



Center for Strategic & International Studies
Washington, DC

Armenian Economic Reforms and Their Political Impact

Vahram Nercissiantz
Chief Economic Adviser to the President of Armenia

Russia and Eurasia Program
Caucasus Initiative

April 11, 2003

Vahram Nercissiantz addressed the CSIS *Caucasus Initiative* about the state of economic reforms in Armenia for the second time in two years. Mr. Nercissiantz gave a detailed and frank overview of the economic challenges facing that country. He reviewed the substantial progress Armenia has made since independence and highlighted the many related factors that give rise to or inhibit change in Armenia.

Mr. Nercissiantz began the seminar by reviewing the causes of Armenia's economic problems. After studying the economic problems of the country extensively, he and his colleagues in Armenia came to the conclusion that the most fundamental problems are rooted in Armenia's despotic political history. Power was concentrated among a ruling elite who used it capriciously and abusively, forcing the general population to develop methods of coping with the difficult realities that ensued. Public institutions instilled fear in the people and stifled creativity and initiative; this did not begin to change until 1990 with the collapse of the Berlin Wall and the onset of the Velvet Revolution.

Mr. Nercissiantz conveyed that he and his colleagues in Armenia therefore concluded that the solution to Armenia's predicament lies in diffusing power through democracy, backed by an effective Bill of Rights. To prevent the further abuse of power, the rule of law and due process must be guaranteed for everyone and applied to everyone regardless of an individual's position in society. Nercissiantz went on to say that Armenia must continue its efforts to develop a market economy and privatize state assets because private property rights promotes freedom. Nercissiantz acknowledged that problems still need to be addressed regarding the fairness of elections and corruption within the civil service.

On the bright side, Nercissiantz noted that all parties and groups are well represented in Parliament, there is lively debate, and Parliament does not rubber stamp decisions made by the president. Additionally, Parliament has undertaken key legislation, including a bill that prevents monopolization and fosters a competitive economic environment.

In outlining Armenia's accomplishments since independence, Nercissiantz pointed out that Armenia has the most open economy in the region and only employs a few price controls in the power sectors. The government does not establish monetary exchange rates, but rather, allows market forces to determine them; there is a small national bank that allows for the free movement of funds in and out of Armenia. The privatization of state enterprises is ongoing and is almost complete with only a few large state enterprises remaining to be privatized. Furthermore, the law guarantees private property rights, including the security of ownership and the right to sell, rent, and buy property.

In addition, positive economic signs for Armenia include a 12.9 percent economic growth rate for 2003, a 48 percent annual growth rate for all exports, and the creation of more than 70,000 jobs over the last two years in the private sector.

Nercissiantz cautioned, however, that much work remains to be done. There is still an unemployment rate of about 25–30 percent, and 45 percent of the population lives in poverty. Moreover, the income gap is high, and industrial development is narrowly based on a few sectors. To address these shortfalls and create new jobs that will stabilize the economy and reduce poverty, Armenia must complete the privatization of state assets (which is currently 80-percent complete) and diversify the industrial base to provide new jobs and security.

In conclusion, Nercissiantz acknowledged that the benefits of the economic and political reforms are not immediately available to the entire population but that, in time, the lot of the average Armenian would improve. He expects that Armenia will maintain double-digit growth rates for the remainder of the decade, allowing for all to enjoy the reforms as quickly as possible.

The discussion that followed Nercissiantz's presentation was lively and touched on many important issues relating to Armenia's financial health, foreign relations, and general, future well-being. One of the first questions raised addressed Armenia's involvement in the field of information technology (IT). For Armenia, IT is a high priority and, to this end, the country has formed a high council on IT and collaborates extensively with the United States in the IT sector. Growth in this sector is enhanced by the large Armenian diaspora in the United States, many of whom live in California, where the IT boom in the United States is centralized. This unique set of circumstances has provided Armenia with direct access to the U.S. IT market and has even led to the listing of Armenian companies on Nasdaq. Despite these connections, a major constraint to the Armenian IT sector is the state of the country's telecom sector, which is suffering as the result of a very unsuccessful privatization effort.

As the discussion moved to foreign policy, a question was raised concerning the extent of Armenia's relations with Iran. Armenia is a landlocked country, but has diplomatic relations only with Georgia to the north and Iran to the south. Relations with Azerbaijan and Turkey are suspended as a result of the ongoing conflict over Nagorno Karabakh. As a result, Armenia has pursued friendly relations with Iran; the two nations conduct a moderate amount of trade, totaling about \$100 million a year, mostly in foodstuffs, and construction and hardware materials. The two countries do not trade many consumer durables because Iranian goods are not as competitive in price or quality as products from the Arab Emirates in the Gulf of Arabia.

One seminar participant brought the discussion back to the issue of the large Armenian diaspora by asking how much money the diaspora actually sends back to Armenia each year in the form of remittances, and what impact this has on the economy. Unfortunately, calculating exactly how much money is sent each year is very difficult and, although both the U.S. Agency for International Development and the World Bank have attempted to calculate the aggregate amount of yearly remittances, no definitive number has been established. The amount is estimated to be \$200 million a year. Most of this money, however, is used as “social protection,” meaning that people use it to pay for cost-of-living expenses, and the money is not invested in the country. To decrease the need for remittances, the economy must be strengthened and more jobs created.

Economic growth, however, is restrained by several factors that must be alleviated before substantial improvement can be made in Armenia. In this regard, state enterprises are the biggest problem because, frequently, they are hotbeds of corruption and typically cling to the old, despotic method of running affairs. The best way to deal with inefficient and corrupt state enterprises is to privatize them, thereby forcing them to act like normal companies, or go out of business. There was a similar problem with the civil service in Armenia, which was rife with cronyism. This problem has been addressed by forbidding government ministers to simply staff their bureaucracies with those individuals loyal to them.

An example of the successful privatization of state enterprises was that of the energy market. In contrast to the privatization of the telecom sector, which was handled poorly and has constrained growth in that sector, an independent regulatory commission was established to guide the privatization of the energy sector. Now that the companies have been privatized, the payment collection rate has risen.

Privatization has also helped Armenia’s financial growth in other ways. When Armenia first became independent, there were 80 banks operating. Some of these early banks essentially acted as private banks for the old state enterprises. However, as privatization increased, the number of banks decreased. Eventually, the number of banks was reduced to 40 and, together with the International Monetary Fund, Armenia introduced strict fiduciary and transparency requirements. Harmonization with Western standards of banking and transparency requirements has not, however, been completed. Although the overall reduction in the number of banks is a positive factor, the Armenian stock exchange is not very active because enterprises are reluctant to completely open their books (in the interest of evading taxes), making reliable audits virtually impossible. The government of Armenia cannot force the financial institutions to make themselves completely transparent, but it can encourage them to do so. The government of Armenia does not allow money to be on-lent at concessional terms. Money received from the World Bank is lent to certain banks at market rates and concessional money is not allowed to distort the financial sector.

The generally difficult economic situation in Armenia is compounded by the fact that tax collection rates are not 100 percent, thereby depriving the government of much needed revenue. Low tax-collection rates are partly a result of the Soviet era and years of generally despotic rule in Armenia. People take a certain pride in avoiding tax payments because they have a general distrust of the government. Fortunately, this attitude is

changing with the younger generations. Another sign that the *weltanschauung* of the younger generations is diverging from that of the older generations is that younger people are far more enterprising and willing to do things for themselves. The attitude that people can wait at home for the state to come help them is no longer prevalent, and a spirit of entrepreneurship is burgeoning.

The last point discussed was that Armenia does not seem to be having the same successes establishing democratic rule, characterized by free and fair elections, as it has had transforming its economy to a market-based one. It was suggested that when considering the progress made by Armenia's democratic institutions since independence, one has to consider that the country has suffered 2,500 years of despotic rule and only twelve years of transitional democracy. Part of the problem results from local leaders, who try to please their bosses with their efforts to "win" the election through ballot-box stuffing or voter intimidation. This approach is reflective of the old mentality, which will take at least a generation to grow out of.

Summarized by Dan Steingart