relatively stable tax revenues, combined with public spending that remains moderate but highly exposed to external shocks, thus results in a structural and highly volatile fiscal deficit (-3% of GDP on average between 2010 and 2019). In terms of the structure of public spending, there has been a significant increase in investment expenditure in recent years, averaging 3.4% of GDP between 2016 and 2021,

then 4.9% of GDP between 2022 and 2024, or about 18% of public spending. This momentum should eventually enable Armenia to narrow the gap with its regional neighbors (see Graph 5).

Since 2024, the government has pursued an expansionary fiscal policy, which is expected to continue given the planned concentration of investment spending in 2025–2026. The public deficit, which accounted for 3.8% of GDP in 2024, is expected to stand at 5.5% in 2025, in particular as a result of military spending (6% of GDP in the 2025 budget), despite efforts to increase revenues. The government's priority spending also targets the construction of schools, as well as improvements in water-related infrastructure (reservoirs). Furthermore, the increase in interest charges on public debt, driven by more expensive domestic debt, is contributing to widening the country's overall fiscal deficit.

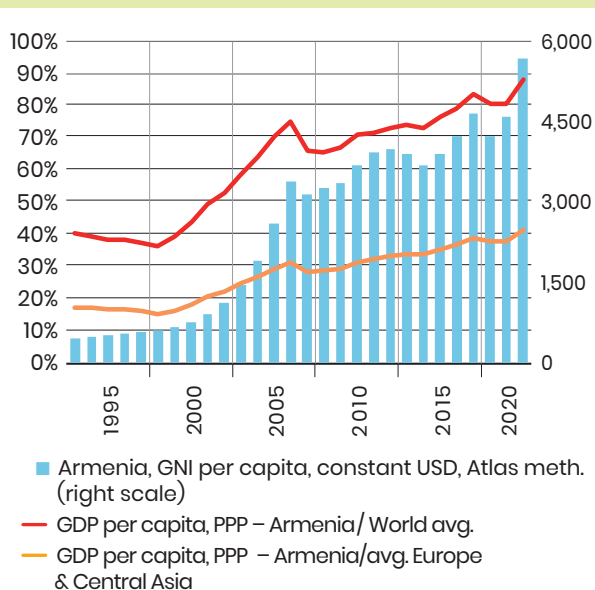
Armenia's external position has significantly improved since 2022, driven by strong growth in exports of goods, in particular mining products, and the development of Armenia as a re-export point in the regional geopolitical environment. The services balance now shows a strong surplus, while the trade deficit has fallen to historically low levels. The external debt ratio has also declined under the combined effect of sustained growth and the appreciation of the dram. However, these positive developments also come with persistent vulnerabilities. While the current account deficit has improved in the recent period, it is expected to increase moderately in the medium term due to the slowdown in remittances, increased domestic demand, and high investment needs. The escalation of international trade tensions poses a major risk for Armenia, whose external accounts remain particularly sensitive to turbulence in the world economy. Since 2022, the country's external buffers have strengthened, with international reserves rising to USD 3.5 billion by end 2024—a level deemed adequate by the IMF (107% of the ARA metric)—while external debt remains contained and is increasing at a stable pace. Finally, the Stand-by Arrangement with the IMF, which is currently considered as a precautionary program, provides an additional liquidity buffer (\$24.12 million) in the event of a shock.

From a structural point of view, the macro-fiscal framework has been strengthened in recent years and would appear to be robust: monetary policy has been particularly appropriate, as a result of the high level of responsiveness on the part of the Central Bank of Armenia (CBA) to the surges in inflation in 2022 and 2023. Exchange rate flexibility and a stronger dram have been an important vehicle for macroeconomic stability. In terms of public finances, the authorities

have adopted prudent fiscal rules to ensure the sustainability of public debt. Finally, fiscal risks appear to be relatively under control and the country has accumulated fiscal buffers to cope with external shocks, thanks to a reserve fund included in the budget (0.6% of GDP), which helps maintain budget stability over the year, and a stabilization fund (1.2% of GDP), which can be used to finance the budget deficit if needed.

3. But this small economy vulnerable to external shocks still faces many challenges

Graph 6: An increase in per capita income by regional comparison



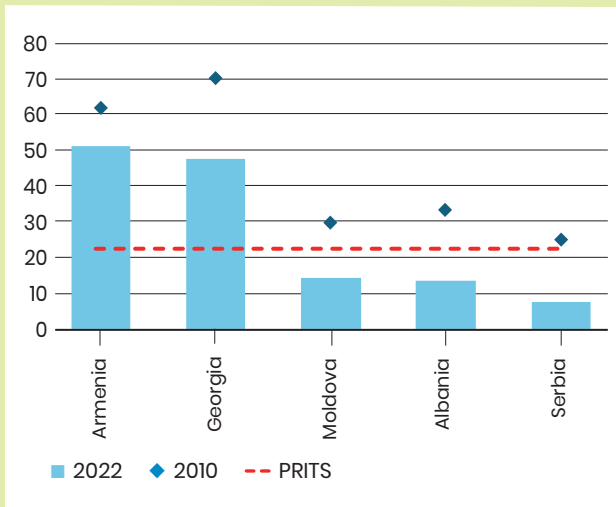
Source: World Bank, Macrobond.

With the strong growth since 2022, the country's GDP per capita almost doubled between 2019 and 2024, from 4,596 to 8,517 current USD. However, this small vulnerable economy continues to face many socioeconomic challenges. Despite a decline in recent years, the poverty rate remains high considering

the country's level of per capita income. In addition, external shocks continue to hinder socioeconomic progress, despite the important role of diaspora remittances as a shock absorber. The poverty rate at the threshold of \$6.85 stands at 51%, or almost 35 percentage points higher than for peer countries (see Graph 7), while measured at the national poverty threshold, it concerned 23.7% of the population in 2023. There are strong regional disparities, with a concentration of poverty in rural areas (27% of the population below the national poverty line). These weak poverty indicators are in particular a result of the lack of dynamism on the labor market and the predominance of the informal sector. Indeed, Armenia has one of the highest unemployment rates in the region (12.9% of the Armenian population in Q4 2024).

The demographic profile of this small economy, with a population of 2.9 million inhabitants in 2024, is particularly unfavorable and poses a structural challenge for the country. Indeed, Armenia suffers from the combined effects of a low birth rate, an aging population and high emigration rates, in particular among young workers. The population is expected to decline to 2.5 million by 2050 (United Nations) and fall below 2 million by 2079. This situation restricts growth potential, reduces the tax base, and places a greater burden on health and pension systems.

Graph 7: The poverty rate (threshold of \$6.85) is extremely high



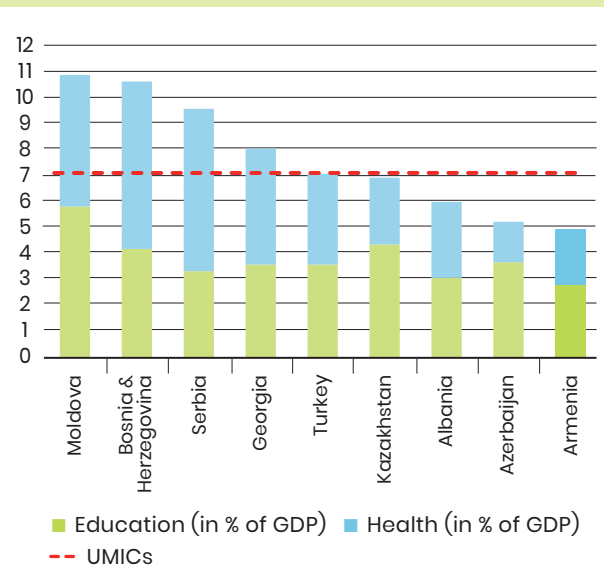
Source: World Bank, Macrobond.

The low level of human capital in Armenia remains a key constraint to growth. Armenia's investment in education (Graph 8) is low by regional comparison (2.6% of GDP on average in 2012 and 2022, against 3.4% in Georgia, 4.1% in Türkiye and 6% in Moldova), which adversely affects labor productivity.

In addition to the geopolitical stress and its impact on the business environment, the country is extremely isolated, with cross-border trade only with two of its neighbors (Iran and Georgia). The lack of connectivity infrastructure also holds back growth potential. However, the Armenian economy has opened up considerably since its independence. In addition, the country's development strategy aims to diversify the economic fabric and boost the potential of the mining sector, as well as export sectors, with the secondary sector currently only accounting for 13% of GDP. The economic structure is mainly based on services (61% of GDP, against 46% in 2012), in particular for activities related to wholesale and retail trade, real estate activities, and financial activities, while the share of the primary sector has been declining for ten years, with the agriculture sector only accounting for 8% of GDP (against 18% in 2012).

Finally, structural vulnerabilities undermine the country's resilience. Armenia is highly exposed to droughts, as well as heat waves and water stress, which affects agricultural productivity, water resources and ecosystems. On average, climate-related loss have cost 0.6% of GDP per year over the last 25 years (CCDR). GHG emissions are low (0.02% of global emissions), but the heavy dependence on gas (63% of the mix) and the aging vehicle fleet contribute to air pollution with high health costs (10.6% of GDP). The country's strategy is quite ambitious, with a commitment to reduce its emissions by 40% by 2030 (compared to 1990) and increase renewables to 60% of the mix by 2040.

Graph 8: Public spending on health and education remains low



Source: World Bank (Health Nutrition and Population Statistics).

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List of acronyms and abbreviations

CBA: Central Bank of Armenia

CCDR: Country Climate and Development Report

EU: European Union

IMF: International Monetary Fund

WDI: World Development Indicators

WEO: World Economic Outlook

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