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## Assessment of the Problems of Attracting Investments to Armenia from the Point of View of the Security Environment

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### Abstract

*Investments play an important role in developing the economy of any country, solving social problems, strengthening the country's defense and ensuring national security. The purpose of this study is to assess the current problems of Armenia's investments in a safe environment and, based on them, propose approaches to attracting investments. In order to assess the factors influencing the investment environment, the article used methods of empirical analysis and SWOT. The results of the model and qualitative assessment, developed using mathematical and econometric tools, show that the volume of foreign investment in Armenia is predominantly influenced by the risk of renewed hostilities, intraregional military and political instability, small reserves of natural resources, infrastructural problems, tax rates, tax legislation, and protection of foreign investors. The results of the SWOT analysis show that the Armenian economy is characterized by high foreign policy risks (the risk of an armed conflict with Azerbaijan), as well as the transport blockade, the shortage of natural resources, and the presence of social contradictions, which means that making a forecast for the investment environment in Armenia in accordance with economic conditions will not be qualified by optimistic or positive results and expectations. Consequently, the article suggested implementing targeted measures that would increase new investment flows.*

**Keywords:** Investment, SWOT, empirical model, tax legislation, investor behavior, tax rate, safe environment, economic sectors

*JEL Classification:* E22, P33, C51.

### Introduction

Investments are the most important driving force of economic development. Currently, attracting investments has become a prerequisite for the development of the global economy and international economic relations. The implementation of investment projects makes it possible to increase production volumes, improve equipment and technologies, which, in turn, makes it possible to produce new improved versions of existing weapons, that is, to stimulate the development of the military industry, perhaps it is precisely this circumstance that determines the relevance and importance of the topic under study.

Thanks to investments, the state can produce high-quality products that meet international standards, create new jobs, reduce unemployment and, ultimately, improve the quality of life of the population, that is, investments are a necessary stimulating

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component of economic life. Practically no country in the world can effectively develop its economy without attracting investments, therefore, one of the conditions for the successful development of national economies is a rational policy in terms of attracting investments. For small open economies with limited financial resources, such as the Republic of Armenia, foreign investment plays an important role in economic development and ensuring long-term sustainable economic growth. Therefore, the study provides for the study of new economic and security issues that are adequate to transformations, an assessment of the impact of factors that hinder investment in Armenia, as well as an overview of the strengths and weaknesses, opportunities and risks of attracting investment.

## **Literature Review**

FDI provides capital sources, encourages technology transfer, spills over to human resource development, builds up a competitive business climate, and facilitates the economy [3]. Numerous empirical studies have examined the relationship between FDI and the factors influencing it [4]. According to Bieleń et al., the relationship between factors influencing investment is multifaceted and contradictory, characterized by heterogeneous empirical results that vary depending on different geopolitical contexts [5].

Sargent T.J., Sims C.A. [15] conducted research on the links between economic policies and variables such as GDP, inflation, employment and investment. The authors used the methods of non-structural macroeconomic forecasting, vector autoregression Borensztein E., De Gregorio J., Lee J.W. [6]. investigated the effect of monetary expansion on capital accumulation and economic growth through such factors as inflation, consumption, production, government, equilibrium [18]. Lee and Tcha have shown that foreign direct investment is the most effective way to achieve economic growth in a host country [11]. Yang investigated the relationship between public and private investment and other factors in the United States and Japan [19]. At the same time, a comparative analysis was carried out. Har Wai Mun et al. Studied the relationship between foreign direct investment and other factors in Malaysia and concluded that foreign direct investment is a good source of economic growth, as well as other advantages in the host country, such as employment, management resources, modern technologies and competitive goods [9]. Taiwo Muritala conducted an empirical study of the effect of investment and inflation on economic growth using the econometric model using the least squares method [16]. I. Ahmed [2] analyzed the impact of foreign direct investment on the growth of GDP through the factors of human capital development, labor force and the potential to absorb physical capital using traditional regression analysis. L. K. Sanaliev, G. B. Kengzhegalieva, A. S. Idelbayeva, Sh. U. Niyazbekova analyzed the innovative development of the economy through the potential of learning, the potential of generating knowledge, the potential of spreading knowledge and the potential demand for knowledge [14]. Stefan Dyrka and Barkhudar Sh. Gussenov

analyzed the main factors of development of foreign economic relations and their impact for the development of the economy [7, 8].

In our opinion, given the current rapidly changing world order, it is more important to assess the role and importance of investments in improving the security environment, therefore, the article analyzes all the factors that will have a significant impact on strengthening Armenia's defense capability and solving security problems, therefore, therefore, the purpose of the study is to assess the current investment problems in Armenia in a safe environment and, based on them, propose approaches to attracting investments.

### **Data And Methodology**

There are a number of factors in the investment environment that lead to changes in investor behavior, therefore, in order to increase the effectiveness of investment policy, it is necessary to take into account this variability and determine the mechanisms of influence of factors that hinder the development of the investment environment and increase competitiveness. Therefore, in order to assess the factors influencing investor behavior in the study, a model was developed that was evaluated using the least squares method, and the strengths and weaknesses of the Armenian investment environment, as well as opportunities and perceived risks, were presented using the SWOT analysis method.

The initial conditions for starting a business in Armenia, property registration, tax payments, issuance of building permits, access to loans, ease of conducting international trade, investor protection, and contract application procedures affect investor behavior, Therefore, in order to identify the correlation between the above indicators, their relationship was calculated using a regression equation, which was presented based on the following formula:

$$I=C_0+C_1*X_1+C_2* X_2+C_3* X_3+C_4* X_4+C_5* X_5+ C_6* X_6 +C_7* X_7+C_8* X_8+\xi_t \quad (1)$$

where`

I- is the volume of foreign investment,

X<sub>1</sub>. is the initial conditions for starting a business,

X<sub>2</sub> - is tax payments ,

X<sub>3</sub> - is property registration ,

X<sub>4</sub>. is the issuance of a construction permit,

X<sub>5</sub>. is access to loans, X<sub>6</sub> is the ease of conducting international trade,

X<sub>7</sub>. is investor protection, X<sub>8</sub> is the application of contracts:

C<sub>0</sub>, C<sub>1</sub>, C<sub>2</sub>, C<sub>3</sub>, C<sub>4</sub>, C<sub>5</sub>, C<sub>6</sub>, C<sub>7</sub>, C<sub>8</sub> -elasticity coefficients,

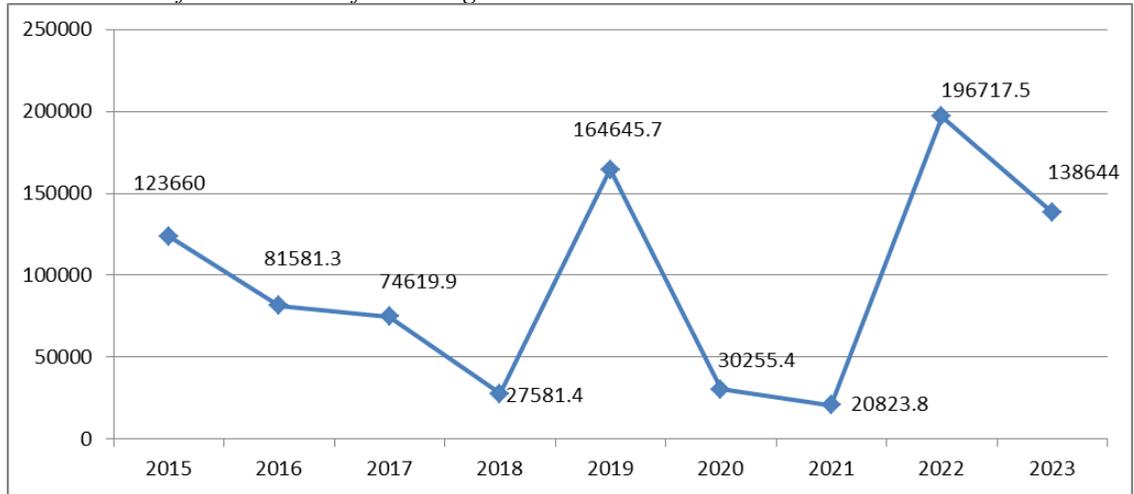
$\xi_t$  - the amount of random error

For the analysis, the volume of foreign investments for 2007-2023 and the factors influencing them were considered -the indicators offered by Doing Business. The specified model was evaluated using the least squares method using the Eviews 9 software: an appropriate regression analysis was performed, however, before evaluating the model, it is necessary to align the data, therefore, for this purpose, we logarithmed the data to avoid obtaining a false multivariate linear regression.

## Results And Discussion

### 4.1 Changes in the geographical and sectoral structure of RA investment flows

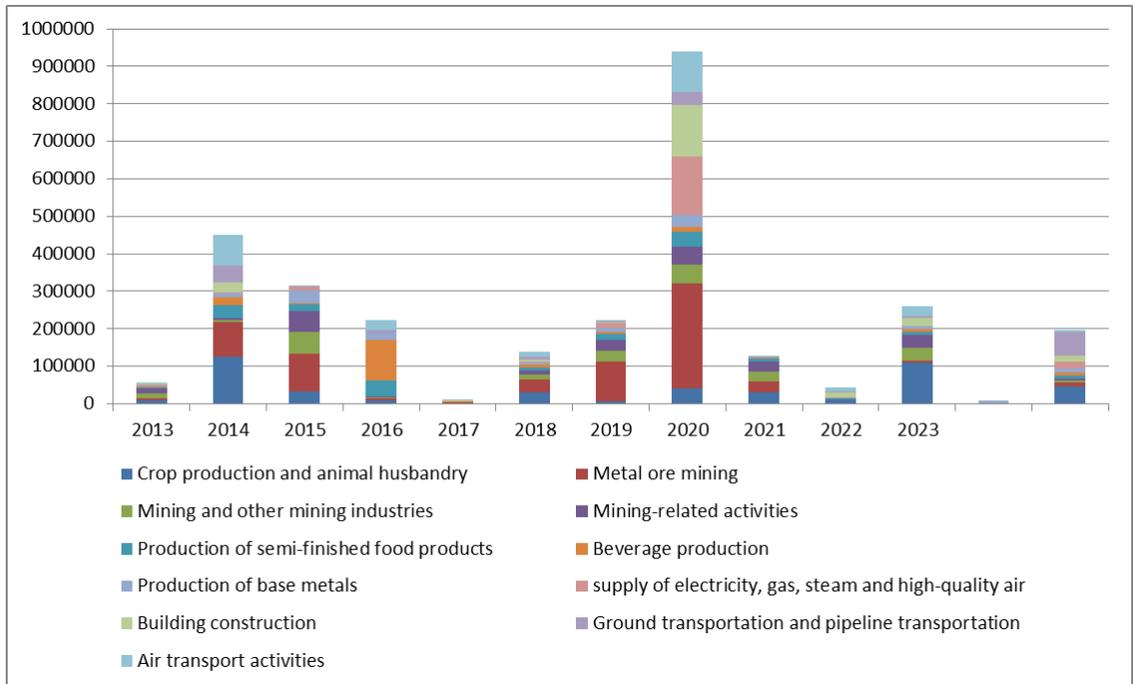
Two factors are of particular importance for the investment process and especially for its management: risk and time. 1. Time is the time interval between investments and their payback., 2. risk is the probability of the risk of being deprived of the expected income stream, the cost of which depends on the degree of risk. In other words, investment risk is an important component of economic risk and significantly affects the business activity of the company. Investments require the resources needed in the investment sector, and developing countries (with the exception of oil countries) usually suffer from low domestic savings rates due to low income growth and limited financial sources. Therefore, sources of external financing, such as employee transfers, foreign aid, and foreign direct investment, are necessary to fill the shortage of financial sources in these countries [10]. At the same time, external financing, in turn, contributes to GDP growth, increased productivity and competitiveness, reduced unemployment, increased exports, and improved trade balance [1].



**Figure 1**

2015-2023 The dynamics of investments in Armenia (million drams) [13].

As can be seen from Chart 1, investments in Armenia tended to both increase and decrease. Like this: In 2023, investments increased by AMD 14,984 million compared to 2015, but in 2020 they decreased compared to 2019 (by AMD 134,390.3 million), which was caused by the coronavirus pandemic and the 44-day war in Artsakh. As for investments made in 2022, compared to the previous year, they increased by 166,462 million drams due to the Russian-Ukrainian war (inflow of funds and human resources), although this did not lead to an increase in the standard of living of the population. The latter speaks about the unfavorable conditions necessary to preserve the cash flows caused by the Russian-Ukrainian war.



**Figure 2** Changes in the sectoral structure of investments in Armenia in 2013-2023 (million drams) [13].

An analysis of the structure of the investment sector will allow the public to determine the future picture of the diversification of production activities carried out in the country. It will also help determine whether the country's economy depends on any industry and whether there is an opportunity to develop the scientific and technical industry in the future.

Figure 2 shows that mining, telecommunications, electric power, gas, steam, and improved air supply account for a large share of investments. The share of the mining sector in total investments over the past 10 years is about 19%. This fact once again proves the dependence of the country's economy on the mining sector. The analysis of the territorial structure of investments carried out in the country is important for the analysis of the investment environment. This will make it possible to find out which countries are receiving investment flows, what connections exist with these countries, and whether investments coming from these countries are a direct result of offshore processes or not.

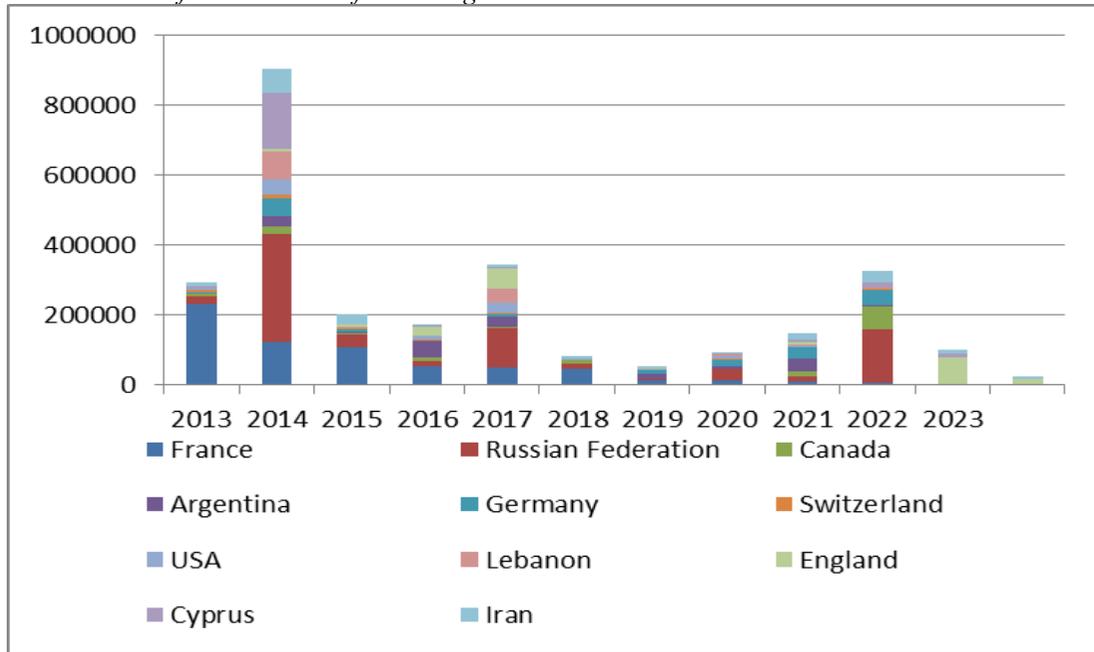


Figure 3 Changes in the geographical structure of investments in Armenia in 2013-2023 (million drams) [13]

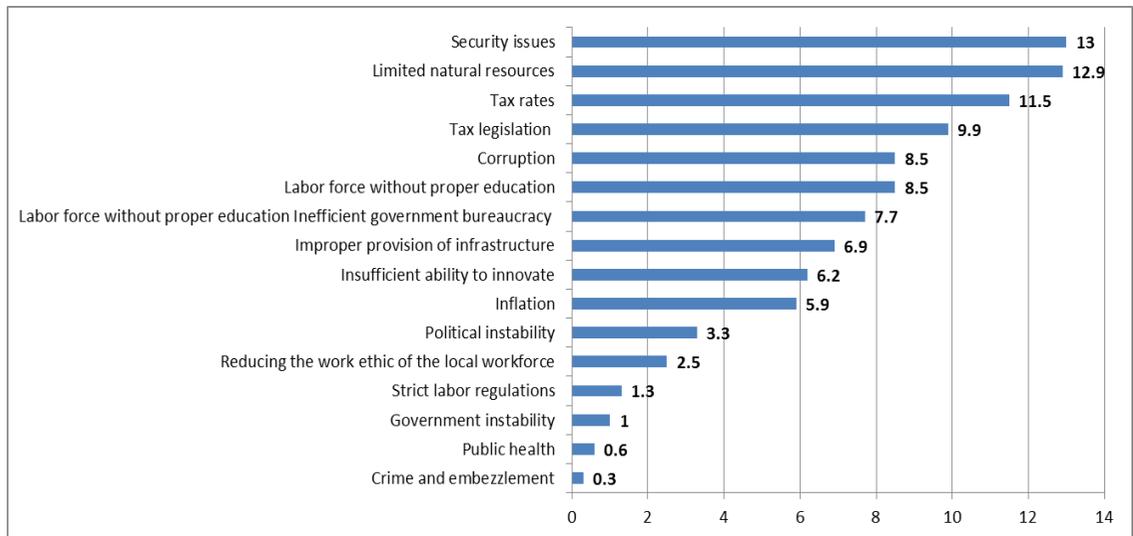
As shown in Figure 3, Russia remains the main donor of foreign investments made in Armenia, in particular, in 2022, compared to 2021, investments from Russia to Armenia increased by 151,328.6 million drams, which was caused by the Russian-Ukrainian war and a large influx of financial and human resources, As a result, double-digit economic growth (12.9%) was recorded [12]. However, in 2023, investment flows from Russia decreased by 89 962.3 million drams in 2022. Investments from France, Germany and the United States also account for a large share of investments made in Armenia, in particular, investments from France increased by 5135.6 million drams in 2023 compared to 2022.

## 1.2 Empirical Results

Therefore, the issue of factors influencing investor behavior was discussed in this article based on data published in the bulletin of the World Economic Forum for 2020-2023, published by the World Economic Forum (Global Competitiveness Index). The study was conducted using a direct method, which is planned to obtain data through a survey (security issues, limited resources,

corruption, the degree of availability of financing, tax rates, customs and trade regulations, tax administration, hired labor without proper education, inadequate

infrastructure, inflation, strict labor regulations, insufficient ability to innovate, declining work ethic of the local workforce, crime and embezzlement on board). Figure 4 shows the weighted values of the factors preventing investment attraction.



**Figure 4.**

The main obstacles to investing in Armenia [17]

As can be seen from chart 4, the main obstacles to attracting investment continue to be security concerns, limited resources, tax rates, tax legislation, and corruption. Therefore, the RA investment policy should provide the following prerequisites:

**1. An open, safe and predictable investment regime, namely**

- Simple, smooth and predictable entry procedures,
- A comprehensive network of international investment agreements, through which, investors are provided with clear rules and areas of activity for trade and investment flows, thereby ensuring maximum predictability of the markets they want to enter,
- predictability and transparency of the regulatory framework for relations between the State and investors in accordance with international investment agreements.

**2. Efficient export-import flows and functions, in particular, open trade and investment regimes with key partners, effective trade assurance (logistics) and trade promotion procedures:**

As a result, the estimated values of the linear regression equation were reflected in:

$$I = -203.5528 - 0.629700 \cdot X_1 + 39.15327 \cdot X_2 + 0.642190 \cdot X_3 - 5.737000 \cdot X_4 + 3.123114 \cdot X_5 + 0.970233 \cdot X_6 + 2.323638 \cdot X_7 + 7.743955 \cdot X_8 + \xi_t \quad (2)$$

From the results of the model, it becomes clear that the volume of foreign investment is dominated by tax payments, access to loans, and investor protection. Therefore, realizing the importance of investments and investor protection, it is necessary to provide tax incentives to strategically important sectors, as well as develop a legal system that will make the country attractive to foreign investors.

To analyze the investment climate in Armenia, it is necessary to substantiate the factors that have a positive or negative impact on the formation of the latter. For this purpose, a SWOT analysis was conducted by comparing qualitative and empirical results. Accordingly, the strengths and weaknesses of the RA investment environment, as well as opportunities and perceived risks, were highlighted ( table 1).

**Table 1**

Analysis of the investment environment using a set of SWOT tools

<b>Strong</b>	<b>Weak</b>
<ul style="list-style-type: none"> <li>• A liberal attitude towards foreign investment and an open-door policy,</li> <li>• Free currency exchange,</li> <li>• Armenia is a member of more than 40 different international organizations.,</li> <li>• registration of property,</li> </ul>	<ul style="list-style-type: none"> <li>• Problems related to the protection of investors' interests,</li> <li>• Limited natural resources,</li> <li>• Infrastructure-related issues,</li> <li>• limited opportunities to enter the foreign market,</li> <li>• Social issues,</li> <li>• tax rates, tax legislation:</li> </ul>
<b>Opportunities</b>	<b>Risks</b>

<ul style="list-style-type: none"> <li>• Development of global markets,</li> <li>• attracting an experienced, creative and well-educated workforce, which will lead to an increase in the number of new jobs and a reduction in emigration.,</li> <li>• increasing the level of security and protection,</li> <li>• improving the country's rating:</li> <li>• Opening of the border with Turkey:</li> </ul>	<ul style="list-style-type: none"> <li>• Resumption of the armed conflict with Azerbaijan,</li> <li>• possible military conflicts in the region,</li> <li>• presence of corruption risk,</li> <li>• Instability of the legislative framework,</li> <li>• Infrastructure risks,</li> <li>• Shock in foreign markets,</li> <li>• Uneven income distribution,</li> <li>• Opening of the border with Turkey:</li> </ul>
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Thus, studying and evaluating Armenia's investment environment, we can state that there are a number of obstacles that do not stimulate investment flows, but Armenia can become a real platform for attracting investments if an investment attraction strategy is developed in which these activities are targeted and targeted.

### Conclusion

The purpose of the article is to assess the current problems of Armenia's investments in a safe environment and, based on them, propose approaches to attracting investments. For small open economies with limited financial resources, such as the Republic of Armenia, foreign investment plays an important role in economic development and ensuring long-term sustainable economic growth, Therefore, the formation of a favorable investment environment in the Republic of Armenia is primarily conditioned by the need to properly counter external and internal challenges directed against economic security and make the national economy competitive.

The results of the article indicate that the mining, financial intermediation, telecommunications, electricity, gas, steam and air conditioning sectors have a large share of investments, and the results of the analysis of the foreign geographical structure

show that Russia remains the main donor of foreign investments made in Armenia. Investments from France, Germany and the USA also have a large share in investments made in Armenia. Using mathematical and econometric tools, a model has been developed and the factors influencing the investment environment of the Republic of Armenia have been substantiated. The results of the model show that the volume of foreign direct investment in Armenia is dominated by tax payments, access to loans, and investor protection. Therefore, realizing the importance of investment and investor protection, it is necessary to ensure the stability of the legal framework and eliminate possible ambiguities. For the effective implementation of investment policy, it is necessary to have a fully formed and fully functioning infrastructure dealing with investment and investor protection issues.

The results of the SWOT analysis show that the Armenian economy is characterized by high foreign policy risks (the danger of an armed conflict with Azerbaijan), as well as a transport blockade, an insignificant resource base, and the presence of social contradictions. This means that making a forecast for the investment environment of Armenia in accordance with economic conditions, especially from the point of view of a foreign investor, will not qualify as optimistic or positive results and expectations. In particular, an investor may underestimate the investment potential inherent in the economy or overestimate the investment risk if many factors hinder the development of the economy.

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