AMERICAN UNIVERSITY OF ARMENIA

A STUDY OF THE VOUCHER PRIVATIZATION IN ARMENIA. PRIVATIZATION: NEITHER PANACEA NOR POISON

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LIST OF ABBREVIATIONS

AMD………………. Armenian Drams

CEPRA…………….. Center for Economic Policy Research and Analysis

CEE…………………. Central and Eastern Europe

CIS………………….. Commonwealth of Independent States

EE…………………… Eastern Europe

FSU…………………. Former Soviet Union

MEBO……………… Management-Employee Buyouts

NIS…………………. Newly Independent States

OECD……………….. Organization for Economic Co-operation and Development

ROA………………... Republic of Armenia

SOE………………… State-owned Enterprise

SU…………………… Soviet Union

USD………………… United States Dollars

USAID……………… United States Agency for International Development

WB…………………. World Bank

ABSTRACT

In any transition from a centralized economic system to a market economy one of the most important steps for governments is the privatization of large and medium-size enterprises, with the goals of improving enterprise management, efficiency and competitiveness.

This essay examines the privatization process in the Republic of Armenia. In particular, it focuses on voucher privatization in Armenia from 1995-1998. The essay begins with explanations of what mass privatization is and what voucher privatization is. It then discusses the transition from a command economy to market economy in Armenia. Finally, the essay identifies advantages and drawbacks of voucher privatization.

Privatization is neither panacea nor poison. The essay stresses that case-by-case privatization strategy that was adopted by the government in the end of 1998 in Armenia was more preferable approach than was voucher privatization. It also points out, that when public enterprises are privatized, these companies, the private providers of public services, must be continually monitored and held accountable by the government to make sure that they serve in the public interest.

THE RESEARCH QUESTIONS IN THE STUDY OF VOUCHER PRIVATIZATION IN ARMENIA ARE AS FOLLOWS:

1. What was the objective of the government of Armenia?
2. Was it met?
3. What did voucher privatization achieve in Armenia?
4. What did we learn about the successes of voucher privatization?
5. What did we learn about the failures of voucher privatization?

EMLOYED METHODOLOGY

The research method employed in this study is a content analysis of data published in the academic writings and in the official Internet WebPages relevant to the topic. The unit of analysis is the voucher privatization in the Republic of Armenia.

By the means of content analysis it was attempted to find out the development of privatization process in Armenia, in particular, the development of the voucher privatization.

The study compares the data of enterprises privatized using vouchers with the data of enterprises privatized using cash.

Introduction

The purpose of this Master's Essay is to look at the development of privatization in Armenia and to focus on the voucher privatization. It will identify the special problems of the voucher privatization in Armenia by looking at the advantages and disadvantages of privatization and the shortcomings of its implementation. Due to the collapse of Armenia's markets both outside and inside the former Soviet Union (FSU), privatization in Armenia occurred without genuinely competitive market. In fact, the nomenclatura of the FSU who had administered industry, became the "owners" of industry, able to not only to sell industry in the privatization process, but also to strip industries of their assets, making restructuring and investment impossible. Because of these special problems, this paper will stress that when public enterprises are privatized, then private providers must be continually monitored and held accountable by the government to make sure that they serve in the public interest. Public officials must ensure that the sales of public enterprises are in the best interests of taxpayers.

Privatization refers to the transfer of assets from public to private ownership. While the first half of the 20th century was characterized by nationalization, in the latter half of the century privatization has taken place on a massive scale. This process reflects general changes in the conception of the role of the government in a democratic society and its national economy. The government is no longer expected to participate directly in entrepreneurial decision making. Instead, it is supposed to support an entrepreneurial environment so that the market mechanism can work. In other words, the government should focus on the distribution rather than the creation of national wealth. (Hargas 2000).

The main reasons for this shift in attitudes regarding the economic role of government is that government intervention in the economy has tended, for a variety of reasons, to be costly. Government bureaucrats, for instance, do not have the same incentives as private sector actors, who are motivated to maximize profits. Additionally, the goals of the managers of state-owned enterprises (SOE) are not always clear and often contradictory. Furthermore, because monitoring of government-run business is often lax, and corruption is more widespread in the state sector.

For this and other reasons, it is widely believed that privately owned firms are better managed and lead to faster economic growth than those owned by the state. Therefore privatization became a keystone of the transformation process in the reforming countries of the FSU and central and Eastern Europe (CEE), where spurring economic growth was seen as almost as important a goal as creating a democracy.

We should point out the difference between privatization in the well-established market economies and privatization in reforming countries. Privatization in developed countries took place only on a limited scope, because much of the economy was already in private hands. On the other hand, privatization in the transition economies has been extensive, since most of the productive resources of those economies were owned by the state.

Another feature distinguishing privatization in reforming countries is the fact that it is taking place in the context of a comprehensive transition process that is already problematic and confusing. "The political and economic awareness of citizens and politicians is much different from what is standard in western countries." (Hargas 2000).

Though privatization is viewed as a necessary component of the transition process, the privatization process itself has been open to criticism. In Armenia and other countries many have been angered by the methods used to transfer property that was formerly owned by the state to private individuals. "It is often sad that the government, by turning over property to people who mismanage it, is undermining the economy." (Hargas 2000).

The issue of whether public services should be produced by government or by private sector is being debated by economists and public officials in many countries, but in transition economies such as the Republic of Armenia, the debate is particularly intense. As a controversial issue, it is generating increasing interest nationwide among state and local government officials. Much of the debate focuses on the effectiveness of privatization. In particular, the effectiveness of particular programs, such as the voucher privatization, is being debated.

Privatization has been occurring all around the world in recent years. Although it is no a new practice, it appears to be growing as more and more services are being considered for privatization. (Peters 1991, 53). There are different motivations for the growing interest in privatization, but in general, it is a part of the growing desire to decentralize government. ("The Privatization Debate: Proponents and Opponents" 2000). This can occur by moving government functions from higher or national levels to lower or local levels. It can also occur by moving government function out of government hands and into the private sector, either nonprofit or profit organizations. One reason that government has been turning to the private sector is to lower costs. This is based on the belief that private sector has greater competition in the market, therefore providing for services more efficiently. Another reason is that because of market competition, the private sector allows citizens to have more choices.

These basic motivations are true in varying degrees of different forms of privatization. At the two extremes are contacting and full privatization. Contracting is probably the most common form of privatization. The government maintains fundamental control over a service by being responsible for planning and financing, while it contracts out the actual provision of services to a private firm. At the opposite extreme is full privatization, where the government has the least control over a service. Basically, under full privatization, the government no longer provides the service at all; instead, private companies are responsible for planning, financing, and providing the service. (Peters 1991,53).

Between these two extremes are a variety of other forms of privatization. These include franchises, subsidies, and vouchers. They vary in the amount of government control exercised over the stages of service provision.

Although all of these forms of privatization are supposed to provide services more effectively, in fact there are a number of concerns about the quality of service, the equality of service distribution or availability, and employment conditions. ("The Privatization Debate: Proponents and Opponents" 2000). However, mass privatization schemes undertaken with a minimum of preparation and little to no experience, as has been the case in the transition economies of the FSU, including Armenia, are particularly open to criticism.

What is Mass Privatization and What is Voucher Privatization?

What is mass privatization? In general, mass privatization involves the packaging or grouping of firms to be privatized utilizing standard systems and procedures for their privatization, as opposed to the more traditional case-by-case approach taken in the UK and other Organization for Economic Co-operation and Development (OECD) countries, which has been widely emulated in many developing countries in Latin America and Asia, and in Eastern Europe. (Lieberman 1995, 14). This is also true of much of the FSU, including Armenia.

One method of mass privatization is the use of vouchers, which are distributed for free or a nominal fee to all citizens. This method was used in much of Eastern Europe and the former Soviet Union in the 1990s. Different countries use different kinds of vouchers. In some countries vouchers could be freely traded and sold, while in other countries trading and selling was possible only under strictly limited conditions by registering them. Another difference was that in some countries vouchers were physical documents while in other countries they were bank accounts. Yet another difference was that in some countries vouchers had actual cash value, while in others they were assigned a "point" value. (This was designed in order to prevent inflation as the money supply increased as vouchers were sold off). Yet another type of voucher, used primarily in Hungary was only to provide restitution to those whose assets were acquired by the state under Communism. ("About Voucher Privatization" 2000).

Voucher privatization was seen as presenting a number of advantages. First of all, it was an efficient way to divest the government of state-owned assets by putting them into the private sector. Second, the process of bidding for voucher shares of a particular firm was also a means for deciding the value of industries and firms. Third, the process of voucher distribution was to create a sense of economic justice by providing citizens with a financial stake in their country and its new economic system. Finally, voucher distribution to all citizens was supposed to prevent any one person or group (such as the nomenclatura) from gaining too great a share of the country's assets. ("About Voucher Privatization" 2000).

However, voucher privatization can also be criticized. First, vouchers often failed to create money, since everyone received a share of the assets instead of them being sold to the highest bidder. This also meant that new capital, management and technology were not invested either, thus indirectly leading to the stagnation of already weak economies. Third, when "everyone" owns a firm or industry, governing it becomes difficult, especially in transition economies where the systems were already weak. Fourth, voucher schemes allowed "insider privatization", where those who managed industry and firms were able to gain control over them through inside knowledge. Fifth, and this could occur in conjunction with "insider privatization", investors could gain control over a firm or industry, strip it of its valuable assets, thus leaving the voucher shareholders with a worthless firm. Finally, investments could be acquired by banks that were state property, so that assets went from state hands to the public and then back to the state.

Below, in Table 1, is an incomplete list of countries that appear to have issued *physical* vouchers, with the date. ("About Voucher Privatization" 2000).

Table 1. Incomplete List of countries that appear to have issued *physical* vouchers, with the date

Former Soviet Union	***Other Socialist Countries***
	Mongolia
Russia	1992
1993	
Tatarstan (republic of Russia)	Czechoslovakia
1995	1992
	Slovak Republic
Moldova	1995 (privatization bonds replace vouchers issued before dissolution of Czechoslovakia)
1993	
Belarus	Albania
1993	1995
Kazakhstan	
1994	Romania
Azerbaijan	1991
1996	1995
Tajikistan	
1997	Croatia
Ukraine	1997
1995	
1996	Bosnia
Georgia	1999
1995	Bulgaria
	1996
Armenia	1999
1994	Hungary (restitution vouchers only)
	1991

Source: (http://www.ups.edu/faculty/poneil/pages/vouchers/aboutvouchers.htm).

Methods of Privatization

Privatization has been in fashion for more than 15 years, if we date its recent flowering from Margaret Thatcher's initiatives in the late 1970s. Shrinking the state's economic presence become part of the economic reform programs that characterized economic policy throughout much of the world in the 1980s. The collapse of communism in Eastern Europe (EE) and the FSU moved privatization issues onto a much larger stage in the 1990s. Privatization in the broadest sense means giving private actors a greater role in decisions about what, where, and how to produce goods and services. A great deal of experience has now accumulated regarding this process. Some of it shows the great potential that privatization has for increasing productivity, income and welfare. (Berg and Berg 1997).

However, it also reveals the complexity and difficulty of effective privatization. Privatization even in the narrower sense of divestiture, the sale SOEs has presented greater challenges than its early advocates envisaged.

Relatively few countries account for most divestiture activity in recent years. Thus, of the roughly $300 billion in divestitures between 1988 and 1994, two-thirds occurred in industrial countries. (This excludes sales of small enterprises and give-aways such as mass privatization programs). The five biggest privatizations, among them Japanese Railways, British Telecom, And Deutsche Telecom, account for some $60 billion in proceeds. Of the $100 billion in developing county privatizations, more than half took place in Latin America. (Berg and Berg 1997).

In developing countries, macroeconomic impacts of privatization activity have been small in most cases. Despite the widespread privatization rhetoric and many formal structural adjustment programs under World Bank (WB) sponsorship, the average public enterprise sector share in gross domestic product for 40 low- and medium-income developing countries between the late 1970s and the early 1990s remained unchanged, as did the sector's share in wage employment. (Berg and Berg 1997).

In the low-income developing countries (those with average per capita incomes below $600 a year) the pace of privatization has been particularly slow. In sub-Saharan Africa, for example, only 1800 (mostly small) divestiture transactions took place between 1980 and

1995, with a sale value of about $2 billion. In only six countries (Benin, Ghana, Guinea, Mozambique, Nigeria, South Africa and Uganda) did total sales through 1995 amount to more than $50 million, which suggests insignificant reductions in the relative size of the public enterprise sectors in most of the continent. Ghana, Nigeria and South Africa account for almost 70 percent of the total sales value of African privatizations.

Overall progress has been much faster in EE and the FSU. Most of these countries have succeeded in moving from almost complete domination by the state sector to predominantly private economies. However, only a few of these countries have been able to divest many state enterprises to new managers, and the problem of using former state assets more efficiently remains problematic in much of the region. The methods of privatization are as follows: 1) Sales of Shares or Assets; 2) Capital Dilution or Capitalization; 3) Management-Employee Buyouts (MEBOs); 4) Mass Privatization. (Berg and Berg 1997).

Sales of Shares or Assets. The classic type of privatization is the sale of full or partial ownership of a state enterprise by public offerings on stock exchanges, by competitive bidding for shares or assets or by noncompetitive placement of shares.

Capital Dilution or Capitalization. Privatization can occur without the state disposing of any of its equity, but rather adding to it by allowing a private investor to by in. the result is a capital increase, with the government's share declining. Many joint ventures are formed in this way.

Management-Employee Buyouts. Three main types of MEBOs can be distinguished. In many developing and transition economies, small establishments, for example, retail outlets, restaurants, hotels, bookstores, trucks and busses, are sold to employees. Countless privatizations have taken place in this way, though they do not seem to show up in privatization inventories.

Mass Privatization. Mass privatization programs privatize hundreds or thousands of enterprise at one time. To make this possible, they generally combine one or more of the above techniques with some sort of free distribution of assets, shares or buying power assets (vouchers).

Transition from a Command to a Market Economy in Armenia

After the collapse of communist regimes in EE and FSU, one of the first priorities of the reform governments had to undertake was to transform the system of ownership. The new governments overwhelmingly chose to pursue a broad program of sweeping privatization, transferring the bulk of state property to the private sector. Given that most property was controlled and owned by the state and that there was no historical precedent for privatization on an economy-wide scale, policy makers had to design from scratch a program to transfer the wealth of the state to private hands. With few exceptions, East European and FSU privatization officials appointed to this task concluded that it would be too slow and unwieldy to rely on the piecemeal sale of enterprises to private investors, as was typical in West European privatization. More commonly, they developed programs to transfer the ownership of state enterprises to private individuals and groups through mass distribution programs, to be followed by or supplemented with piecemeal sales. (Appel 2000, 520).

As one can imagine, this policy makers and technocrats could design the mass privatization program in ways that held different distributional consequences for society, such that some groups would benefit more than others, for example, citizens over foreigners, one former elite group over another, managers over labor, and so on. In the Czech Republic the government designed a mass privatization program in which the were no special privileges for any particular groups in society. Once the state transformed medium-size and large firms into corporations, any adult citizen could obtain from the government vouchers that could be exchanged for shares in the newly created corporations there were no explicit privileges or discounts for participants in the voucher program, although foreigners could not participate. In Albania and Hungary the privatization program similarly avoided granting privileges to particular domestic economic and social groups; Hungarian privatization is unusual, moreover, for encouraging foreign participation over mass participation. (Appel 2000, 520-521).

In Russia privatization officials initially adopted a mass, voucher-based program modeled closely on the Czech experience. There was, however, one crucial difference that became more pronounced over time. Although the Russian program started out distributing vouchers equally to all citizens, the program later added enormous privileges for employees. In fact, in 72.5% of Russian enterprises privatized through the program, 51 percent of shares were reserved for the employees of that enterprise. Privatization officials in other states similarly designed programs to benefit workers. In Bulgaria 20 percent of shares were offered at 50percent discount; in Lithuania 50 percent of shares were available to managers and workers at a discount; and in Ukraine a leasing program essentially transferred for free large blocks of shares to worker cooperatives. (Appel 2000, 521).

One of the most important stages in any transition from a centralized economic system to a market economy involves privatization of state-owned and operated enterprises. In the Republic of Armenia (ROA), these enterprises included not only large centralized enterprises such as electrical power, telecommunications, and banking, which are sometimes state-controlled or at least heavily regulated even in market economies, but also large and medium size “cooperative” enterprises, such as mineral water, beer, wine, and brandy producers. Tourist service providers such as the airlines and hotels were also state-controlled. Industry and manufacturing, including such concerns as the electrical supplies, chemicals, and textiles were also state-controlled. Land and housing were also state-owned and operated, often through the enterprises with which they were associated. That is, housing was provided to employees through the employer, a state-owned and operated enterprise itself.

Privatization of different enterprises is obviously a complex and demanding task, as each type of concern, if not each individual enterprise, raises different issues. Thus, there may well be a legitimately stronger role for government to play in some of those concerns than others. This is particularly true of possibly security-related enterprises such as power and telecommunications, and even the airlines and banking. The need for strong government role is compounded by the fact that some enterprises also provided necessary services to the public. Indeed, all types of infrastructure necessary to the daily viability of a nation may well require strong government role if only in oversight. Such enterprises can be distinguished from those, which are necessary for a vital economy, but do not form the infrastructure of the country. Some of these enterprises, such as defense-related manufacturers such as chemical industry may have important, even necessary roles to play, not only in the vitality of the economy but also in the security of the nation. In market economies the government often has a role to play, particularly as the leading bidder on contracts; yet essentially these enterprises are private. Yet other enterprises, such as the wine and brandy industry, may be quite necessary to economic success, yet not have strong ties to security. In market economies these are fully divested of government role except in the most general sense of oversight and establishment of safety and quality standards. Finally, those enterprises which are regularly regarded as "private", that is, housing and the land surrounding it (or worked by someone), is yet another type of enterprise.

Given the variety of types of enterprises that existed under state control in the ROA, it would appear that the privatization process would require careful planning to ensure the careful consideration of the various issues unique to each type of enterprise. A "one size fits all" approach could well ignore important distinctions. Yet, with that said, it also appears to be clear that all enterprises to be privatized share certain objectives to be realized in the privatization process.

By reducing and even eliminating the government's role, enterprises hope to improve their management, efficiency, and competitiveness. From the very beginning of economic reforms, state policy was aimed at drastically reducing its role in the provisions of services and the production of goods in order to promote the private sector as the major source of economic development. In this way a class of owners could be created who would then introduce the competition mechanism, thus enabling the transition from a centralized economy to a market economy.

Development of Privatization Process in the Republic of Armenia

In fact, Armenia was the first of the FSU republics to privatize state property. After the Declaration of Independence, in February 1991, the Supreme Council adopted the decision titled "Fundamentals of Privatization". According to Ghaltakhtshyan, Minister of Privatization, "this decision stated that the transition to market relations in Armenia is to be implemented through privatizing state property." (Ghaltakhtshyan 1999).

Privatization occurred in several stages. First, land was privatized. Armenia was the first CIS Republic to privatize agricultural land. As a result the old collective and Soviet farms ceased to exist, and were replaced by peasant farms. The property of the collective and Soviet farms was re-valued and divided between the employees. The share of each employee was determined on the basis of several factors (previous salary, experience, etc.). All those who could show some peasant origins were given the chance to participate in land privatization, but priority was given to the current inhabitants of villages and the countryside. Land was graded according to quality and, to ensure fair distribution, families received a mixture of land parcels. This however meant that in many cases landholdings were scattered rather than contiguous, hampering economies of scale. (Eloghlyan 1999, 42).

Privatization undoubtedly resulted in an immediate increase in production, and the agricultural market quickly stabilized. Subsequent growth has been held back somewhat by restrictions on access to credit, and on the comparatively slower privatization of agro-industrial enterprises and other institutions in the agricultural sector. Agricultural holdings were largely transferred to those who worked the land at virtually no cost. These holdings were not transferred to enterprises associated with them, but the rights of use were transferred to the owners. (Eloghlyan 1999, 43).

Housing was the next to be privatized. Parallel to the privatization of land, the Government acted quickly to initiate transfer of houses and apartments to private ownership. State apartments, which were formally leased by the inhabitants, were transferred to them free of charge. This led to the development of the growing real estate market. With the assistance of US experts, the residents of apartment blocks have been encouraged to form non-profit associations to maintain the communal structures and areas and contract with utility suppliers. (Eloghlyan 1999, 42).

After land privatization, the privatization of small, medium and large enterprises began. In 1992 the Armenian parliament adopted the Law on Privatization of State Enterprises and Unfinished Construction Projects, which became the cornerstone of the whole process. Latter the Government presented the Privatization Programme for 1993-1994, which was also approved. The programme outlined the selected forms of transmission of state owned enterprises into privately owned companies. It should be noted that, as Armenian law makes a distinction between land and the real property (e.g. factories and other buildings) upon it, privatization of industry has involved only the latter. In other words, privatized companies operating today do not have outright ownership of the land on which their premises are situated.

In Armenia as well as in other CIS and CEE countries, privatization was believed to be an efficient procedure to boost the economy and secure growth. The population was actively involved in the process, especially in the period of so called 'small privatization'. Employees were inspired with the idea of becoming part owners of the company. This actually was an easier process with the presence of actual owners and with the relatively small size. According to the Human Development Report (HDR 1998) of Armenia, "these small businesses such as cafes, convenience stores, beauty salons, etc, were largely sole to employees through direct sales at nominal prices." Therefore most small business owners were able to purchase their businesses from the State. Further business profits were used as payment. This system enabled the state to quickly privatize small businesses and thus begin development of the entrepreneurial class. According to the Center for Economic Policy Research and Analysis (CEPRA), former directors automatically became executive directors. This was true in about 80% of small businesses. This did lead to certain difficulties, however, since such managers might well have knowledge of their product but not of business management and strategy.

The Law defined privatization as "the liquidation of state owned enterprises and unfinished construction units in favor of Republic of Armenia citizens, their groups, non-state enterprises and enterprises with state participation, as well as foreign citizens through forms and orders stipulated by ROA legislation." (Eloghlyan 1999, 44).

One form of public participation in the privatization process was through the issue of privatization certificates. These certificates, which latter were called vouchers, were distributed only to ROA citizens and were declared legal tender for purchase of equities, shares or stock to be privatized. As such the certificates could be accepted only at nominal value, which was initially 10,000 Armenian drams (25 USD at the time of issue). Originally the certificates were designed only for the 1993-1994 programme and new certificates were envisaged for the 1994-1995 privatization programme. However, because of some delays in implementation of the 1993-1994 programme, some companies were not privatized on schedule. Therefore, validity of the certificates was prolonged, initially until 1995, and later they became valid until the end of the privatization process. The nominal value of certificates was also reevaluated and was increased to 20,000 drams (40 USD). (Eloghlyan 1999, 45). The question arises, how did the face value of vouchers have been decided? First of all the list of those enterprises that were planned to be sold were excluded from the list of enterprises that should be privatized by vouchers. Than, the sum of the value of assets of all enterprises that are going to be privatized by vouchers were divided on the number of population, thus, resulting the price of the voucher. (Markossian 1995, 11).

As privatization of medium and large enterprises has proceeded, new forms of privatization have been developed and existing models adjusted. Whilst this has somewhat complicated matters, bellow is the outline of the commonest six forms:

- Incorporation;
- Sale to the lessee;
- Auction;
- Competition;
- International bid;
- Liquidation.

Incorporation of state enterprises began with partial free privatization: 20% of the shares of each enterprise was distributed to the employees free of charge. The size of individual share packets was calculated on the basis of the length of service, current salary, etc. of each employee.

The second stage of the incorporation of medium and large enterprises was by close subscription. In this stage the employees had the option to by a further 30% of the shares.

Close subscription could be considered also as an independent form of privatization, since as of November 1998, 141 enterprises have been privatized by the employees without proceeding to open subscription. In these cases the enterprises were transformed into close join-stock companies.

Open subscription was the third and final stage of the incorporation of medium and large enterprises. Here the rest of the shares, which remained in state hands, were offered to potential investors without any restrictions.

Privatization through open subscription began in March 1995. Of the first 100 enterprises, 62 were over-subscribed. In such cases the authorized capital of the enterprises was increased, as envisaged by the regulations.

This was done without prejudice to the 20% previously distributed to then employees. Thus, for example, if an enterprise was corporatised with a total of 1000 shares of nominal value 100 dram each, of which 200 were distributed to the employees and the remaining 800 were over-subscribed four times, then the share capital would be correspondingly increased to 4000 shares, of which the employees would still receive 20% that is 800 shares.

Sales of enterprises to lessees is another form of privatization, which in the period to November 1998, has involved 174 enterprises. Along with the above-mentioned forms, a relatively small quantity of medium and large enterprises (15 as of November 1998) have been sold in auctions. Auctions have been conducted mostly for testing purposes. Some state enterprises, which were viewed as particularly attractive in the long-term, were planned to be privatized through international tenders. Where an enterprise failed to be privatized it could be liquidated and the assets sold off. In practice there has not been a single case of liquidation up to November 1998. (Eloghlyan 1999, 48).

By 1998, 1250 state enterprises had been privatized. Most of these firms were privatized through the use of a voucher system. A voucher privatization program was approved for all types of enterprises, both large and a small. Voucher distribution began in October 1994 and concluded in March 1995. Within an enterprise the employees received 20% of the shares, and the remaining shares were auctioned off. However, in 1997 there was a major change in the privatization program. According to Ghaltakhtshyan (1999), “This approach marked the transition of massive privatization to programmed privatization.” As was true with many countries undergoing privatization, the state’s expectations of obtaining “quick cash” was not met. The financial rewards of a well-run business may take 7 to 10 years to appear, but, as the minister sates, “many countries expect substantial yields from privatized property. When comparing different methods of privatization (certificates or money) the monetary option is quite advantageous.” (Ghaltakhtshyan 1999).

This thinking formed the background to the decision to change the privatization policy in Armenia. After the change, in 1998, remaining enterprises were auctioned off for money. By November 1998 more than 3 million of the original 3,189,000 vouchers had been used, with only 142,00 remaining, which were permitted to be used until December of 1998. (Eloghlyan 1999, 57).

Accomplishments

The voucher privatization that officially stopped on December 31, 1998, got underway over three years ago after every Armenian citizen handed a certificate later called voucher. The strategy has been defended by former Prime Minister Hrant Bagratyan. (“Voucher Privatization Comes to Close in Armenia” 1998).

By the end of the mass privatization programme in December 1998, the ROA had transferred ownership in more than 1,400 medium and large enterprises and more than 6,000 small businesses. (Markossian 1999). More than 1,200 state enterprises have been privatized mainly for vouchers. (“Armenian minister says voucher privatization to be completed in one year” 1997). Table 2 shows privatization results by the end of 1998.

Table 2. Privatization Results

	Year 1998	1995 – 1998
Medium and Large Enterprises	217	1,460
Small-scale Businesses	603	6,620

Source: (http://privatization.am/gi/gi3.html).

Voucher privatization was the only way to do large-scale privatization in Armenia and other newly independent states (NIS). The reason is extremely simple. First, there is no way to sell all those assets. Second, the local population has too little money and foreign demand is insufficient. The only foreign investors that enter these countries are corporations which bring their own management. Finally, the portfolio money coming through financial markets is very limited due to the countries' inadequate financial infrastructure and poor information on corporate governance.

The only way to privatize large holdings is to start by giving shares away. The government is unable to sell these enterprises directly because it does not have enough contacts or expertise, with the result that process is too centralized. A government sale also invites all kinds of criticism from the political opposition. They may claim the price is too high, the asset is a national treasure, etc.

At least the voucher privatization in Armenia provided a chance to foster the emergence of market institutions. The successes of the voucher privatization in Armenia were only in that, first, the distribution of vouchers had gone very well. Indeed, all citizens received vouchers for free. Second, much of the state owned assets were transferred to private hands, which is one of the preconditions in any transition to a free market economy.

The voucher privatization program in Armenia ended in December 1998, to be followed by a cash privatization program. A number of major sales of enterprises have been accomplished. Over 1,500 companies have been sold, about 65% of the total offered. No doubt these sales and the restructuring that followed them helped contribute to consistent economic growth in Armenia since the low point of the early the 1990s. Indeed, in 1998, real GDP growth was estimated to be 7.2%, with projections for continuing increases. (Spira 1999). Many of the companies behind this growth are former state-run enterprises now privatized.

Many of these major sales involve international advisors. Thus, for example, Merrill Lynch was contracted to work on the sales of 14 key enterprises, although only four of them have been successfully completed. These include Armentel, the Telecommunications Company; the Yerevan Brandy Factory; and the hotels Armenia and Ani. (Spira 1999).

The sale of Armentel in 1998 is the largest of the transactions. 90% of its shares were sold to the Greek Telecommunications company OTE for approximately 142.5 million USD, as well as investments of 260 million USD committed. Recent upgrades in lines and equipment, as a broader range of services, are evidence of the new energy that OTE has provided. On the other hand, Armentel still operates essentially as a monopoly (despite the proliferation of Internet telephone companies and cellular telephone companies), thus not offering the advantages hoped for in privatization. (Spira 1999).

Another major sale is that of the Yerevan Brandy Company. It was completely bought out by Pernod Richard, the French Spirits Company, for 30 million USD. One of the positive features of the sale was the requirement to maintain and develop the local brands, many of which were famous throughout the former SU and even elsewhere. (Spira 1999).

Both the Hotel Armenia and the Hotel Ani were bought by the US Investment Group. 80% of the Armenia was sold for 8 million USD and 22million USD investment package, with Marriott Hotels to mange the property. The Hotel Armenia will be a full-fledged member of the international hotel chain, a virtual guarantee of healthy bookings of international visitors in the future. Ani was completely sold for 4 million USD and 5 million investments. The recent renovations are evidence of the improvements bought to these two properties brought about through privatization. Similarly, the Hotel Yerevan has been sold to RENCO SPA, and Italian Construction firm, for 1 million USD and 6 million USD investments. It, too, is undergoing extensive refurbishment. (Spira 1999).

Other major concerns that have been sold include the DCA diamond-processing factory to Fanfino Ltd. Of the British Investment Group for 3 million USD. Other beverage companies that have been sold include the Abovian Brewery and Mineral Water Factory, with Castel as the manager. Textiles and spinning factories have also been sold. Sisian textile and Goris textile were sold to the Garni Investment Corporation and Maralik Spinning factory to the US-Armenian Investment Group. (Spira 1999).

Unfortunately, cash sale privatization strategy has not developed as quickly as it could. Further complicating the situation were changes resulting from the Parliamentary elections in May 1999. However, there is still certain optimism in that the new Government appears to be willing to continue case-by-case privatization of large entrepreneurial and infrastructure companies and other non-strategic enterprises. However, there is a sense of concern over sales, and a more cautious approach appears likely. While positive results have clearly resulted from case-by-case sales, sufficient attention has not been paid to key issues such as transparency and public relations. The result was lower public acceptance for privatization than perhaps was deserved, such as the popular perception of the Yerevan Brandy Factory as providing a somehow less than authentic version of Armenian brandy, without recognizing the improvements in quality control. A more cautious approach with appropriate attention to public perceptions will enable future sales to be viewed more positively.

See accompanying Table3.

Table 3. Privatization Transactions

Name of Company	Purchasing Group	Transaction Details
Armentel (Armenian Telecommunications system)	OTE (Greek Telecommunications)	142.5 million USD for 90 % stake, including buy-out of private shareholder group, plus260 million investment over 5 years
Yerevan Brandy Factory	Pernod Richard (French Spirits Co.)	30 million USD for 100 % stake, plus commitments to development brand and local suppliers
Hotel Armenia	AK Development LLC (US Investment Group)	8 million USD for 80 % stake, plus 22 million investment. Marriott Hotels has been hired to manage the property
Hotel Ani	Ani Investment Group (US Investment Group)	4 million USD over four years for 100 % stake, plus 5 million investment
DCA (diamond processing)	Fanfino Ltd. (British Investment Group)	3 million USD for 100 % of company
Hotel Yerevan	RENCO SPA (Italian Construction Firm)	1 million USD for 100 % stake, plus 6 million investment
Abovian Brewery and Bjni Mineral Water	Local Investment Group	French beverage company Castel brought in as majority Shareholder
Sisian Textile, Goris Textile, And Maralik Spinning Factory	Garni Investment Corporation (US-Armenian Investment Group)	2 companies purchased at open subscription and the third through international tender

Source: www.privatization.am/gi/gi2.html

Of the more cautious proceedings are the privatization plans for both electricity and water enterprises, keep components of the infrastructure of Armenia.

In the electricity distribution sector, there is a two-stage process. First the enterprises were restructured to create four new companies, representing Yerevan, North, Central, and South Armenia. Second, these companies are being offered for sale in two separate packages to different investment groups. The sale is for a combination of cash and investment/development commitments. Raiffeisen Investment Bank of Austria is advising on the transaction, with United States Agency for International Development (USAID) and WB providing support. Although a number of solid offers have already been received and pre-qualified, more offers are possible when the offering terms and tenders are finalized in early 2000. (Spira 1999).

Also being offered for privatization is the Yerevan water distribution and treatment system. The Yerevan Municipality and government are currently reviewing proposals for technical updates to the water system. A number of serious offers from experienced and reliable firms have occurred, including from France, Germany, Korea and other countries. This privatization plan is seen as essential in improving the quality of water and reliability of service, effects of privatization sure to be approved by ordinary citizens. This kind of clearly positive result is the kind of public relations attention that is needed for public acceptance of privatization. (Spira 1999).

By the May 2000, 1,518 medium and large enterprises of different branches of economy in the ROA have been privatized of which 1,110 through open subscription, 132 trough the sale to worker collectives, 188 trough a lessee, 18 through auction, 62 through competition, one through investment fund, and seven as a result of the sale of 34% of state-owned share in previously privatized enterprises. Ten companies were liquidated because privatization of these companies was not held. 6824 small and 39 unfinished constrictions were privatized. (Markossian 2000).

The receipts to the state budget from the sale of state property were more than 127,9 billion Armenian Drams (AMD), from which 101,1 billion AMD received from enterprises and 26,3 billion AMD from small businesses and unfinished constructions. (Markossian 2000).

During 1999 compared to the previous year there was a decrease of receipts to state budget from privatization. During 1998 the receipts to state budget were 48,6 billion AMD, from which 43, 8 billion AMD by cash. (Markossian 2000).

This data proves that case-by-case approach of privatization adopted by the GOA was and is more comprehensive than was the voucher privatization. If we multiply all vouchers that were used, approximately 3,189,000 by 20,000 AMD (face value of a voucher) we will receive 63,8 billion AMD which were received during long period, over three years. The above mentioned data shows that only in 1998 receipt to state budget was 43,8 billion AMD by cash.

During last year in the ROA the speed of privatization substantially decreased due to a several reasons. First, unpredictability in the political sphere and unstable atmosphere in the region and in country. Second, huge debts of enterprises that are going to be privatized. Third, enterprises have not been restructured before privatization. Finally, investors have not complete trust about how their investments and property rights will be defended.

Drawbacks

Privatization in Armenia, whether through vouchers or cash sales, is intended to develop the private sector and create a market economy. Through bidding for shares of state assets could become private assets; the value of assets would be determined; and the public, through private ownership, would have a real stake in the economic system. Has privatization in Armenia achieved these goals?

As has been discussed, it is true that a number of enterprises have been successfully privatized, and through the process their value has been determined. But certainly much criticism has been leveled against the privatization process in Armenia. Most significantly, since it led to the end of voucher privatization and its replacement by cash sale privatization, is the argument that voucher privatization did not raise substantial revenues for the government. As the article “Voucher Privatization Comes to Close in Armenia” (1998) points out, “…critics, including Finance and Economics Minister Eduard Sandoyan, say the voucher privatization has not brought substantial revenues to the state budget, not turned most citizens into shareholders.” It is essentially cashless, and in fact, acts negatively on the government budget, since creating vouchers and distributing requires the expenditure of government resources. The government receives little or no revenue from giving away enterprises and does not necessarily eliminate expenditures or inefficient ones. Also, the distribution of shares could have an inflationary effect on the economy. Nor did voucher privatization lead to a real stake in the economic system for most citizens. In fact, this has been described as “a mirage” because no investment funds become operational until 1997, years after the privatization process had begun. Furthermore, it is still the only one, and thus has not brought about the advantages of the competition mechanism. (Eloghlyan 1999). In part because of the drive to achieve privatization as quickly as possible, the scheme did not provide this stake for the majority of the population. Most of the population, struggling to make ends meet, sold vouchers at less than face value (despite regulations.) Often vouchers were sold at only 20-30% of their face value. Besides the need for money, most people had no incentive to keep their vouchers, as a voucher worth 25 USD (later 40 USD) did not provide a significant share in an enterprise. Thus most people sold vouchers to those entrepreneurs who were able to recognize their value and have the means by which to acquire significant amounts. This led to the popular impression of “a minority of crooks exploiting the regulations to buy up enterprises at effectively up to four times less than auction value, and then selling off the assets to make a handsome profit.” (Eloghlyan 1999). Actually, most privatized enterprises ended up concentrated “in the hands of elites-directors of enterprises, high ranking state officials, and political figures.” (HDR 1998) As has been described elsewhere in the FSU, new owners stripped the assets and even transferred the money abroad. Investment funds used vouchers to gain control over a firm, strip them of their assets and making a profit for the fund, while shareholders has a worthless enterprise. Other investment funds were actually owned by banks that were state property, so in fact the enterprises remained state property.

Nor has privatization led to an infusion of new capital, management, and technology in many cases. One problem in particular is when privatized enterprises went to former managers they did not always have knowledge about how the market operates. Although managers may have considerable manufacturing experience, they may not have management and strategy experience. (CEPRA 1997). Furthermore, the owners and managers of a newly privatized enterprise were sometimes one and the same person, inclined to act in his own interests rather than those of the shareholders. On the other hand, in other cases ownership was too widely diffused to be effective and weakened the corporate governance of enterprises. This allowed for "insider privatization" when old directors could gain control over the majority of shares. Even in the best situations there were constraints on private sector development—the blockade and other transportation problems, inflation, breakdown of the banking system, erosion of purchasing power in the domestic market, poor infrastructure, and rising costs of raw materials and energy.

In the relevant Government regulation concerning the use of vouchers in the privatization process, it was stipulated that any investment must be valued at the nominal value of the vouchers, irrespective of their current market value. In practice, a number of factors (including: citizens' need for cash and reluctance to invest long-term: the initially slow rate of the privatization process, and thus the limited availability of investment objects; the non-existence of viable investment forms, such as investment funds, through which an investor with limited means could spread risk) meant that, on the secondary market the value of privatization vouchers quickly fell, reaching a low of 2,500 AMD (a quarter of the nominal value) in the second quarter of 1994. In fact, as "Armenia. Nations in Transit" (1998) points out, “The value of the vouchers, which had a face value of $46, had fallen to $6 to $7 in open trading.” Those with means to by vouchers in quantity on the market were thus able to obtain significant share packets in the subscriptions at bargain prices.

However, many of these problems would have been prevented if the privatization program had been more carefully planned. In particular, a regulatory role for the government as the administrator of contracts with the private sector would have prevented many problems.

Conclusion

Privatization is neither panacea nor poison. “…while privatization continued overwhelmingly to worsen the economic and social welfare at the prospects of millions, the package as a whole would continue to create more social problems than it tackled.” (Brendan 1998).

Privatization is not enough. It matters who the owners are. If it is not politically feasible to import foreign owners, who are more likely to run privatized businesses honestly, and to reinvest if profit opportunities exist, the second best choice for large firm privatization may be for the government to begin with case-by-case privatization of selected firms with strong profits and reputations for honest management, watch these firms carefully once they are privatized, and work hard to develop the legal and institutional infrastructure needed to limit insiders’ ability to self-deal.

Even without immediate privatization, the promise of running a to be privatized company (with privatization conditioned on future performance), plus the need to compete in a world market, can motivate its managers to undertake some restructuring. If the company generates cash, the government will have a better chance of retaining enough revenues to maintain basic services. The government’s ability to detect and control theft will be higher if the enterprise is still state-owned. And the enterprise’s long-run sale price will be far higher if it is sold in a stronger legal environment, in a fairer auction, and perhaps with more foreign participation than was politically acceptable in the near term.

Various arguments for and against voucher privatization have been discussed in the essay. The essay has discussed issues concerning the development of privatization in Armenia, in particular, the problems of voucher privatization. The objectives and process of privatization had to be rethought in Armenia. As democracy requires the fullest participation of all societies people in the political processes affecting their lives, so corresponding economic systems should have as their objective that the whole of society be enabled to contribute to and benefit from them. Reliance on free markets and the private sector failed that test in Armenia by excluding large numbers through unemployment and poverty.

"No privatization glove fits all hands." (Berg and Berg 1997). A public offering may be right where the priority objectives are development of the stock market and wider spread of share ownership, and where government has adequate time and resources. Where overall economic growth is slow and public sector assets are poorly used, sale to an outside investor may be the most promising route. It is likely to lead to the fastest restructuring, especially in the case of trade sales to foreign investors. For the rapid sale of a large number of small- and medium-sized enterprises, auctions are the obvious method. Where speed is high on the priority list, as in transition economies with ambiguous property rights and weak controls where insiders have a strong stake, MEBOs are appropriate, in particular for small- and medium-sized firms. To privatize large numbers of enterprises rapidly, there is no practical alternative to mass privatization schemes involving widespread distribution of ownership. Where there is a very small supply of modern sector capitalists and entrepreneurs, methods that give the highest priority to entrepreneur-creation should move to the fore. Here small-scale opportunities have to be generated through the fragmentation of public sector activities and through the leasing and contracting out.

Much of the frustration that can surround privatization derives from the inability of any method to fully satisfy the multiple objectives that characterize typical programs. Public flotations generate revenues for the state, invigorate capital markets and broaden share ownership, but hasty implementation and poor price setting may seriously dilute positive impacts for corporate governance. Trade sales, often the most efficient in terms of enterprise governance, raise nationalist hackles if foreign buyers appear, disturb egalitarians because of benefits to rich people and also may suffer from too-speedy implementation or insufficient transparency. Politically attractive and socially equitable instruments, such as mass distribution or transfers to trusts, often end up with insider-dominated buy-outs or concentrated ownership by investment funds; effects on productivity through better corporate governance are uncertain. (Berg and Berg 1997).

The goal to achieve privatization as quickly as possible in Armenia brought with it numerous negative consequences. Because of sharp decline in incomes, the majority of population was forced to sell its vouchers to cover its daily expenses, often at 20-30% a face value. Thus, what was supposed to be a democratic process of privatization, whereby every citizen would have a stake in the newly privatized enterprises, actually ended up concentrating ownership in the hands of elites-directors of enterprises, high-ranking officials, and political figures. (HDR 1998). Theses special problems show that voucher privatization in Armenia was inefficient. Although experienced in manufacturing new owners (former directors) do not have sufficient knowledge and strategic thinking. (CEPRA 1997). Lacking managerial skills, new owners failed to operate industries, thus, striping of its valuable assets and leaving the voucher shareholders with worthless firm. “The ‘rights’ conferred by ownership of an axe do not usually include the right to use it to chop up one’s wife.” (Wiseman 1991, 261).

Thus, these special problems show that cash privatization strategy, adopted by the GOA since 1998, was more comprehensive approach than was voucher privatization because it brought substantial money to state budget. Besides, foreign investors and owners of enterprises in Armenia make it possible for many enterprises to operate in public interest. However, there are still a lot of privatized enterprises that do not operate. The paper points out, that when public services are privatized, government becomes the administrator of contracts with private sector. Hence, the government, as the administrator, is responsible for monitoring the private suppliers of public services. Theses private suppliers must be continually monitored and held accountable, for example, through regulations, to make sure that they serve in the public interest. Government officials must ensure that public contracts for private services are in the best interest of taxpayers.

When it is done properly and with care, privatization harnesses the powerful market forces of competition, accountability, and incentive.

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