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REFORMS IN THE ECONOMY OF ARMENIA

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The subject I am going to speak upon is vast; it embraces almost all the aspects of our reality. It is not merely the economic policy; while speaking about the latter it is hardly possible to stay within the frames set by the reality: the political situation, the external policy, and the limitations the Republic of Armenia has. No matter how hard we try to apply different classical methods to the reforms of economic policy, the media presents our attempts as experiments in the Republic of Armenia; they are portrayed as reforms having no precedents anywhere in the world. Frankly speaking, I could agree with these opinions as the Republic of Armenia itself is a unique country with all its problems. Actually one could hardly find another country having the same situation as the Republic of Armenia, where all the possible obstacles to economic activity are accumulated in one country during a given time span. Countries do go through different difficult periods that last two or three years; they are rarely so prolonged and full of so many difficulties.

Yet, I think that a certain optimism is lacking in the process of all our economic reforms. I will speak not only about the reforms that have been accomplished or



are in process. No economic reform can serve the people and the objectives of entrepreneurs if the people themselves are not imbued with optimism, if they do not see that optimism emanating from the authorities, international organizations, embassies, humanists and scholars. The economy is a rather real thing, and in their economic decisions people naturally make calculations, consider the principal macroeconomic trends, study the economic indicators, etc. All this is very important, but much more important is to have no apprehensions, to have an anticipation of growth; thus everyone's revenues will increase, and it will be possible to have economic activity in the country.

I would like to present everything from the very beginning. In a number of cases economic reforms in Armenia were compulsory. There were actions that could have been taken within a longer period of time and in a more thought out manner; sometimes there were circumstances that did not allow those actions.

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We can take, as an example, the first economic reform--the creation of private ownership. This was similar to the other CIS countries, to all the countries whose economies were more than 90% based upon the principles of State ownership. Today we hear reproaches that privatization means alienation of ownership, alienation of the property and fortune which was created by everybody, and which is now being given away to individuals. I do not want to argue with these opinions. Actually, in many cases, that is so. But things would be similar if everything were private from the very beginning, because one person is successful while the other is not. If, within the framework of a State, one individual is much richer than another, the attitude of the poor towards the rich can be comprehended because the land, the water, the air and the other elements, making the concept of State, are, after all, considered by many people as a system of common property and liabilities.

The Soviet Union was characterized by State ownership and State administration. Our new authorities faced the problem of a lack of experience in governing a State and an economy. There were several fundamental questions that had to be addressed. The first one

was the type of ownership upon which the Republic of Armenia was going to base its future.

The issue of management was clear for all those who were developing economic policy. It seemed natural to everybody that management should be private. Economic entities cannot be managed by the state; otherwise there will arise a conflict of economic interests between these entities, that are constantly in competition. There are countries where state ownership is much greater than in Armenia, but state management in these

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countries is zero, and they have a lot of success in their economy.

In privatization, decision-making is very important. I will touch upon the aspects that have not been looked into, at least not from the angle that I consider essential. There was a moment (I had a minor role then in all those discussions) when we were absolutely aware that the time, the promptness of decision making, was extremely important, that losing time could bring Armenia to an unprecedented state, observed in different neighboring countries. Armenia had such economic capacities that could not ob-

viously be privatized overnight, or even over many years. We were looking for areas where we could make the first attempts. And that was land. Actually the Republic of Armenia is one of the countries, the only one in the CIS, that has accomplished the effective privatization of land. Many people imply that this was all done by international organizations. I must say that the privatization of land should not be linked to anything. However, I could not claim that at least from the formal viewpoint we have had good results. Today we can forget about the problems pertaining to the form of privatization, but we cannot forget that our more than 350,000 rural enterprises have no future. I am not afraid of these words because that is the reality. It is impossible to maintain really efficient and competitive businesses on these pieces of land. That is evident, and all calculations are suggesting that. Today we have many real contradictions. On the one hand, we assert the immense success of the privatization of land, while on the other hand, we are attacked by a host of accusations and analyses proving that the state of affairs in agriculture in terms of efficiency is inferior to that of those countries where the land has not been privatized even.

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The point is whether the authorities will heed the opinions of scholars and different political powers and will try to introduce some efficiency into agriculture by new methods. Let's say, for example, by requiring that the lands be merged, or by reducing taxes for those who have merged their lands, or by any other policy that would encourage the integration of small pieces of land, hence the growth of efficiency. This would be an action that would discourage every other owner of a small piece of land to invest in agriculture.

In other words, it is obvious that if the state has committed errors and is conscious of those errors, it must understand that it is possible to improve the main indices of economic growth once the errors are corrected. Otherwise the recent decrease of 60% of our indices can persist. The point is how can the state, today, encourage and assist increased efficiency in agriculture. All discussion about whether privatization was right or wrong is not pertinent; the authorities should consider actions for mitigating the harm of liquidating today's agricultural enterprises and merging them with bigger and more successful ones.

The second important point is that the rights of proprietors should by no means be trespassed, no matter what the national or international reasons, except perhaps in very exceptional cases. And this concerns all economic spheres.

The main point that the authorities should formulate and advocate is that for quite a long time, the State's actions will be aimed essentially at the protection of private ownership. The State will not assist entrepreneurs who do not maintain the financial criteria and thereby harm others. Recently I have heard about many enterprises,

industrial and agricultural, which, being insolvent, are not able to pay for water and electricity, or pay taxes. This is preposterous. But these are people who have private enterprises. And they think they can go like that unpunished, that if any action is taken against them, people will come out into the streets manifesting against the economic policy which allegedly renders the population jobless. Whereas an entrepreneur's sacred duty is to take the risk and guarantee employment to his men. Otherwise we will have an unregulated market in Armenia.

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Some people justly consider that the regulatory role of the State should be manifested by immediate methods.

With respect to taxation, these are the exemptions and privileges; with respect to credit policy, these methods can have the form of credit extensions. We are facing a very serious problem, because it is unacceptable that only some authorities try to find solutions to it, while the others leave things nonchalantly as they are, thinking that the future will be the judge. I think that this is unacceptable. I admit that if people were alike with all their characteristics, everything would be fine and some people would not have more advantages than others. But this is not the case. Even in a game, the winner would never say to the loser: "Look, I know that you have problems in your family, so let us consider that you are the winner." The rules of the game are extremely simple, and the main task of the State should be regulation, i.e. it should first define the rules of the game then place sanctions against

those who break the rules. If the state does not carry out this second component of its role, if it does not penalize the one who has broken a rule even if it was a bad rule, if the state admits that the rule was wrongly defined, this will create a precedent for people not to observe other rules either. In consequence, the state will lose its authority, and people will have to rely entirely upon themselves alone. This will require more time, more money, and greater risks. In the end, we will have less capital and less turnover, attributes that are essential for economic growth.

I am trying to touch upon all the unsolved or partially solved problems that the State is facing. When we speak about the regulatory role of the State, we should not forget its role to conduct a macro-economic policy. This policy comprises two elements that, I would say, have been addressed successfully. The first element is macro-economic stability, for which the main criterion of evaluation is inflation. This is also a rather painful achievement because a great drop in inflation is a sign of decline in economic growth. This holds true particularly for big enterprises that suffer less from high inflation than from its decline.

A drop in inflation has another dangerous consequence which is the absolute decrease of the monetary volume. Besides liquidity problems of enterprises, this phenomenon can have other disastrous consequences for the economy of any country. Translated into figures this means that if the GDP of the Republic of Armenia is served by about 70% of the monetary volume, today we have ten times less, i.e. about 7%. This amount is so inadequate for any country whose size or

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economic structure are comparable with Armenia's, that we should not be surprised why we are not able to reduce the interest rate today. This is a problem that has persisted for three years. We have stability but we have also an absolute incongruity between the monetary volume and the GDP. This situation is explained by the existence of a shadow economy. I want to add immediately that the appearance of the shadow economy is not the result of a lack of regulations. The shadow economy has emerged because of the imperfection of the banking system. Also, this is a common phenomenon for those countries where quick structural changes are observed, such as the decrease of inflation, when small volume quick cash turnovers make it possible to avoid taxes. Small and flexible enterprises profit more from such a situation.

The forecasts for the future depend greatly upon the development of the banking system and upon the consistency with which the state will penalize those who ignore the rules, which in this case means avoid paying taxes. With respect to macroeconomic policy, I should say, of course not blaming all the problems on the monetary policy, that our current account is in a disastrous state. We have taken three actions that inevitably led to this situation: firstly, we liberalized prices; secondly, we adopted a free trade regime, eliminating quotas, the main technical barriers of penetrating into the market; and thirdly, we conducted a free exchange rate policy. All three of these measures should have been defined precisely by law, and the same law should regulate the outflow of capital from Armenia. The capital flows into the Republic of Armenia, makes a short turnover and then, given all the risks

that are apparent in Armenia for the capital, flows out again. Thus we have a vast increase in imports with no corresponding increase in exports as a counterbalance. Today we are thinking about imposing customs limitations on quantities of certain commodities that can be produced in the Republic of Armenia. Would this be advantageous for the macroeconomic policy, for the development of the national economy? The answer is yes if we had a population like our big neighbors. If we were like Russia and had a vast market that would enable us to create competition and organize financially efficient production to serve the needs of the market, such

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limitations would be justified for a period of time. However, for Armenia, such measures would not be appropriate. And, of course, the other countries would retaliate with the same measures against Armenian exports. Thus it means that these limitations can be taken against countries whose markets are smaller than ours, and it would be irrational with respect to the countries whose markets are bigger than ours because eventually we will need to use those markets. While studying the prospects of a common CIS customs union, we should analyze all the profits and losses that that represents for Armenia.

With respect to economic policy we have adopted three principles. The first is the free trade policy. The objective is to encourage export, since Armenia has a small market. This is our policy with all countries. The second is the policy of subsidies and liberalization of prices. The position of the Re-

public of Armenia is clear: we have never accused another country of dumping. Recently, everybody speaks about dumping by Iran. I must say that is not the case. What Iran does is not dumping in the actual sense of the word. The fact that commodities are cheap in Iran and they are imported into Armenia and sold cheaply is not dumping. That country evidently has a system of subsidies, state purchases, etc., but we cannot accuse Iran of dumping and we cannot impose any limitations upon the import of their products. This would be protectionism. We could speak about dumping if Iran, or any other country, sold its products in the Republic of Armenia cheaper than they are sold in that country, just to conquer the Armenian market.

However, there is another difficulty. Today, the industrial enterprises have resumed their production. And I think they will develop their production and will have success if we do not interfere, if we do not sacrifice all our budget resources to assist inefficient enterprises. Then we can think about replacing imports with our own production. Our position in this matter is clear: we are conducting a policy of free market for foreign currency and capital, i.e. capital investments can be made in Armenia without restriction and the capital can be taken out. The Armenian branches that will be able to compete with Iranian and Turkish imports may have a chance of coming out on top. These are the branches having elaborate production, and once we have solved the problem of quality in Armenia, these productions can be competitive. Naturally, we are excluding high technologies as they are not among the elements of macroeconomic policy.

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I would like to present at this point our technological policy, which is related to the macroeconomic policy indirectly. As I already mentioned, although we have attained macroeconomic stability, it is important that the state play a regulatory role. Here we can speak also about state assistance. In Armenia, there is no such thing yet, for obvious reasons. All methods of State assistance practiced throughout the world consist of financial assistance. There is no way without direct financial commitment. Exceptions are the tax exoneration, which only in a couple of countries is considered as the main encouraging lever of economy. There are classical theories on tax exoneration and exemptions, but that is something different. All the other assistance methods contain money. The source of that money can be either state enterprises, that ideally should have provided other spheres with subsidies too, as was done years ago, or the state budget. Both sources have limitations for us; moreover, we have to consider issues like economic proficiency and priority. The state budget in itself can ensure macroeconomic stability or destroy it entirely. The macro-economic perspectives depend largely upon the nature of the state budget.

The state budget has two important elements. The first element is the deficit. If the deficit is big, it means that the state spends more than it receives, that the other economic agents create more than they can use. It is not a matter of tax collection. Even if the taxes are collected 100%, there may be a deficit. The deficit of the state budget means that the state uses more than it has, while those who contribute to the creation of that budget, use less than they are supposed to. If we are to use the deficit to cover such expenses that will not have

the reverse effect for the same economic agents, we can say unequivocally that we have budgetary restrictions for effectively conducting our macroeconomic policy.

The second important element of the budget is the budgetary expenses and the extent to which these expenses are related to the deficit. Here two important questions arise: can the deficit of the state budget be immensely big and can the state make any capital investments? With this respect, I must say that next year, or even this year, we will have to make a decision about the use of the funds created by privatization. By definition, these funds can cover the deficit; they are not incomes. The

"All discussion about whether privatization was right or wrong is not pertinent."

state can use these funds in investments to carry out its technological policy. This is one of the possibilities, though not the best one. The second option would be to use those funds for repaying the debts of the banking system. Paying its debts in this manner would mean that the state spent, during the year in question, as much as it had. This would mean that the economic agents would have as much as they had created. In consequence, important changes can occur in the country. If the country succeeds in balancing its budget, at least during the coming few years, we can have significant economic growth. Many countries have successfully adopted this policy, using the funds of privatization not for investments but for enlarging the state reserves, creating conditions for foreign private investments to enter into the country without risks; they have not used credits of the

Central Bank or other credits, leaving the national economy to use those credits and develop.

What important things need to be done for the future? Firstly, we should continue to maintain macroeconomic stability. A country must have stable macroeconomic indices for at least five years to be called macroeconomically stable. Secondly, we have to complete the privatization. We have already a rather well formed private sector. That is a great achievement. However we have a lot of things to do yet. The legislative field should be completed, particularly the Civil Code, which is very important for the development of private ownership and largely for all economic relations. Thus in the range of institutional changes the completion of privatization is the second important task. Thirdly, we must be able to change the structure and management of our infrastructures within the shortest periods possible. We already have important achievements in the sector of energy, but the other infrastructures urgently need to be restructured too. Otherwise the country can fall into the precipice of decline for a long time.

These three points will be at the center of our economic policy. But before we can start accomplishing them, we must radically change the system of social protection of the vulnerable groups of our population. I am confident that very soon the National Assembly will vote the necessary amendments to some laws, and the Government will consequently take decisions which will terminate the inefficient and unfair distribution and redistribution of those petty sums that the Republic of Armenia allocates for these purposes. This is extremely important to be able to make a fair redistribution to the vulnerable population.

QUESTIONS QND ANSWERS

- If there is no war, when will the Republic of Armenia, in your opinion, reach the highest world living standards?

- There are different standards. If we take the United Nations' standards, we meet these standards for certain categories. But globally, as you said, if there is no war, I think that the country will need at least 25 years to come to a normal state.

- Knowing today's prices, when do you think the average salary can reach \$300?

- If the salaries reach 90%, instead of today's 10% of the income of the main part of the population (according to our studies today salaries make up 10-15% of the income of the population) to attain the figure you mentioned we have to increase our national income five times.

- Do you think that mitigation of the taxation system would be rewarding? Wouldn't we collect more taxes by reducing them rather than placing sanctions, even if done fairly?

- Both ways are correct. Today the tax burden is not heavy because of rates; it is heavy because of payment deadlines. Besides, our taxation system today imposes taxes upon expenses, which is not cor-

rect. As for the VAT, I think we could reduce its rate. Simply as far as we have not adopted the ideology of a consumer country, we are obliged to take the CIS rates, particularly those applied in Russia.

- Listening to you speech I had the impression that the line of the government may change soon. Is that correct?

- The line of the government, as far as the economic reforms are concerned, has been constantly changing for the last six years. But the main fundamental elements, I hope, will not change. One thing is certain: an enterprise must be managed privately not by the state. This approach cannot be changed. Certain things will be changed in the course of the time, not because the policy will change, just because we learn constantly. Today it is difficult to evaluate the actions that are taken. Of course, there were many errors that have to be corrected. It would be catastrophic to change diametrically the main directions, discard the achievements and try to reverse the process of the most important thing, privatization. If there is such a drastic change, I will resign from the Cabinet immediately.

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