

ARMENIA'S PARTICIPATION IN THE GLOBALIZATION PROCESSES

Arsen VARTANIAN

*Third Secretary of the Department of
International Organizations,
Ministry of Foreign Affairs of the Russian Federation
(Moscow, Russia)*

Integration of the Republic of Armenia (RA) into the global trade and economic system, which began after 1991, is proving to be a far from smooth process. Its main focus is carrying out targeted reforms aimed at liberalizing trade conditions, opening up markets, and creating conditions for free competition. The steps taken have brought the country's economy closer to the standards of the World Trade Organization (WTO) and prepared the way for the republic's entry into this international structure. For example, a great deal of preparatory work has been done to improve the legislative base in the economy and in trade in keeping with WTO requirements. This preparatory work has been especially aimed at creating propitious conditions for equal competition, the development of small and medium enterprises, and the protection of domestic markets, as well as at encouraging anti-dumping measures. What is more, significant changes have been introduced into the Customs Code and legislation on the protection of intellectual property rights.

On the whole, Armenia's entry into the WTO has been difficult and rather painful for its transitional economy. It progressed slowly and had to surmount obstacles along the way, including those raised by certain public officials and the parliamentary opposition. Nevertheless, on 10 December, 2002, the WTO General Council in Geneva officially approved Armenia's membership in this organization. All that remains is for the republic's parliament to ratify the membership protocol. Thirty days after the WTO secretariat sends official notification that this procedure has been successfully concluded, the country will automatically become a full-fledged member of the World Trade Organization.

The RA believes that membership in the WTO will fortify its legal framework and market mechanisms aimed at ensuring its participation in international trade. What is more, after receiving the status of most favored nation, the republic will have the best guarantee of its access to the world economic markets, which, in particular, will make it possible for it to significantly increase export to the WTO member states due to the removal of trade barriers. At the same time, the country's investment climate will improve and the activity of foreign investors in various segments of its economy will increase.

As we have already noted, the transition to integration into the world economic system has been rather agonizing for Armenia. Shock therapy, which began with a devastating earthquake (at that time 25,000 people were killed and 500,000 were affected in some way or another) and the Nagorno-Karabakh conflict, damaged the republic's economy. The high inflation and abrupt rise in consumer prices which resulted from this put the total GDP in 1993 at no more than 50% of the same index for 1990.

In 1994, with the international community's support, the RA government began carrying out large-scale stabilizing measures. Since that time, intensive structural reforms have been conducted in the country: the currency system has been liberalized, state agricultural land, state companies, and

state enterprises have been privatized, and the financial and tax spheres have been reformed. Along with this, the state's role in the national economy has changed, free trade conditions have been introduced, trade barriers have been lowered or eliminated altogether, and measures have been adopted to make the national currency convertible the national currency and set a floating rate for it. The main tasks of the stabilizing reforms—to achieve stable macroeconomic indices, raise economic efficiency, and so on—have basically been accomplished. For example, during the last 10 years, growth has constituted an average of 6%. An abrupt rise was seen in 2001-2002, when it was equal to 9.6% and 11%, respectively, but then it fell once more to 6%, while between 1998 and 2001, inflation did not exceed 3%. The main guarantors of these achievements were agriculture and the light industry, the significance of which after the collapse of the Soviet Union and breakdown in traditional ties between the republic and other post-Soviet countries dramatically grew. The food industry, construction, the extraction industry, and the production and processing of precious metals have been undergoing dynamic development. But at the same time, the percentage of heavy industry has proportionally dropped.

The privatization which began in 1991 primarily affected the land and housing spheres. In this area, Armenia became the first CIS state to successfully complete the privatization of farm land (1991-1993). By 1999, almost 330,000 private farms (the average size of each amounting to about 1.2 hectares) were created in the country. They helped to resolve the food problem, that is, the republic's demands for agricultural products have been covered and favorable conditions for their export abroad have been created. In 1995-2001, the annual increase in this area amounted to 4.5%, even despite the drop in its share in the country's economy from 44% in 1994 to 25% in 2001.

The Law on Privatization and Demonopolization of State Enterprises and Incomplete Facilities adopted in 1992 formed the legal basis for privatization. By 1998, approximately 70% of small and more than 60% of medium and large enterprises were transferred to private owners. Vouchers circulated freely on the market right up until this program was completed (1998), and their market cost did not exceed 30-40% of the nominal. In 1998, a new law on privatization was adopted. It set the general pattern for this process and designated its main tools and principles, including ensuring equal competition in this area and attracting investments. These measures made it possible to either sell or hand over the management of several large enterprises and companies to foreign investors.

After 1998, the privatization process slowed down a little. The reason for this was the absence of efficient markets and developed infrastructure, the weakness and underdevelopment of the banking system, and other factors. Nevertheless, according to the data for 2000, 83% of medium and 90% of small enterprises had already been privatized in the country. The main target of this process was the energy sphere: unprofitable state enterprises were liquidated, and the infrastructure was gradually transferred to private owners. By 2002, privatization in this area was completed. Largely due to the timely launching of this mechanism, power engineering, which has always been considered a strategic industry in the republic, became a well-established system by 2004 with set market rules and began to bring in profit (for example, in 2004, the country produced more than 6.5 billion kilowatts of electricity, 5.78 billion kilowatts of which were used for domestic needs and 704 million kilowatts were exported).

Before the stabilizing programs were launched, the fiscal system was in a pathetic state: according to some data, in 1993, the budget deficit amounted to 54% of the GDP. It was partially covered by funds allotted by the republic's Central Bank. In 1992-1996, tax reform was carried out which ended in the adoption of a law (1997) regulating the tax sphere and laying the foundation for the formation of a contemporary tax system in the country. This made it possible to increase the corresponding revenue into the state budget: its percentage in the GDP increased from 10.9% in 1994 to 14.4% in 2001.

What is more, there was also a qualitative shift from direct to indirect taxation. As a result, in 2001, the budget deficit was reduced to 4.3% of the GDP (at the beginning of 1992 it was more than 50%). But dependence on foreign financing drastically grew: in 2001, more than 65% of the budget deficit was covered by foreign investments, as a result of which the country's foreign debt increased, reaching 905 million dollars (more than 40% of the GDP) in the same 2001. More than 75% of this sum constitutes debts to multilateral creditors (transnational companies, transnational banks), and 25% to states. In so doing, the RA received approximately 78% of its loans under concession conditions, which makes it easier to pay back debts. Targeted redistribution of loans was organized as follows: financing structural macroeconomic and social reforms and investing in specific projects in power engineering, agriculture, construction, and transportation.

The country's leadership began carrying out an independent monetary policy in 1993 after introducing its national currency (the dram) into circulation. At this time, the republic's banking system was not stable: the Central Bank's currency reserves could not ensure stability of the national currency, the macroeconomic situation was complicated, and the country was experiencing hyper inflation. But as early as 1995, the Central Bank was able to take inflation under control and stabilize the currency exchange rate. However, at that time (at the initial stage) the Central Bank's possibilities were extremely limited: it could only operate on the currency-exchange market and, later, on the credit market. Only after 1996 did the Central Bank have the opportunity to use market tools to control the country's currency market, as well as coordinate fiscal and monetary policy, which had a favorable effect on the interest rate: in state banks it dropped from 56% in 1996 to 18.7% in 2001.

In 1994, reform of the financial sphere began. Its goal was to consolidate and restructure the banking sphere, increase the capitalization of banks, and improve the legal foundation of activity in this sphere. Much was achieved in practice: fundamental laws were adopted regulating the activity of banks and delegating the country's Central Bank broad control powers, and the minimum threshold for bank capitalization was set (beginning in July 2005, a bank's capital could amount to no less than 5 million dollars). The Central Bank was able to react more efficiently to the situation, including with respect to so-called problem banks. Foreign banks gained access to the national market for the first time, and widespread privatization of the banking system was carried out: today there are 28 private banks in the RA (the last state bank was privatized in 2001). But this system is not developing as quickly as might be hoped. Banking reserves are no higher than 17.5% of the GDP, and the percentage of its private crediting is equal to 8%. The reason is insufficient capitalization of banks, the slowdown in legal reforms, and the underdeveloped system of banking credits.

The economy's dependence on export, which is largely for political and geopolitical reasons, has created prerequisites for increased activity of the country's leadership on the international investment market. The republic is striving to liberalize trade as much as possible by strengthening the legal foundations of its relations in this sphere with foreign states. Free trade conditions are being applied in the RA's relations with its main CIS partners (Russia, Ukraine, Georgia, Kyrgyzstan, Turkmenistan, Moldova, and Tajikistan). As a WTO member, Armenia has achieved most favored nation treatment in trade with several states. The liberalization of foreign trade conditions and the establishment of a floating exchange rate have made it possible for the country to join Art 8 of the Agreement on the International Monetary Fund.

There is a standard import tariff rate in the RA (two tariffs have been instituted—0% and 10%), but certain restrictions are envisaged here. They were introduced with respect to dual-purpose commodities (arms, drugs, nuclear materials), as well as for environmental, health care, and security considerations. Export goods are not taxed, with the exception of sensitive materials (explosives and radioactive substances), but the export of textiles to the European Union countries is licensed.

During recent years, the increase in import greatly exceeded the increase in export. In 1998-2001, the rates of the first amounted on average to 11.3%, and of the second to 0.4%. During this time, the balance deficit reached 9.5% of the GDP, it decreased a little by 2002 (to 8%), and in 2003-2004 to 6.6% and 6.1%, respectively. These results were reached on the basis of higher export growth rates than in previous years. Compared with the first post-Soviet years, the export structure had essentially changed. The main export articles are diamonds (36%), agricultural and food industry products (14%), and electric energy and ferrous metallurgy (12%).

The attraction of foreign investments, particularly from the private sector, is a key element of the republic's economic policy. For this purpose, it gradually eliminated tax-fiscal, administrative, and other restrictions which interfere with attracting private capital, and additional measures were carried out to improve the investment climate in the country and reduce the risks for investors. They include the above-mentioned widespread privatization of state enterprises, the development of infrastructure, and the increase in competitiveness of export products.

The results of these efforts are as follows: between 1991 and 2001, foreign capital (more than 900,000 dollars) was invested in the development of more than 2,000 private companies. These funds mainly came from Russia, several EU countries, the U.S., Canada, Iran, Syria, and Lebanon. A special feature of foreign investments in the RA is that most of their owners are representatives of the Armenian diaspora. What is more, the republic receives donor assistance from international institutions. Between 1993 and the present, the International Monetary Fund, World Bank, European Bank for Reconstruction and Development, and other organizations pumped a total of more than 800 million dollars into the Armenian economy. Here it is worth noting that whereas in the first years investments were mainly made in trade, recently they have increasingly been going into industry and the service sphere. (For example, in 2001, more than 50% of these funds were invested in industry, 40% in the service sphere, and 8% in trade.) What is more, foreign investors are attracted by the mining industry; between 1991 and the present, around 200 million dollars have been invested in the development of mines.

With the adoption of the Law on Foreign Investments in 1994, the republic declared an open doors policy in this sphere. According to western experts, Armenian legislation in investments is one of the most progressive and liberal of all the countries with a transitional economy. A noteworthy feature of national investment legislation is the absence of double standards in regulating direct investments by foreign and local investors with respect to restrictions in such areas as the environment, security, employment, and health care (a non-discriminating approach is used with respect to foreign investors). If unfavorable or unforeseen circumstances arise, the state guarantees the private investor full compensation of the funds invested. In so doing, there are no restrictions on full conversion or return of capital, including profit, dividends, interest, and revenue obtained from this capital, as well as taxes paid.

In order to attract foreign investments into the country, the RA has signed corresponding bilateral agreements on their stimulation and protection with more than 30 states, and similar agreements with another 25 countries are being drawn up. Along with this, Armenia is a participant in the International Convention on the Settlement of Investment Disputes and a member of the International Center for Settlement of Investment Disputes.

Globalization has had a great impact on the development of the republic's social and human resources. The transition to a market economy has given rise to the need to reform the social sphere, as well as to resolve questions relating to the protection of civilian rights and freedoms and to the standard of living and prosperity of citizens. The need has arisen for granting social guarantees, helping the population adapt to the new labor conditions, and protecting the most vulnerable social branches—health care and education. But despite the steps taken, the transition to a market economy has

proven excruciating for the social sphere. Only in recent years has the situation improved slightly: according to the human development index for 174 countries, the RA has moved up from 103rd place (1995) to 76th (2002).

Unemployment is the main social problem rearing its head as the republic becomes integrated into the globalization processes. In 2001, its level topped 15%, and in 2003 even reached 20%. In so doing, women constituted 64% of the unemployed, and those aged between 30 and 50, that is, the most economically active part of the population, made up 60%. In order to resolve this problem (and unemployment as a whole), the government hopes to organize special courses to retrain and provide people with professional skills, help small businesses to thrive, institute a program of social assistance for the unemployed, and improve the development of the labor markets in the country.

Unemployment issues are directly related to another inevitable consequence of globalization, the migration problem. For a country with a small population, the latter has become a serious test, between 1991 and 2001, more than 800,000 people left the republic (over 25% of its residents). According to the data for 2001, the number of workers amounted to 1.4 million people (45% in agriculture, 25% in industry, and 30% in the service sphere). The main reasons for such mass migration are the low level of income and the lack of protection of social and civilian rights.

Impoverishment and poverty of most of the population stand out among the social problems. The 12-year program to combat poverty (2004-2016) adopted by the government envisages reducing the poverty level from 50% to 19%. After its endorsement, several positive indicators appeared in the country, which made it possible to hope for a gradual solution to this problem. Most important, in 2004, employment in labor-intensive production branches increased and the labor market in construction and agriculture became livelier, which made it possible to lower the unemployment level by more than 10% in 2001 and 9.8% in 2003, as well as increase average wages (in 2004, they rose by almost 30%).

The problem of poverty has created another negative factor—it has promoted the spread of HIV infection in the country. Whereas in 1995, there were three AIDS victims in the republic, by 2000, this number had jumped to more than 1,500.

Another headache is corruption of the state system. Despite the achievements in carrying out liberal-democratic reforms (RA legislation in this sphere is recognized as one of the best among the CIS countries), corruption is hindering advanced development of the national economy.

As for inflation, it has never been one of the most serious problems in Armenia. 2004 was probably the tensest year, when the inflation level rose to 7%. Especially since this proved to be totally unexpected—experts had forecast a drop in inflation growth rates from 4.7% in 2003 to 3% in 2004. But this did not happen, since the increase in world food prices in 2004 stimulated an abrupt jump in bread prices in the country, which led to such a dramatic rise in inflation. All the same, the forecasts for the future are comforting: specialists predict a smooth drop in its level.

The market reforms in the country and its integration into the globalization processes on the whole are going successfully, but in so doing the republic is feeling both the positive and negative sides of globalization. Most experts believe its possible negative consequences to be Armenia's final registration as a member of the WTO (as we mentioned above, all that remains is for the republic's parliament to ratify the corresponding agreements), which will inevitably provoke a rise in price for the country's agricultural produce. This rise has already begun (since 2002, prices have risen on average by 10%). All the same, according to several economists, this jump will soon be partially compensated for by an increase in the overall investment attractiveness of the country's economy. The prognosis is such: thanks to the liberal legislation with respect to foreign investors, their activity will rise, which will make it possible not only to retain the republic's export status, but also reinforce it (mainly by means of diamonds and agricultural produce). But there are also several

unresolved problems in this area, first and foremost, an integrated competitive environment for local producers and importers must be created.

It is worth noting that compared with other CIS countries, Armenia on the whole has pretty good indices. For example, in 2004, the volume of its GDP (in terms of value) amounted to 11.79 billion dollars (the per capita GDP is 3,500 dollars), and the real increase in the GDP is equal to 9.9%, whereby in agriculture, it is 23.4%, in industry, 35.1%, and in the service sphere, 41.5%.

Experts say that the initial, most difficult, stage in the RA's integration into the world economy is over, but long and painstaking work lies ahead to further improve the legal base, reform the financial, tax, and banking systems, and optimize industrial production and the trade and service spheres. But the main vector of these processes is entry into the World Trade Organization. Among the main achievements of recent years, economists note liberalization of trade conditions, privatization of the state sector, development of private business, lowering of administrative barriers in foreign trade, creation of a favorable investment climate, institution of a stable national currency, and reform of legislation in the trade and economic sphere.

According to the evaluations of many experts, in the mid-term, the republic's economy can expect slow, but most important, sustainable development (with progressive growth in its main indices). The smooth drop in GDP growth rates noted since 2003 will continue (in 2003, indices in this sphere amounted to 13.9%, in 2004, to 10.1%, in 2005, according to preliminary data, to 6.5%, and in 2006, according to forecasts, they will be equal to 6%). But this process, according to the same experts, will not be of perceptible detriment to the country's economy, since it will retain a firm foothold with respect to other indices.

In recent years, there has been quite a low and steady inflation level (in 2003, it amounted to 4.7%, in 2004, to 7%, and according to preliminary estimates for 2005 and forecasts for 2006, to 2.6% and 3%, respectively), as well as a stable national currency exchange rate (between 1996 and 2003, it fell by a total of 20%, and by 2004 had risen again by 5%). What is more, significant progress in the financial sector is expected. The banking segment of the economy, despite its modest dimensions (there are no more than 10 large banks functioning in the country), will operate quite efficiently. Experts predict successful development of the RA's regional economic cooperation, particularly with CIS countries. The republic is an active participant in sub-regional and regional integration groups, including within the framework of the CIS structure, the Black Sea Economic Cooperation Organization, and others. Retention of a favorable investment climate will be assisted by the above-mentioned large-scale privatization of the state sector. What is more, in the next few years, an increase in the inflow of foreign investments is expected, which should be promoted by diversification of the economy, as well as further development of its leading branches: the electronics industry, diamond processing, the pharmaceutical industry, and machine-building. It is important that these branches are already pretty competitive on the world markets. But there is significant reason for anxiety: the abrupt drop in growth rates of industrial production from 14.9% in 2003 to 2.1% in 2004. This collapse was related primarily to the significant reduction in diamond processing of 17%. But specialists forecast a two-fold increase in the indices in this sphere by 2009. What is more, against the background of the industrial slump, other important spheres of the economy are successfully developing. This particularly applies to agriculture, where in 2004 growth constituted 14.5% (in 2003, it was only 4%).