
Reforms of second generation necessity in Armenia

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YEREVAN, August 21. /ARKA/. Armenia must carry out reforms of the second generation at a very high rate, the Prorector for University Education Development, Russian-Armenia (Slavonic) University, former minister of finance and economy of Armenia, Professor Edward Sandoyan stated in his interview to the ARKA News Agency.

'It is a happy fact that during the parliamentary election campaign RA Premier Serge Sargsyan repeatedly pointed out the necessity for reforms of the second generation in the country. All this suggests that we will have rapid changes.'

Sandoyan expressed his satisfaction over the fact that the Government's economic team has been replenished with highly experienced professionals. Specifically, he believes that the appointment of Nerses Yeritsyan RA Minister of Trade and Economic Development is a hope-inspiring factor as Yeritsyan has proved to be a 'first-rate professional not involved in any political games.'

'Everything suggests that the public is mature to realize the need for professionals, without whom progress, especially in reforms of the second generation, is impossible,' Sandoyan said.

According to him, Armenia has not made any headway since 1999, reforms have mainly slowed down and even stopped, even in the spheres that are in urgent need for them. The problem is that we can miss a chance for rapid and essential development if we fail to implement necessary reforms in certain spheres.

What is the need for reforms of the second generation?

The first stage of reforms, which was launched when Armenia gained its independence, implies transition from planned economy to market economy. The transition was chaotic and difficult, accompanied by serious problems resultant from the collapse of the USSR, Nagorno-Karabakh conflict, aftermath of the earthquake, loss of all corporate ties. The situation was so serious that Armenia ranked first or second among the former USSR republics as to economic recession.

In those conditions Armenia managed not only to survive, but also overcome most serious problems, chiefly restore the disaster area, but also - and this is the most important - ensure the institutional bases for market economy. This process was most complicated and accompanied by both faults and effective solutions. However, all of this is for historians.

What should be done next?

We are now in a situation, when our economy can hardly be defined as market economy. It has features formally resembling those of market economy, but they are in essence far from being features of market economy. This is the reason for public discontent, and Armenia remains a country of modest means, in the aspect of both per capita GDP and infrastructure development. The main problem is that we have low-level economic competition and, consequently, high-level concentration of business and property, monopolization of various trade and economic fields.

We have high-level corruption and low-level economic competitiveness compared to the counterpart countries. The export-oriented economic sector is not efficiently developed in the country, whereas this is the only direction of our further development. The institutions of protection of property right, competition, contract enforcement are in embryo. The matter concerns inefficient legislation, administration and judicial power. More complicated tasks involve reforms of education, science and public health.

We have serious regional, energy, transport and communication problems, which hinders the country's further development as well, especially when the matter concerns regional integration, including transport and energy integration.

All of this requires reforms of the second generation - institutional, more essential reforms, which can be most painful and long-term ones. They cannot be carried out in a year or in three years, but they should have been started long ago. Strong authorities, enjoying the population's confidence, are able to start such reforms.

I can see this potential now. The parliamentary elections reduced the number of populists, the degree of destructivism, and we see the legislative body more logically completed. This can enable us to make a breakthrough. Therefore, the authorities need the population's great confidence to make some, even unpopular, steps, which are certain to produce results.

What is the importance of economic reforms?

Reforms are necessary for maintaining positive macroeconomic indicators. At first sight, these indicators are stable in Armenia - steady economic growth, the second largest growth among developing countries after Azerbaijan. A rather stable market situation, low controllable inflation and considerable reduction of poverty and unemployment. However, when we look at the quality of economic growth, we can notice the lack of deep institutional economic reforms.

This is fraught with most serious consequences because we are now using the natural conditions producing results. If we continue on the same lines, we may lose all the sources of economic growth.

Over the last 15 years, Armenia's economic growth has mainly been ensured due to economic rehabilitation. Among other very strong clusters of economic growth have been import substitution and diamond-cutting. However, import substitution cannot be an everlasting process, and the diamond-cutting industry, which has for a long time constituted 30%-40% of our exports and imports, is beginning to decline because of more expensive labor force.

Unfortunately, construction is the principal cluster of economic growth. Of course, it is good that our construction industry is developing. But the point is that it is housing construction, not the construction of enterprises, that is being carried in the country, which will not result in rapid multiplication of potential of economic capacities, but only in the improvement of housing conditions and of the quality of the country's housing stock. This is very good and important, but the element of consumption is very strong here. Using conventional terms, we can say that it is important for us to develop sectors and clusters, which can create new potential for further development.

Another cluster is agriculture. This is a good thing, especially in agricultural produce processing. But its potential is seriously limited as well.

Moreover, the situation can be complicated due to the fact that, under the WTO-set terms, we are to make our agricultural sector taxable soon, which

will cause a rise in the price for agricultural produce and reduce competitiveness on the foreign market. If the financial bodies fail to ensure adequate taxation, and the Government fails to find the right mechanisms of backing the agricultural sector, it may cause serious quasifiscal losses. On the one hand we will have higher prices, and on the other hand we will not be able to enhance the efficiency in the agricultural sector by backing it.

Further economic growth may slow down without economic innovations. Armenia needs the development of economic innovations. This requires a very high education level, which may take years and even decades. It would be naïve to believe that rapid development of information and high technologies is possible in the country. With the domestic potential lacking, it is only possible when a technologically mature investor having efficient innovations makes high-quality strategic investments. However, this requires a proper investment climate.

High-quality human capital is also necessary, which is ensured through education. Our education system leaves much to be desired, and the investments we have been making are insufficient and inefficient. Even if we increase the investments, they will not produce any results, as structural and institutional reforms are required, which would ensure the compatibility with the technologies and mechanisms that are producing results in Europe and the USA. In any case, if we do not have new economy, the economic growth may slow down in the future.

Our Diaspora is our oil!

One of our major advantages is a mobile and active Diaspora, which provides Armenia's economy with money transfers. Our Diaspora is our oil. And if financial institutes are efficient and adequate to this situation, economy will have great advantage. Economy is getting serious injections from the Diaspora - according to some data, up to \$1.5bln a year. If this sum is compared with Armenia's GDP and state budget, it will be clear that this is the most significant factor of economic growth, source of its financing.

The money flows eventually increase the population's solvent demand, which is the major factor enhancing the economic capacity, and if we properly adjust our economy to financial institutes now, we will get a great effect without ecological and financial problems. At present, the Armenian community in Russia is most active. It is due to them that we can see large-scale construction in the center of Yerevan. This is a new generation, the ones that left Armenia in early 1990s, got firmly established and made great progress in business. This community ensures increase in direct foreign investments and private foreign transfers.

However, the two components of economic growth create certain problems. We are under the threat of what is known as 'Dutch disease'.

Dedollarization of Armenia's economy in progress.

The result of the increase in currency supply in Armenia is that, over the last three years, we have observed unprecedented revaluation of the Armenian dram and, therefore, dedollarization of economy and high-rate enhancement of the Armenian dram's role in the money supply.

On the one hand, this is a positive factor, which affords ample opportunities to enhance the efficiency of monetary and credit policy being implemented by the Central Bank of Armenia (CBA) and of the channels of influence on the money market.

However, this worsens the conditions for development of most of the export-oriented clusters. We can also observe the devaluation of the population's private transfers and savings as most of them are in the form of foreign

exchange. Since, according to the CBA, about 36% of the country's population are dependent on private transfers, in many cases their real purchasing power is reduced due to the USD devaluation. This results in the most dangerous phenomenon, namely, the rise in the cost of living in Armenia. This situation is to importers' great advantage, which is bad for economy, as we must have an opposite situation, which would not contribute to the increase of exports.

When we face the rise in the cost of living and human capital, that is, labor force, we must take into account the fact that many businesses will become unprofitable.

We can already notice a decline in jewelry production, because diamond production and cutting mainly involve labor expenditures. The rise in labor expenditures causes a rise in production costs. This makes many enterprises reduce their output, and unfortunately, they may very soon stop operating, as it will be much more effective to establish such production in such countries as China and India.

The same can be observed in the sphere of information and high technologies. A programmer has become an expensive pleasure in Armenia. This is not the low-paid labor force two or three years ago.

On the other hand, it should be noted that the future of the country's economy must not be built on low-paid labor force as, sooner or later, this factor come to an end under conditions of economic growth.

However, labor force became more expensive in Armenia not due to larger incomes, but because to the rise in cost of living, and the rise in the cost of labor force was relative, not direct. In the USD terms our workers receive more, but in the AMD terms their incomes actually remain the same.

Problems of lack of institutes of financial intermediation.

If these processes had been accompanied by natural changes on the market, the revaluation of the national currency would have caused a fall in prices, first of all in import prices, unless any considerable rise in the world prices for some imported products was recorded. We do not have this. On the contrary, the prices for many goods and services are rising.

All this causes a rise in the cost of living and labor force. We are having an increase in the purchasing-power parity, and the closer it is to European and American prices, the less efficient our economy will be, because all this is not the result of economic growth, related natural processes and the population's enrichment, but of only the exchange rate policy. This is the main danger. We need very serious reforms. Specifically, when we speak of the money market, we need a developed financial sector, instruments and financial products, which would allow us to attract considerable funds from the consumer market and direct them to longer-term capital and other projects. This function is performed by relevant institutes of financial intermediation we are lacking.

Steps to create a system of nongovernmental accumulative pension fund, mortgage crediting market, conditions for development of all types of insurance, including life insurance, have been necessary for a long time.

Insurance and pension funds must be come the organizations to come to the capital market with 'long' money and turn into consumers of debt instruments, which, in turn, may appear due to the same mortgage institutes.

A mortgage crediting body with state capital to issue mortgage securities should have been formed long ago.

Armenia also has to develop corporate securities. Relevant procedures are under way. Specifically, the entry of the Scandinavian OMX company to Armenia's market is a direct way to integration of stock exchanges and to real-time entry to European and international capital markets. This will allow Armenian issuers to attract funds on foreign markets for developing their businesses, allowing investors to have foreign securities circulate on Armenia's capital market.

The banking sector must be engine of the other segments of the financial sphere.

Armenia's banking sector remains very small compared to those in many other countries, which is accounted for by the underdevelopment of other non-bank financial institutes, whereas Armenia is an undoubted leader in the efficiency of bank management and banking supervision in the post-Soviet area.

That is, everything necessary has been done for effective development of the banking sector in Armenia. But time has shown that it is not enough, as, being the center of the financial sector, the banking sector is supposed not only to be supported by other financial institutes, but also become an engine of the other segments of the financial sphere. The lack of these niches results in the banking sector's further insignificant role in the country's economic development.

Therefore, it is most topical when a new Government led by the Premier states the necessity for reforms of the second generation, as it is only such reforms that can resolve the country's current economic problems. P.T. -0--
