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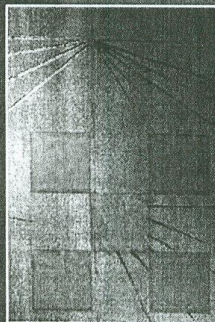
Trends of Economic Development in Armenia

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After the collapse of the Soviet Union Armenia has, above all, faced the challenge of economic viability on its path to a free market. The current state of the economy and the prospects of economic reforms have been greatly determined also by the social, political and human factors unique to the country, such as an economic blockade by the two neighbouring countries, consequences of 1998 earthquake, the country's geographically landlocked position, continuing conflict with the neighbouring country, and deficiency of critical natural resources. It is against this scenario that we discuss several economic reforms and the state of economy in Armenia.

One of the first steps Armenia took towards a market economy was the change of the ownership structure by increasing the share of private sector - i.e., privatisation. Already in 1997, 75% of GDP were produced by the private sector.

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As of June 2000, of 2073 medium and large-size enterprises approved by government decree for privatisation, eight are in process of privatisation, 326 have failed to be privatised, and for 1533 privatisation has been completed. (As for the dynamics of privatisation, 1460 enterprises were privatised in 1998, 1514 in 1999 and 1533 by June 2000).

The speed of privatisation in Armenia has differed across sectors of the economy: Armenia was the first of the former Soviet republics to privatise land within a very short time period, and now 90% of it is privately owned. Privatisation of state-owned enterprises has been more gradual. However, almost no (further) investments have been made to re-structure these enterprises and these enterprises do not adhere to hard budget constraints. Only 10% of the large and 25-30% of the small and medium size enterprises function at their full capacity.

In Armenia price liberalisation shocks proceeded in four stages. First, fuel-energy and raw material prices were raised to international levels. Later followed price increases on most goods and services, and eventually (in 1994) - on bread, electricity and medicine. The government plans to continue a price liberalisation policy and elimination of controlled prices such as for bread, heating, house rents, public utilities, and to keep control of only a few food items. But, in order not to aggravate social hardship, the government continues to subsidise also public services, public construction and urban transportation.

De-monopolisation of the economy and the creation of a competitive market go hand in hand with the price liberalisation in a market oriented reform. De-monopolisation process cannot be considered completed in Armenia. It is difficult to give official estimates in this sphere, but there still is a monopoly in such businesses like cigarette production, telecommunication, import of gasoline and spirit, and the print and its distribution industries (the latter two are state monopolies).

Fiscal responsibility of the government is one of the critical preconditions of successful transition. Based on various estimates we can argue that one of the less successful points of the government's economic policy has been and remains its fiscal responsibility. First, the state is running a big, annually increasing budget deficit: In 1998 the deficit comprised of 2.1% of GDP, in 1999 it had reached 5.7% of GDP, and this year de facto deficit approximates 8% of GDP.

The external debt of the government is growing at a fast rate as well, approaching the 50% permitted limit: In 1998 the debt outstanding comprised of 38.9% of GDP, in 1999 - 45.4% of GDP, while only for the second quarter of 2000 the estimate is 44.5%. The other part of the government's fiscal responsibility is an effective tax system, which includes both the discipline of collecting taxes and the optimum tax rate. One of the staggering points in the economy is optimal tax collection and the size of the shadow economy. First, no considerable change is observed over years in the share of tax revenues in

GDP: In 1998 the share of tax revenues in GDP was 16.6% (total revenue/GDP ratio was 18.1%), while, in comparison, the mean for CEE countries for the same year is estimated to be 25%. In 1999 total revenues comprised of 17.1% of GDP, with tax revenues comprising of 85.1% of total revenues, in 2000 total revenue/GDP ratio is 20.1%. The reason is the large tax gap or tax arrears - i.e., potential taxes not collected, that have lingered over the years. In 1998 tax arrears equalled 35 billion Armenian Drams (AMD), in 1999 this figure increased to 48 billion, while by the 2nd quarter of 2000 it has mounted to 53 billion AMD. In 1996 the size of the informal economy in GDP was estimated to be 52% (while 28% and 39% in CEE and NIS countries.) Some high-ranking officials of Armenia report that currently about 40% to 60% of the economy is in the informal sector.

Small and medium size businesses in Armenia complain about unfavourable tax rates, stating that they cannot be profitable if they fully pay taxes. "A considerable number of enterprises (65-70%) hide, or intend to hide more than 50% of their income thus indicating an expansion of the shadow economy".

Finally, a country transforming to a market-oriented economy should have a sound social safety net, since the collapse of the economy, privatisation, liberalisation of prices, etc., have created a huge army of vulnerable social groups. The social safety net can hardly be estimated as adequate in Armenia, and poverty is a serious concern and problem for the country. The

government has recently changed the social payment system into a unified monthly payment on family basis (The various types of social payments in the past - unemployment assistance, payments to orphans and single people, payment to single mothers, are abandoned for the new system of poverty allowance). This money is however negligible and cannot alleviate poverty in Armenia. Today 80 to 85 % of the population in Armenia are on or below poverty level (90% of the population consider themselves socially vulnerable). The real unemployment level is from 25% to 28%, if we consider the hidden unemployment level as well. The level of underemployment (especially in the public sector) is very high, and there is great social-economic polarisation: 90% of the country's private wealth belongs to less than 10% of the population. Average monthly wage is half than is necessary for the minimum subsistence level calculated to be 50 - 60 USD.

Although economic reforms have been put into execution in the country, it is difficult to make future predictions as to what are the economic perspectives of Armenia. The low level of investments that could have a catalytic effect on the economy persists in a situation of high level of unemployment, underemployment and poverty, increasing budget deficit and outstanding debt. The govern-

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ment faces a fiscal dilemma and coping with it will need the effective implementation of *comprehensive steps*—which basically means working out a comprehensive package of an economic policy. However, such policy can be effective only if it is tuned by similarly comprehensive political reforms towards a free and democratic state that practices strong Rule of Law and Human Rights. This is the guarantee for the success of economic reforms today and a strong economy in future. No doubt such a foundation has been laid by Armenia's accession to the Council of Europe this year.

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