Statement

by

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at

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Ladies and Gentlemen,

I have been invited to speak about the political economy of the reforms in Armenia. I will thus review, first, the political foundations of the Armenian reforms and the strategic directions of the transition; and then I will relate some of our achievements to date and the challenges that lie ahead. After my statement, I will be available to respond to your questions and comments.

Before doing so, I want to thank the Carnegie Institution for inviting me to this important center for encouragement of knowledge to improve mankind. I hope lessons of Armenia’s transition experience would be a useful addition to this knowledge base.
In the summer of 1990, shortly after the break down of the Berlin Wall, and about two years before the collapse of the Soviet Union, when the so called “velvet revolutions” were unfolding, I recall passionate debates concerning our vision for the future of Armenia and the design of the foundation from which the reforms will flow and carry us forward. After some deep soul searching about the roots of our socio-economic problems, so as to identify the fundamental causes of the distortions in our society, we gradually, but surely, came to the conclusion that the fundamental cause of our problems throughout our long and tumultuous history is the despotic political culture that has dominated the entire Region.

By despotic political culture, I mean concentration of power and arbitrary use of it. Regardless of the ruling despot of the time, the Shahs and Shahenshahs, the Khans and Sultans, the Czars and the Soviet dictators, (and of course occasionally we had some of our own home-grown despots), all had one thing in common: concentration of power and arbitrary use of that power. Despots deprived our people arbitrarily from their property, liberty, and even, of their lives. People were always vulnerable and insecure and, therefore, over the centuries designed survival techniques and instruments, such as flattery, treachery, deceit and many forms of corruption so as to survive. Despotism of the national or imperial rulers often infected officials at lower ranks such as governors, mayors, village and party chiefs, all the way down to school principals and teachers. As such, they instilled fear and insecurity complexes in our people, and, thus, stifled individual initiative in creating, innovating, enterprising and producing. Despots managed our society with top down social engineering of one form or another. This was the picture, more or less, until 1990.

From this fundamental diagnosis we began to design the foundation of our reforms. We clearly recognized that if the cause of the despotic political culture was concentration of power, then extrication from it must be through orderly diffusion of power. In practical terms, this meant two parallel tracks of transition: (a) to liberal democracy and (b) to open, mostly private, market based liberal economy.
Clearly, the principal prerequisite for our transition, particularly in the context of our long authoritarian past, is transition to liberal democracy, i.e. democracy and the rule of law for individual rights, together. Democracy alone is not enough for us because it only guarantees the power and status of the majority and often it upholds the old power structures that resist change and shirk adjustment and, thus, some are simply left out. That carries the risks of relapse to our old autocratic habits, if it does not guarantee liberty and rule of law for everyone. In liberal democracy, on the other hand, we would not only elect our own government, but we also would have our individual rights protected by due process of law that applies to everyone living or enterprising in modern Armenia.

We recognized that we can not have a fully functional market economy in Armenia without liberal democracy, because a market economy requires checks and balances, a legal framework and administrative transparency that is essential for fair competition in an open market, where citizens can enterprise freely, regardless of whether they are a member of the majority or minority, foreign or domestic, rich or poor, a man or a woman, from the ruling authority or from the opposition. And private property is the institution that would limit the power of the state and enable democratic institutions to evolve and thrive in modern Armenia. We adopted the institution of private property in Armenia not only because private ownership sharply increases productivity of land, labor, and capital, but also because private ownership sharply promotes the cause of freedom. And it was mainly for this purpose that we privatized land in January of 1991, exactly one year before the collapse of the Soviet Union.

Fifteen years ago, when we gained our Independence, we declared our commitment to liberty, democracy and social justice as I have just described for you. Subsequently, we expressed these commitments contractually in our Constitution, enshrined them in the laws of the Republic, and the transition proceeded.
Diffusion of the political power in modern Armenia is being achieved through a lively National Assembly where all political parties above a 5% electoral threshold and independents are represented. The deputies debate freely, forge coalitions, and legislate through compromise and not the rubber stamps of yesteryears. Though we have had some problems in the electoral processes, particularly concerning deputies with conflicts of interests, the National Assembly by-and-large functions reasonably well, reflecting the present state of the Armenian political maturity.

The judicial power is being diffused through a program of judicial sector reform so as to forge an independent judiciary that can guarantee due process of law, enabling citizens to confidently go to the courts to claim their rights and settle their disputes, rather than fearfully submit to greedy judges in contests of graft. Whilst comprehensive institutional reforms have been made in this direction and some progress realized, admittedly behavioral modification by both judges and citizens is slow to ensure a credible and genuine independent judiciary at this stage, and it may take a generation for us to see substantial progress.

The knowledge power is being diffused through a free and mainly private mass-media to ensure public access to all news and provide a feedback mechanism for the authorities. Raising professional and ethical standards for a free mass-media through self-regulation is the next logical phase in this sphere so as to encourage the media to report news and not make news, and the authorities to guarantee freedom of the media in all its forms and manifestations.

Diffusion of executive or administrative power is being achieved through a comprehensive civil service reform, which aims to establish objective criteria and practices in recruiting, appointing and promoting competent and credible civil servants. It provides checks and balances so as to uproot arbitrariness of public officials and substantially reduce corruption of civil servants, and instead promote competent and
efficient civil service and, thus, help to improve public governance throughout Armenia. Progress here remains to be assessed after some years of implementation experience.

Economic power is being diffused through a program of privatization to enhance a competitive, private sector driven production and distribution, enabling the citizens free choice of enterprise and employment. Progress here is significant as private sector share of employment has increased to over 80% and private sector share of GDP is now also around 80% and rising. Our concern now is no longer monopoly of the state, but rather measures to prevent formation of monopolies and oligarchies in the private sector that may concentrate economic power again, this time in few private hands. We plan to deal with this through anti-monopoly legislation and executive regulatory framework to enhance competitive economic environment. We realize that private enterprises can be just as tyrannical as governments, and whilst governments in democracies are constrained by their constitutions and voters, private enterprises in the absence of proper legislation and effective regulation could become unlimited authoritarian institutions and oligarchs.

I do not claim today that we have a fully fledged liberal democracy in Armenia. I do claim, however, that we are in transition towards liberal democracy, and in the fifteen years since our independence we have achieved plenty as compared to our past, and as compared to our neighbors. Our principal comparator and destination, however, is the Western style liberal democracy, and to achieve this whilst we must work very hard now, a generation change may be required because old habits die hard and behavioral modification is more readily accepted by the young. Let us remember that democracy is not an event, but a process. It requires time for the political institution to reform and adjust, as all of today’s 22 mature democracies of the world have done. Let me add at this point that a package of extensive constitutional amendments to sharpen the separation of powers, and to enhance individual rights and checks and balances, was approved through a plebiscite last November.
And now allow me to turn to our economic achievements and challenges that lie ahead. Ever since independence in 1991, the Republic of Armenia has embarked on an intensive program of structural reforms for transition from a centrally planned to an open, mostly private, market economy, through democratic processes along the lines of the principles that I outlined earlier. The main objective has been to create strong macroeconomic prerequisites for private sector driven economic growth with equity.

In the first phase of the reforms:

- All producer and consumer prices, and trade, is liberalized. Today Armenia is the most open economy in the region with minimal import tariffs (0 & 10%), no export tariffs, and no quantitative restrictions (no quotas, at all).
- Agricultural land and housing is privatized, and privatization of state enterprises is now nearly complete. All small enterprises, and over 1800 medium and large enterprises, have been privatized. Privatizations convey all property rights, including security of ownership and the rights to sell, to rent, to pledge as collateral; in line with liberal economic concepts of private property.
- The essential infrastructures have been substantially rehabilitated and are ready to support the rapidly growing production.
- A favorable and progressive taxation regime has been established and it is working as an important instrument of fiscal policy. The incidence of taxation is one of the lowest amongst the transition economies.
- The Central Bank has been established, the national currency introduced, and a small, but evolving private banking system is working as important instruments of monetary policy. There are no exchange controls and funds can be transferred freely into and out of Armenia by residents and visitors alike.
- Social assistance has been rationalized from general subsidies to targeted assistance, and directed primarily to the vulnerable groups. The subsidies are transparent and budgeted, so as to ensure effective control and affordability.
• The basic legal framework for the new economic system is in place, and is developing along the lines of liberal economic concepts of private property, freedom and sanctity of contract.

• The economy has been stabilized, as the annual inflation rate since 1998 has been around low single digits, and the national currency, Dram, has been the most stable currency in the region for several years. The economy grew steadily from 1994 to 2000 around 5.5% annually; and then since 2001 the economy has been growing around 12% annually; and this last year the economy grew at 14%. We expect another double digit growth rate also for this year.

• And all these have been achieved despite the adverse influences of some serious external shocks, border conflicts and closures, and domestic tragedies.

Nevertheless, there have been imbalances in the pattern of economic growth and distribution because poverty (around 25%; down from 56% in 1998), unemployment (around 15%) and income inequality remain disturbingly high. Consequently, the level of Gini coefficient is still unacceptable in Armenia. The income based Gini coefficient was around 0.27 prior to transition and it is currently estimated at around 0.4 (down from an all time high of 0.65 in 1996). Rural poverty has been particularly severe since benefits of the fast economic growth have been slow to reach the countryside. Here I must add that the expenditure based Gini coefficient in Armenia is significantly lower at around 0.3. This difference is mostly attributed to the shadow economy and large scale private family remittances from abroad.

Mobilization of public and private resources have been rather weak. Annual tax collections have been only around 14% of GDP (or around 17% of GDP if social security payments are included) mainly due to tax evasion through collusion of public and private sector officials. Mobilization of private sector savings by the commercial banks have also been rather low as loans by the entire banking sector comprise only around 8% of GDP. Moreover, equity markets have not yet developed mainly because of closed and opaque corporate governance.
Greed, vanity and incompetence have sometimes induced deviations from economic policy causing waste and misallocation of scarce resources. Simply said, abuse of both power and freedom has at times obstructed implementation of otherwise sound economic policies, and instead created clandestine private-public officials' self-serving partnerships. If unchecked, such deviations will undermine economic performance and create serious economic and social problems. Clearly, country economic management must be driven by policy and not transactions.

President Kocharyan’s Administration, therefore, has undertook decisive measures to improve governance to enhance efficient resource mobilization in both public and private sectors. For efficient mobilization and allocation of public resources, the strategy now calls overhaul of the government machinery to substantially reduce waste and corruption and to reform administration of taxes and customs. Implementation of a comprehensive anticorruption action plan, addressing abuses of authority and rent seeking behavior in all branches of the Government, is an important component of the Administration’s strategy to improve public governance. For mobilization of private resources, the strategy calls for an extensive and coordinated set of measures to simplify administrative procedures and remove obstacles to trade and investment, and encourage development of the enterprise sector through open and transparent corporate governance. In a nutshell, the strategy here is to substantially reduce the cost of doing business in Armenia, so as to enhance Armenia’s competitiveness in the global economy.

New institutional interventions to improve country economic management, and to eliminate administrative obstacles so as to enhance the enabling environment for investors, are creation of the Economic Coordination Council, of the High Business Council, of the Armenian Development Agency, and of the Information Technology Council, all reporting directly to the President of the Republic and composed of key cabinet level officials. Foreign and local businessmen and NGOs are appointed to the boards of the latter three on a rotational basis. The Prime Minister is designated as chairman, and the President’s Chief Economic Advisor as vice chairman, for all four of
these structures, so as to enhance linkage of policy design with policy implementation. These institutional interventions are functioning as mechanisms for public-private policy dialogue and demand driven reforms of policy and administration.

As a result the business environment has dramatically improved. According to the 2005 Index of Economic Freedom published by the Heritage Foundation and the Wall Street Journal, Armenia is the “most open” of the Newly Independent States. It has improved from the 115th place in 1996 to the 27th place in 2005, together with Japan, and well above countries such as France, Italy and Norway, and miles ahead of its immediate neighbors. According to the same index Georgia occupies the 68th place, Turkey 85th, Russia 122nd, Azerbaijan the 123rd place and Iran 156th place.

Whilst in the past investors were understandably reluctant to invest in state enterprises, today, as I indicated earlier, over 80% of the economy is private, and growing, both in terms of GDP and employment, and it is wide open for investment. The new private enterprises are now modernizing and restarting the old and idle state factories and production enterprises (most of them now privatized), and starting new factories and production clusters, this time in line with Armenia’s comparative advantage (knowledge-based, technology intensive, high precision, and high value added goods and services).

Equity in distribution is to be achieved through improved employment opportunities in a more competitive and robust private sector, particularly expansion of small and medium enterprises and improved administration of the public sector, so as to prevent financial hemorrhages, and to reallocate the recovered resources to priority social development purposes. In a nutshell, the strategy here is to reduce poverty through growth with equity by investing in people and promoting a free and competitive business environment so that investments are made and jobs created. Clearly, the most challenging overall issue confronting the Armenian economy today is poverty reduction, particularly in rural Armenia. The Government’s Poverty Reduction Strategy, therefore, addresses
many essential measures required to deal with this challenge through growth with equity. Strategic investments targeted to the rural sector, and assisted by funding from the World Bank, Millennium Challenge Corporation and others, are now in progress for this purpose. Let us remember that we must have sufficient and competitive production so as to be able to distribute the benefits justly with social sensitivity.

This evolving program of political and economic reforms has been, and continuous to be, fundamental and far-reaching. Clearly, it requires a great deal of personal sacrifice and behavioral modification by all of us during transition, and benefits of the reforms are not immediately available to all segments of the population at this stage. We are determined, however, to continue to implement the reforms through democratic processes of open debate, mutual compromise, checks and balances, and due process of law. We believe reforms implemented through democratic institutions are far more stable and sustainable, and enhance public confidence. By improving the business and investment climate through reform of public and corporate governance, and with additional foreign and domestic private investment, we expect to maintain our high economic growth rates for this decade and with progressive distribution of the yields of that growth, the benefits of the reforms will be appreciably felt by the entire population through progressive improvements in quality of life.

Thank you for your attention.
After a rich 30-year career in the World Bank encompassing four continents and over twenty countries, in both technical and management positions, Mr. Nercissiantz was appointed Chief Economic Advisor to President Kocharyan of Armenia right after the 1998 Presidential elections. Ever since 1990 Mr. Nercissiantz has been one of the intellectual leaders of Armenia's post-Soviet reforms and economic transition, assisting directly two Presidents and ten Prime Ministers of the Republic in different capacities. As Chief Economic Advisor, Mr. Nercissiantz directly reports to the President of Armenia and advises the President on strategic directions for economic transformation, policy design at macroeconomic and sectoral levels, and country economic management.

Concomitantly, Mr. Nercissiantz is Vice Chairman of the National Economic Coordination Council, of the Armenian Development Agency, of Armenia’s High Business Council, of the Information Technology Council and of the Armenian MCA Board of Governors, supporting the Prime Minister who is the Chairman for all of the above Councils and Board. Mr. Nercissiantz is also Armenia’s Governor in the World Bank Group’s Board of Governors.

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