
Armenia : Promoting Economic Activity and Investment through ...

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PRESS RELEASE - 20/8/2007

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Armenia: Promoting Economic Activity and Investment through an Improved Business Environment

Courtesy of the CALIFORNIA TRADE OFFICE

In the early '90s, the Armenian government successfully implemented its first generation of reforms, which provided a strong foundation for sustainable growth. Since 1994, the Armenian economy began to show signs of recovery from a major contraction experienced during 1991-93 when the country lost nearly 60% of its output. This transformation rapidly accelerated from the beginning to mid-2000 thanks to a focused effort aimed at improving the overall business environment and the supporting framework for investment. The country continued enjoying relatively high rates of economic expansion and recorded an incessant double-digit growth since 2002. Demand for Armenian products abroad also grew significantly.

This strong performance has been largely dependent on financial assistance from the Diaspora, World Bank, USAID, UN organizations, European Union, and bilateral donors. Acceleration in private-sector investment, reflecting an improving business environment, is also a determinant cause of this performance.

The government's economic policy adopted Private Sector Development (PSD) as one of its key elements since the beginning. This is mainly evident from the massive privatization effort undertaken by the state where about 90% of the economy was sold to private entities, as well as in the enactment of a number of economic policies that supported the growth of the private sector. These actions set the tone for the coming economic growth.

Armenia's good performance in the last 3 years, in particular, was reinforced by a certain diversification of the economy. While agriculture and food processing continued to grow, the light industries sector also showed signs of vitality and at times a very strong recovery. The backdrop for all this remained a solid and stable macroeconomic framework and an improved fiscal performance. The latter is a significant achievement for the state, i.e. while the fiscal situation improves and becomes stronger, the government has more flexibility in terms of revenue mobilization and public

expenditures. This also means more flexibility to undertake larger and long-term initiatives rather than crisis management. The government, indeed, now enjoys a much better prospect for controlling the economy and planning its development.

The achievements attained by Armenia came at a cost and despite some serious constraints. Particularly, to-date, transport costs within and out of the country remains high and freight forwarding is still a complicated affair in respect to other countries in the region. Nonetheless, the economy continues to develop -- not to a lesser degree thanks to Diaspora interventions. From this perspective, the importance of Armenians living outside of Armenia should not be overlooked. Remittances by family members living abroad remain a very important part of the economy and appear as the single biggest source of foreign currency source for Armenia. This is also telling from the point-of-view of Armenians who have successfully established themselves in foreign countries and continue to support their relatives and friends.

Armenia is one of the most liberal and open market economies in the region and even globally according to a number of recent studies and surveys. Moody's just rated Armenia Ba2, while the Economic Freedom Index released by the Heritage Foundation and Wall Street Journal ranked Armenia 27th out of more than 150 countries. The latter uses 50 indicators such as capital flows and foreign investments, banking and financial systems, monetary, budget and trade policies, salaries and prices, state interference in the economy, property rights and regulations and black markets. This demonstrates that progress in trade and price liberalization, increased investments in infrastructure, privatization or closure of most state-owned enterprises, and efforts to streamline government regulation, have considerably enhanced the business environment.

The 2006 Annual Administrative and Regulatory Cost Survey also suggests noteworthy improvements in the business environment. When asked about the general satisfaction with the quality of regulations, administrative requirements and bureaucratic behavior of state agencies, only 38% of Armenian businesses considered it as a problematic constraint, while the average rating was 3.50 (somewhat satisfied) [1]. This percentage is calculated as the sum of the number of companies responding very dissatisfied, dissatisfied and somewhat dissatisfied. This is a considerable improvement over the results of the 2004 and 2000 surveys, when respectively more than 60% and 71% of companies were dissatisfied with the overall quality of business regulations. It is also worth noting that in the 2006 Survey large companies were somehow more dissatisfied (45.83% of large companies) with government regulations than medium (41.41%) and small-sized (35.03%) enterprises. Furthermore, companies operating in different sectors of the economy have almost the same level of dissatisfaction with government regulations - commercial companies being a little more constrained with the overall quality of business regulations.

In spite of all commendable improvements, corruption remains a key area of constraint and needs to be addressed. Armenia's ranking in the Corruption Perception Index has not improved marginally between 2000 and 2004, thus, indicating persistent administrative barriers/discretion to doing business.

Transparency International Corruption Perception Index

Rank 2000 (1-90)

Rank 2004 (1-133)
Score 2000
Score 2004

Slovenia
28
29
5.5
5.9

Estonia
27
32
5.7
5.5

Hungary
32
40
5.2
4.8

Lithuania
43
41
4.1
4.7

Czech Republic
42
54
4.3
3.9

Latvia
57
57
3.4
3.8

Poland
43
64
4.1
3.6

Turkey
50
77
3.8
3.1

ARMENIA
76
78
2.5
3

Russia

82

86

2.1

2.7

Azerbaijan

87

124

1.5

1.8

There are also overall concerns regarding the tax, customs and general public administration areas. Firms, especially small and medium-sized ones, still feel there is room for improvements in this area. Many argued that dealing with taxes and other regulatory requirements is time consuming, not transparent and adds to the overall cost of doing business. In other words, it evidently puts strain on the private sector's capacity to do business since dealing with administrative issues is time-consuming and costly.

On the other hand, Authorities seem to be genuinely pushing for improvements allowing for transparency and openness. In the tax and customs systems, they aim to make it easier for clients to interact with these agencies, although it is obvious that it is not enough to change pertinent laws, but, institutional cultures must also be changed. However, sustained effort and time are needed for bringing about institutional change. Sustained effort means that the government has to commit itself to progressive improvement aimed at eradicating this cancer from the system. Some of it can be dealt with by obvious administrative changes such as the ongoing implementation of self-declarations for taxes and customs that aim at reducing contact with customs and tax officials.

Another important area for consideration in terms of improving the business climate is the need to reduce the overall transaction costs for doing business. This doesn't just mean bills for utilities or transport, it also means time and other wasted efforts. This area needs to be progressively improved and adjusted over time. Confidently, progress is already being made, but certainly there is no impression that this is a very easy task.

The Administrative Barriers Study prepared by the Foreign Investment Advisory Services (FIAS) of the World Bank Group suggests that, in general, there have been notable improvements in a number of administrative procedures affecting businesses since 2000 -- including business registration and licensing. While strongly commending these achievements, it is important to record that the more difficult tasks of ensuring efficient and fair tax and customs administration, transparent privatization and lease of public land and construction coordination remain to be tackled. Therefore, it is of critical importance that the government recognizes and prioritizes some fundamental issues that have not been fully addressed over the last several years. While certain areas, such as enterprise registration, licensing and title transfer registration have seen consistent improvements, there are plenty of administrative procedures that remain complex and cumbersome, especially for smaller businesses and new entries (both local and foreign).

Comparing Armenia with other countries based on the official time for

company registration indicates that there is still room for reductions to catch up with best practice countries in terms of simplicity and speed of enterprise registration and related institutional arrangements (such as information sharing among government institutions, use of single registration form and identification number).

Over the past four years, a variety of changes have occurred in various locating processes that have helped to accelerate land acquisition and planning approval procedures. Although significant progress has been made, further streamlining measures should be implemented to remove existing development barriers for investors. Attention should be given to further streamlining the existing land and construction processes, which remain cumbersome for investors and are not always transparent or accountable.

The activities of the Business Support Council (BSC) were instrumental in bringing a number of investment climate issues to the agenda of the government in recent years.

The BSC served as the high-level forum for identifying administrative barriers, addressing them at the technical level through public-private sector dialogue, and implementing reform in a comprehensive manner that ensures accountability within government and to the business community.

Following the findings of the FIAS study, an action plan was developed by BSC. A critical component of this effort is to assist the Armenian government in implementing the proposed action plan for the removal of administrative barriers to investment, which could serve as a tool for achieving ongoing and sustained improvements.

Experience suggests that an action plan is most effective when it is detailed, when it accurately presents the concerns of businesses, when it includes feasible solutions that are the result of public consultations, and when it mandates responsibilities and imposes realistic deadlines. It should also contain performance indicators to evaluate if the desired impact is being achieved. In Armenia, the level of public-private interaction that took place in preparing the agendas of the Business Council meetings and follow up on the originally agreed action plan was not sufficient to tap into the full potential of such an instrument.

In summary, there is no reason to believe that the momentum created in the country cannot be sustained (despite a number of risks), and, if progress continues this way, confidently, the economic growth will benefit all segments of Armenian society.

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[1] On a six -point scale, where 6 stands for very satisfied, 5 - for satisfied, 4 - for somewhat satisfied, 3 - for somewhat dissatisfied, 2 - for dissatisfied and 1 - for very dissatisfied.
