
Exporters and outsourcing providers had to cope with 25% handicap

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Interview with chief of party of USAID/CAPS (Competitive Armenian Private Sector) program, Hayley Alexander

How do you estimate the decision of the government to give addressed help to business? Are the measures applied effective enough? The assistance rendered by the Government is giving out loans, temporary buying of stocks and state credit guarantees. Are they all appropriate, and is there a need of other mechanisms?

Just last week I was invited to a round table with the US Ambassador, the IMF, the World Bank, the EBRD, and other USAID projects. The topic was: The impact of the international financial crisis on Armenia. The general feeling, which I share, is the government's response has been reasonably positive, especially with regard to the speed at which the stimulus program has thus far been implemented. One thing I like about the financing programs they have undertaken is they are flexible, everything from equity investment to loans to guaranteed loans, depending on the situation with the individual companies they are trying to support. I think this sort of flexibility is appropriate and ensures government money will be used more effectively than if a one-size-fits-all program were to be adopted. On the other hand, the problem with this sort of government financing is the private sector's inability to submit viable proposals for consideration. From the initial request for proposals, I understand approximately 70 proposals were received and only about a dozen were adequate to be short-listed.

This is the result of basic lack of capacity on the part of companies to articulate what they want to do and how the financing will benefit them and the country in the longer term. As a result, only a small number of companies have been able to access the government funding, and many more surely need it. So in the macro sense, the Armenian government's stimulus program has thus far failed to reach enough companies to have a significant impact on the economy as a whole. My suggestion is for the government to also offer strategic marketing (planning) and proposal writing assistance to those who need it in advance of submitting a proposal. This sort of help is normally best subcontracted to local business services providers. The CAPS program, for instance, regularly contracts with local consulting firms to do this sort of work. The EBRD BAS (Business Advisory Services) program does as well.

Another aspect of the government stimulus program is in need of improvement as well. The government has yet to clearly define and communicate an overarching, strategic vision for the financial crisis avoidance effort and whether or not other programs are planned. As the situation stands, the measures undertaken appear somewhat out of context with any broader objectives, which remain unclear.

It is important to note that one of the most positive steps to stimulate economic health, which the government has taken recently, has been the floating of the dram to allow its devaluation. The situation before, with the dram artificially propped up at 305/dollar, was absolutely untenable. The overvalued dram has been a major impediment to cost competitiveness for most producer and service provider sectors in Armenia. It became crystal clear something needed to be done. The notional stability in valuation

could no longer be supported due to the sudden and dramatic drop in remittances and exports, both of which should have weakened the domestic currency. The revaluation of the dram should go a long way to easing the choking effect the overvalued currency had on exporters and outsourcing providers, who too long had to cope with a 25% handicap. Certainly information technology, tourism, pharmaceuticals, engineering services and many others will stand to benefit greatly from the re-valued dram. Mining will too, though international nonferrous metals prices will need to rebound as well.

Give your view of the changes in excise duty, which had been raised in last December and has been again lowered recently. Does Armenia need to undertake measures with a flavor of protectionism to enhance the sales

of internal production? What reaction does the situation get from American entrepreneurs?

Protectionist legislation is all too often viewed as the simplest way to support domestic industries that are struggling to compete. Unfortunately, these measures rarely succeed in the long term as trading nations have a nasty habit of responding in kind, which then cripple exports more broadly. Moreover, these measures tend to be applied to industries that are not competitive, for whatever reason, and the artificial protection simply masks the causes and prolongs the hard choices to improve domestic company competitiveness. In the mean time, the sheltered industries fall further behind their worldwide counterparts who, without such protection, have been forced to become more productive (and effective marketers). If the local producers are offering needed goods and services, and the dram is now 20% weaker, why not let them do their best to compete? The best of them will find a way which in the end will strengthen each sector.

How do you assess the project of 3-year tax exemption for VAT for the enterprises, which import equipment, on progressive basis (less than 70 mln AMD ` 1 year, 70 ` 300 mln AMD ` 2 years and more than 300 mln ` 3 years)?

I would not say the same for investment incentives as I said for protectionist measures. In other words, investment incentives and those measures which increase productive and value-adding capacity in the country should be supported. These are necessary because the most successful economies do provide investment incentives, and even more importantly, they offer these in transparent one-stop vehicles with clearly elucidated reasons to invest. As the situation is now, potential investors to the IT industry, for instance, are told the government considers IT a strategic industry ` and this is touted as a reason to buy into Armenia. But what does this mean? How will this proclamation reduce the investors' costs? How will they find qualified labor? What does labor typically cost per month? What government programs are available for those willing to invest in R&D? What happens if foreign investors become embroiled in a business dispute? These is the sorts of information foreign investors need to know.

Will the financial crisis affect the process of occupation of Gyumri technopark? What benefits will the `tenant' companies have, and are they effective? Are there corruption risks for Gyumri to be occupied by large business only, or, perhaps, a risk of forbidding the SMEs to start business in Gyumri unless they are backed by large enterprises? Why, up to now, there hasn't been any announced participation in the project by private companies, both from Armenia and abroad?

The Gyumri Technopark is a large and complex program. To succeed, it requires a public-private partnership to develop on a scale that has not yet often been witnessed in Armenia. Government needs to seed the program

with a measure of state funding to demonstrate commitment and incentivize interest among investors and participants. However, the main financial injection must come from the private sector, which may not see a return on their investment for some time. This is a particularly difficult moment to seek such investments from companies but the program needs to keep moving forward. The question is whether or not this program has a champion with the time and capacity to ensure forward motion. The lag in announced companies for participation is, as far as I can see, simply due to the program being at an early stage in development ` the international economic situation is not helping matters either.

Regarding who from the private sector will participate, it is natural that some of the larger companies will be first to express an interest, because: 1) they have the resources to do so and 2) a core of larger companies with the ability to engage in R&D projects is a positive factor. I have heard nothing to indicate there will be any systemic barriers to small company participation; moreover, the proposed design focuses on SMEs as the primary users and beneficiaries.

Thank you
