

The transition in Armenia had some distinctive features. The transition towards free market economy may be divided into three main categories.

1. Public/private sector relations;
2. The institutional bases of the market economy;
3. Social safety: Poverty problem.

Let us review them.

### **1. Public/Private sector relations**

Here we should first of all refer to the privatization process in Armenia, the past and present issues. The whole privatization process can be divided into two stages. The first stage, which in essence can be called a quantitative stage, had to deal with politically-related tasks. Both in Armenia and other former Soviet Republics the main goal of the privatization process was not a greater efficiency of enterprises or creation of new market entities. The idea of was to get rid of public ownership as soon as possible. And that was natural. There was a transition from one economic system to another one based on totally different principles. The privatization process came to ensure irreversibility of the adopted free-market relations.

The second stage of privatization launched from 1997 may be called qualitative. One can see a rapid drop in the pace of privatization and changes in approaches to and methods of expediting this process. Thus there were different priorities of economic development, financial and economic stability was already ensured. It was time to think about rapid economic growth. The new approaches to economic development emphasized the quality of the privatization process.

The quantity of privatization transactions carried out on a competitive basis has since increased. Thus a single case of privatization is simultaneously a step towards economic development, increase in productivity and a solution to social problems. This privatization stage is also distinctive by the influx of foreign investments. This type of privatization also ensures the achievement of the next goal of privatization strategy: the focus on transaction prices allowing to make funds for implementation of programs directed to economic development. While positively evaluating the main results of the second stage of privatization we need to move to the third stage, which is privatization through the capital market. Perhaps, in this stage we are already late.

In terms of further expansion of the privatization process and involvement of different strata of the population, the privatization of big and medium-sized public enterprises in the form of open joint stock companies is imperative. This type of privatization has its advantages. Shareholders in joint-stock companies interested in such privatization would significantly expand the social basis of privatization, thus contributing to the successful implementation of the overall process. The problems facing the existing capital market and efficient privatization in many cases are interconnected.

It is well known that among the targets of privatization policy are greater economic productivity and creation of necessary conditions for the formation of a stratum for successful owners. The achievement of these goals is almost impossible without a capital market acting as a bridge between entities presenting supply of financial

recourses and entities presenting demand for those recourses. What is more, the capital market may become a venue for the efficient fulfillment of the core privatization process, especially when the RA Legislation stipulates this kind of privatization.

So it is obvious that the maturity of modern business methods in Armenia no longer has any alternative. Everyone owning even a single stock of any company should feel a real owner and should play his part in pushing that company to work in an open environment and to become transparent in order to monitor ongoing developments. The developing capital market for its part should not only play a major role in boosting the privatization efficiency, but also should create real conditions for supporting enterprises' post-privatization activities and implementation of new investment projects.

In the current state of public/private sector relations we also need to focus on the issues of governance which involve numerous problems. Let's begin with the effective use of private property. Obviously along with the privatization process the state should ensure all necessary conditions for the efficient operation of the private sector. While the goals identified for separate periods can be considered mainly achieved, the same cannot be said for the business-friendly environment. The de-facto protection of property rights, proper legislative framework and existence of independent courts could be considered the necessary institutional basis, which is a precondition for free business, and economic development in any country.

From this point of view it's useless to insist on functioning of the simplest scheme of property right protection, which is: every business entity should possess certain rights and be entitled to transfer /sell/ them to any entity be it individual or business. Corollary to this he can apply to the court in order to get a compensation for the duly income. At first glance, everything in this pattern is clear and easy to fulfill, especially within the framework of the RA legislation. Yet in practice, we always face with serious problems in any point of that chain.

Let's look at the issue of efficient use of the ownership in some important sectors of the economy.

### ***Infrastructures***

The development of infrastructures (energy, irrigation and drinking water supply, roads, aviation, communication and telecommunication, heating) as a key precondition for business promotion is far from being ideal. We failed to attract considerable investments into this sector. Moreover, taking into account depreciation of the system and poor management, the poor state of infrastructures will become obvious. Initially it is necessary to organize separation of different functions and the property rights.

The state strategy in this sphere is to gradually reduce its role in infrastructures' management by retaining only regulatory functions. The managerial function together with the property right is transferred to the investor.

This approach helped to overcome the difficulties of the energy crisis and not only meet the country's energy needs, but also to export electricity to the neighboring countries. The power stations were separated from the electricity transferring companies, and those companies were separated from the distributing network. Market mechanisms began to function in the sector, leaving the state only responsible for tariff regulation and fair competition.

The logical continuation of this policy is supposed to be further privatization and investments by owners themselves. Considering the huge amount needed for

investments in infrastructures, the private investor would agree to act on these terms only if a clearcut management system is in place.

Today, one of the key issues in the sphere of infrastructures is to draw a clear line between public and private ownerships. Something which has been overlooked up to now. The RA Government should come to a final decision what to privatize in the sphere of infrastructures and what to keep under the public ownership by the clearly defined principles, then make an announcement, in order to clarify the situation in this issue.

### *Social Sphere*

In the context of Public–Private relations it's worth mentioning also problems facing the social sphere. Here we still have too many problems to address. It is certainly acceptable that a state, especially in countries like Armenia, will guarantee a minimum set of public services. This was repeatedly declared in our country. Anyway, currently there is no final definition of what such a set of minimal services means, what it includes. The society as a whole is not well informed what kind of assistance it may expect from the state in the field of services. This is true both for health care, education and culture.

The next problem refers to the ownership and management aspect of the issue. We are not clear about what will be passed to the private ownership and accordingly what might stay under the public ownership. The importance of the matter is first of all stressed to enhance the predictability of the government policy and thus it is placed among the top priorities.

Besides the problem of government assistance we have problems also in the sphere of governance. The most serious and poor outcomes of the divisions of functional and governing agencies are likely to exist here as well. For example, every doctor also acts as a "cashier", a "manager" and so on. So we can not further postpone the spread of the traditional methods of management over the existing system. Anyway it may be necessary to show a sound example of privatization of management function to showcase some success stories to the public.

The low level of management ethics and traditions in enterprises is a big challenge today in Armenia, which decreases efficiency of private ownership.

Today it's getting more and more apparent that success of the privatization process in Armenia mainly depends on maturity of the private companies. Yet transfer of the property right to the private sector is not enough to ensure economic growth. There are some problems to be solved, such as introduction of new approaches to management. It's a tricky problem to solve, as it is related to people's capability to accept the reality.

The experience of the first half of 1990s came to prove that the managerial functions' transfer to the private entrepreneurs wasn't enough to ensure the enterprise restructuring in Armenia. Mostly the previous chiefs used to buy the enterprises, having no idea of future development trends. The administrative personnel often remained conservative, because the heads of companies stuck to the ideology of the centrally planned economy. And the new managers primarily cared about their own revenues brushing aside any investment initiative.

Enterprises restructuring, also responsible for the quality of the privatization process, begins with retraining of the personnel. This was proven by the experience of Japan and West Germany. In 1997 at the initiative of the first president of the Russian Federation

a huge group of future managers /3000 people/ were sent to the USA for retraining. Armenia should do the same thing.

Another problem is corporate governance. Along with protection of owners and stockholders' rights separation of company's managerial functions also plays an important role. The fact that the owner and the manager of a particular enterprise are different persons is strange rather than normal for our society. The world experience comes to prove the advantages of corporate governance. The owners of most Armenian companies don't seem to understand whether they are owners or managers. It becomes a rule, because of the colossal number of companies with one single stockholder. As a result, the introduction of new technologies and methods of corporate governance in Armenia is being delayed. So the role of the capital market to play in the companies' privatization is undeniable and is considered to be a new trend in the privatization process.

The clarification of the state's regulative function is another major issue. Reforms carried out in Armenia have never presumed decentralization of regulative and supervising functions, though there were such elements in the reforms. It was particularly reflected in the court reforms, when the criminal cases were separated from the civil ones. The tradition, inherited from the Soviet period, of imposing a strict regulation of relationships and supervision on the state level is still alive in Armenia. Therefore the state's regulative function is pushing aside the incentives of business entities' actions. When there is a function to be regulated, then first of all the direct participants are interested in setting and applying regulative and supervising methods. Therefore the conclusion to reach is the state's gradual transition from the position of the main participant in the economy to the position of its regulator. But the regulation in its turn should necessarily consider the incentives and behaviors of private entrepreneurship.

## **2. The Institutional Bases of Transition**

The fundamental principles of democracy, which in practice can be specified as absolute values, should become deeply rooted in the day-to-day life of people. Therefore, within an environment of a newly created democratic system, they are extremely fragile. Here, the main role of the state should be to implement social and legal measures, with the view of strengthening these values.

I think that those were the objectives with crucial importance, which should have been addressed and achieved during the aforementioned period, i.e. starting immediately after the parliamentary elections in 1995. However, I have to admit, that until now our state didn't manage to fulfill this task. We should definitely try to identify those main reasons, which continue to serve as an obstacle, and only then to outline the plan of future actions.

So, which were the obstacles? There were three of them.

The first and foremost is that until now, the state and the authorities failed to turn the Society into a participant and a supporter of political, economic, social and institutional reforms. Furthermore, by focusing exclusively on the problems of creating and consolidating the public system, our governors have been almost ignoring the objectives which were necessary for establishing and consolidating the new state and, as a result, today we don't have an organized society, which would serve for the strengthening of democratic values and creation of a modern civil formation, would be protected by the state, recognize the priorities of national development and introduce its claims to the

state. Accordingly, our priority should be a greater focus on the formation and consolidation of a new society, without weakening the state and its development.

The second reason for our failures was the negligence of the necessity to harmonize political, economic, social, legal and institutional reforms implemented in our country.

Actually, while carrying out mass privatization, our country failed to create mechanisms for protecting private ownership rights and their transfer. Legal reforms lagged at least 4-5 years behind economic ones, as a result of which the legal framework for protection of private ownership was established only in 1998 and became effective in 1999, while privatization started from 1992. It is natural that during such a short period, the legal framework could not totally protect private ownership.

During the process of mass privatization, the state didn't establish the necessary institutional structures serving a market economy. Thus, until now, in Armenia we don't have a predictable and a regular market of land and real estate. The system of insurance is in an absolutely poor condition, the mechanisms of private investments and pension funds have not been established, the banking system is not sufficiently capitalized and does not seem to understand challenges of future development, and the process of privatization is based not on stock exchange mechanisms and possibilities of attraction of additional capital through issuing new securities, but on the old system of privatization which is totally inconsistent with our current targets.

The third main obstacle for establishing a democratic society is the failure to reassess the role of the state.

In fact, during the period of independence, our country failed to ensure the transfer of the role of the state from an immediate participant in economic relations and activities to a founder, regulator and supervisor of economic relations. There are still many areas where the framework of economic activities is not regulated, free competition is not ensured and the Government is not willing to give up its control of various economic activities. While, being an immediate participant of these processes, it can not totally safeguard interests of private owners.

Besides, this situation is the main cause of the existing rampant corruption. Our country did not establish public executive bodies, which could restrict the role of the state in economic transactions – like an anti-monopoly agency, an institution responsible for bankruptcy and financial rehabilitation, or an agency responsible for restructuring the state-owned companies. The procedures for management of Armenia's natural resources have not been adopted, and such crucial laws such as "Law on Concessions" have not been enacted. There is a strong opposition to privatizing such monopolistic sectors as the energy sector, transport, irrigation and drinking water.

One of the major prerequisites for changing the role of the state is the need to strengthen the role of local governments. Disputes relating to powers of municipalities and communities are common. Sooner or later we should acknowledge that creation of powerful local communities is one of the priorities of the state, and should appraise the performance of municipalities and mayors based on their willingness to delegate to communities their authority to manage subordinate sectors or, in other words, to curtail their own powers.

In addition, we didn't manage to change the role of the state in terms of enacting and enforcing laws and court decisions. We have numerous democratic laws, the implementation of which is not ensured by the existing state structures, whereas a fair and a consistent implementation of laws on a day-to-day basis is one of the major tasks of the state.

Thus, we identified the main three obstacles for setting democratic values. The first is the neglect of the society. The second is the neglect of processes, which accompany and coordinate the reforms. And the third is the neglect of the urgent need to reassess the role of the state.

Which are the ways for overcoming these obstacles? There are two of them.

1. During the process of the formation of a civil society, we should be able to ensure the mechanisms of consolidation of the society so that people who have specific ideas, preferences and professional interests can consolidate their approaches and extend their social orders.

For example:

- One of the major prerequisites for the consolidation is the formation of political parties, a goal, which has not been realized in Armenia. Political parties have not become ideological formations, but have rather turned into a tool for adjoining the influential leaders and obtaining some important leverages;
- Public organizations, public opinion and media were not prepared sufficiently in order to serve as an efficient mechanism for expressing interests of the society, a major function of the state;
- Even in labor relations, the objective of consolidation has not been achieved. In Armenia, trade unions continue to act in the spirit of the Soviet era, although today the state has ceased to be the sole employer. Furthermore, most of GDP is produced in the private sector. The state acts as an employer only in a small number of state-owned enterprises. In spite of this, trade unions fail to implement the necessary organizational and structural reforms;
- We were unable to improve the role of such structures as professional unions, organizations protecting interests of the consumers, etc.;
- Even in terms of condominiums, which are one of the most efficient ways for consolidation of society, we did not proceed further than taking decisions and adopting resolutions.

In other words, we really need to put a strong emphasis on the strengthening of the society by choosing mechanisms for a strategic implementation of public assignments and by making it easier for different groups of people within our society to express themselves.

2. Within the framework of public administration reforms, we should first of all concentrate on balancing the state system. Obviously, due to some objective and subjective reasons, some of the state institutions acquired excessive powers at the expense of the others. Having an environment of underdeveloped judicial and other systems, which are supposed to protect the rights of public organizations and people, today we have superfluous supervising, security and military structures. I think anyone would agree that the mechanisms for human rights protection and punishment should balance each other.

We should be able to ensure the full participation of the members of society in the process of state governance. We should be able to break the existing psychological complex, which is the result of election practices that we have evidenced during the last 9 years, and to regain peoples' confidence in its constitutional right of executing the power. One of our major omissions is that within the numerous relief programs we should have envisaged a possibility for technical modernization of the election procedure, with the view to raise the level of transparency. I am convinced that if we don't restore the lost confidence, we will lose the chance of building efficient state mechanisms.

### **3. Social Safety: Poverty Problem**

Poverty in Armenia has emerged, on one hand, following the dissolution of the Soviet Union, as a result of disruption of integrating economic ties with other Union republics, particularly with Russia, resulting in inactivity of enterprises and, on the other hand, set-off by economic blockade of the country since the beginning of the Nagorno Karabakh conflict.

Land privatization in 1991 to some extent alleviated the process of impoverishment in rural areas, but later on, owing to losses caused by bad weather and natural conditions (floods, storms, hail, freezing, drought, land and mudslides, etc) and as a result of inflation, considerable portion of rural households approached poverty line, while many plunged into extreme impoverishment.

The Republic of Armenia still belongs to the group of countries with low (below 765 USD) per capita GDP (which in 2000 in Armenia was 503 USD), falling behind countries with below average (766-3035 USD), above average (3036-9385) and high (from 9386 and up) GDP.

Being aware of how critical this issue is, government of the Republic of Armenia spares insufficient efforts trying to alleviate expanding poverty and lead the country out of the social and economic crisis through application of financial resources obtained from foreign states and international organization in the form of credits or humanitarian aid. To that end, credits and grants were mainly channeled towards creating principal market economy structures (structural reforms), while to coordinate the distribution of in kind humanitarian aid intended for the population (fuel, clothing, food, certain household items, health and hygiene products, etc.) the PAROS system was established by the Armenian Ministry of Social Welfare, which initially encompassed almost all households in the country.

However, due to unstable and slow economic growth, postponed results of structural reforms and a sharp drop in the amount of humanitarian aid, the government decided to revise the principles of compensations and allowances allocation, recalculate financial resources made available to various population groups through payments and transfers and reallocate them towards alleviation of poverty based on estimated degree of family impoverishment levels.

The idea in itself is good, because, first of all, a market economy does not accept a compensation system (I and II group handicapped, single unemployed pensioners enjoyed benefits and compensation payments towards rent, communal services, communications, electricity, water, gas and other bills, transportation expenses), and secondly, the sole fact that a person (or a family members) belongs to a certain social segment, is not enough basis qualify as a needy. As far as allowances are concerned, they are mostly given to children, single mothers, unemployed women with a child (children) below 2 years old, handicapped breadwinners, etc.

Allocation of compensation or other monetary allowances for the needy and the poor is not an effective way of poverty alleviation, especially with funds being so small. It is rather a state-undertaken measure aimed at somehow cushioning the almost insolvent problem of supporting themselves for families below the poverty line, and through that, by slowing poverty spreading, save time to implement measures to neutralize and eliminate major underlying causes of poverty, as these measures not only require vast financial resources, but are also very time-consuming.

The family allowances system was introduced in Armenia on January 1, 1999 by the November 19, 1998 Decree of the Government of the Republic of Armenia No. 727 "On the Creation of a Family Allowances System in the Republic of Armenia", which at the same time established the Procedure of Assignment and Payment of Family Allowances in the Republic of Armenia and defined a 5% quota of needy families in each community.

Summarizing our analysis of the launch and implementation of the family allowances system, we have come to the following conclusions:

1. family allowance system was launched in Armenia in 1999 with serious shortcomings (both in methodology and in administration) and rectifying measures implemented during the last two years have not produced the desired effect,
2. family vulnerability assessment methodology is in urgent need of correction and improvement,
3. it is high time a family allowance institute is established and assessment principles of family vulnerability degree are determined; the system made open, transparent, manageable and accountable,
4. if the operation of the family allowances system aimed at poverty alleviation is not accompanied by additional poverty prevention measures, dissipation of state budget resources allocated for family allowance system will continue accelerating deepening and spreading of poverty with all its social consequences.