



MINISTRY OF TRADE AND
ECONOMIC DEVELOPMENT
OF THE REPUBLIC OF ARMENIA



THE CONCEPT PAPER

SUSTAINABLE ECONOMIC DEVELOPMENT POLICY FOR ARMENIA

**Prepared for the “Sustainable Economic Development Policy for
Armenia” project**

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Introduction

This concept paper sets out a methodological framework and the main principles of a long-term economic development strategy to be elaborated for the “**Sustainable Economic Development Policy for Armenia**” Project.

The need to elaborate the strategy is dictated by a range of existing factors:

- The issues of the transition period- the establishment of stable macroeconomic environment, liberalization of trade and prices, privatization and formation of the legislative and institutional basis of market-oriented economy have been mostly overcome.
- The experience of developing, and particularly, of a country in transition shows, that the prevalence of the private sector, favorable macroeconomic and liberal legislative environment are only necessary, but not sufficient preconditions of economic **growth**.
- Several factors that conditioned the economic growth during the last years, especially, the state and private external transfers, enhancement of the utilization level of existing capacities, and import substitution cannot maintain their influence.
- Despite of the successes in exports and investments during the last years, their level, structure and tendencies cannot be considered as satisfactory.

The need to elaborate the strategy is also justifiable by the fact that in spite of several programs implemented and proposed by the government, particularly, PRSP, MTEF, SAC V and PRGF, in some degree dwell on the issues of economic growth, however, the direction, timing, the level of exploration cannot and do not correspond to the requirements presented to the program, which is intended to outline the long-term economic development strategy. From this point of view, it is more important, that the future program be examined and elaborated not as an opposition, but as an addition to the more general processes, which relate to the different areas of the country’s current socio-economic development.

The first chapter is dedicated to the main qualitative and quantitative goals of the program, which will characterize the levels of economic development. The second chapter presents a brief analysis of the main factors of economic downturns and upturns during 1990-2002, with special attention to those factors behind of economic recovery since 1994. The latest global economic trends are analyzed in the chapter three, so as to envision the likely structural changes in the global economy in the visible future. The following two chapters look at the main development potentials and weaknesses of Armenian economy and attempt to elaborate some basic principals for a long-term development strategy of the Armenian Economy. In the next two chapters the strong and weak aspects of Armenian economy are analyzed, as well as, an attempt is made to bring forward some basic principles for elaboration of the proposed program. The closing chapter suggests the structure for elaborating a long-term economic development strategy of Armenia.

Goals and priorities

1. Basic goal – Qualitatively the long-term development goal can be described as a transition from the category of low-income countries to the category of high income countries, in a maximum possible short period of time (for example, during the life of one generation).

2. Quantitatively this goal can be divided into several sub goals, where the most important one is to provide stable economic growth rates in a long-term perspective as the base for improving the quality of life, reduction of poverty and social development. For example, the annual average growth rate of GDP at 6%¹ will double the GDP in 12 years, at 7% – in 10,5 years, at 8% – in 9 years. Besides this, if we assume that dynamics of the poverty reduction remains as it was in 1999-2001², the level of poverty will amount 25,3% in 12 years with 6% growth rate, 19,2% with 7% growth rate, 12,5% with 8% growth rate, compared with 50,9% in 2001. Taking into account PPP of AMD compared to the US dollar and the assumption that this ratio and the population number in Armenia will remain constant, GDP per capita will comprise \$5030 in 12 years with 6% growth rate, or 15,8% from the US per capita GDP in 1999, \$5630-- with 7% growth rate, or – 17,6%, and \$6300-- with 8% growth rate, or – 19,7%. In 20 years these figures will comprise respectively \$8000 or 25% with 6% growth rate, \$9700 or 30,4% with 7% growth rate and \$11650 or 36,5% with 8% growth rate. In 2001 PPP (which comprised 3,378, based on data, provided by the National Statistical Service of Armenia)³ per capita GDP in Armenia comprised \$2500⁴, or 7,8% from US per capita GDP in 1999. Taking into account the assumption that the growth rates of US per capita GDP will comprise 2% annually⁵, the mentioned ratio in Armenia will comprise 16,2% in 20 years with 6% growth rate, 19,6% -- with 7% growth rates, 23,6% -- with 8% growth rate. Such high growth rates are theoretically and practically possible in the long-term perspective. Based on the data provided by the World Development Indicators 2001⁶, the countries that had more than 6% average annual growth rates are: Botswana – 10,6% (PPP per capita GDP – \$6540 in 1999), China – 8,1% (PPP per capita GDP – \$3550 in 1999), Hong Kong – 7,3% (PPP per capita GDP – \$22570 in 1999), Indonesia – 6,9% (PPP per capita GDP – \$2660 in 1999), Southern Korea – 8,1% (PPP per capita GDP – \$15530 in 1999), Malaysia – 7% (PPP per capita GDP – \$7640 in 1999), Oman – 9,5%, Singapore – 8,3% (PPP per capita GDP – \$22310 in 1999), Thailand – 7,3% (PPP per capita GDP – \$5950 in 1999), compared with 3,2% growth rates in developed countries during the same period of time. Taking into account the assumption that growth rate in Armenia will comprise 12,2%⁷ in 2002, the average rate of economic growth will comprise 6,6% in 1994-2002, which will put Armenia in the same row with the mentioned countries.

3. Other systemic economic or social goals, such as poverty and inequality reduction, development of social sphere, income regulation policy, etc. should be subordinated to the goal of maximizing the long-term economic growth rates, which, on the one hand means that, policy changes in these spheres should be made, by taking into account their possible influence on economic development, and on the other hand, without extreme necessity (systemic crisis, involvement in military conflicts, natural disasters) they should not lead to changes in already formed basis of the economic system in Armenia – open economy, liberalized systems of financial and trade regulation, absence of centralized regulation of prices, low inflation and macroeconomic stability policy, etc.

4. Socio-political development goals, such as development of democratic mechanisms of control, protection of human and property rights, division of power, their accountability to society, appointment and change of authorities through free elections, independent judicial authority, independent mass media, formation and development of institutions of civil society,

¹ Corresponds with average growth rate of GDP in 1994-2001

² Based on our estimates, every percent of economic growth in 1999-2001 provided the reduction of poverty in about 0,253 percentage point

³ Social Snapshot and Poverty in Armenia. Statistical Analytical Report. Yerevan 2002, p.182

⁴ Based on officially announced number of population (3002 thousand people), according to the results of 2001 population census

⁵ This figure shows the average growth rate in 1965-1999. World Development Indicators 2001, p.26

⁶ World development Indicators 2001, p.26

⁷ Data provided by National Statistical Service of Armenia for 10 months of 2002

anticorruption policy, etc., from one side should be viewed as external restrictions or conditions for economic development, and from another one – the social requirements, the volume of which is connected with economic development, and will substantially increase in the development process. In our opinion the western values and institutions are closer to the Armenian nation and it is the only and natural choice among the currently existing ways of organizing society in the world⁸.

A. Analysis of economic development and socio-economic policy in 1994-2002

1. The basic goal of this analysis is to display and quantitatively evaluate the major factors and restrictions of economic development. Meantime, the analysis should allow singling out and classifying all the factors, which determined the economic development in 1994-2002 and which, from the economic aspect, will in the mid and long term perspective:

- Be determinant for future too;
- Continue to have a positive impact, but will not be determining;
- Lose their impact or their impact will be insignificant;
- Transform into negative and constraining factors.

2. If during the analysis it becomes obvious that there is a possibility that factors and restrictions, which were the main determinants of the development in the past are exhausted, or the continuation of development, based on its past determinants may substantially restrict the growth rates in mid-term and long-term perspectives, the analysis should display the moment, when it is necessary to change the existing determinants and introduce new factors, which will provide continuing stable economic development in long-term perspective.

3. There is a strong necessity to analyze the crisis period of 1990-1993, to -demonstrate and quantitatively evaluate the conditions in the beginning of economic growth and the level, intensiveness and duration of their effect on the processes of economic development, including the shift in the factors and determinants of economic development.

4. Qualitative and quantitative analysis of the integration level of Armenia into the world economy, to demonstrate the real and potential place of Armenia in the world, her existing and potential comparative advantages and the level of their utilization, the role of the integration in achieving the basic qualitative goal of the development: the transition from the category of the

⁸ A distinction of the models of society (S. Huntington. The Clash of Civilizations. Remaking of World Order. A Toughstone Book. 1997) is based on confessional differences, in accordance with which the Islamic, Far-Eastern and Judeo-Christian type of civilizations with fundamentally different mechanisms of organization of public interactions are distinguished, and each of them is divided into the subtypes with different behavioral values. According to (Culture Matters. How Values Shape Human Progress, Lawrence E. Harrison, Samuel P. Huntington, Editors, Basic Books, 2000) the economic development is determined by culture, i.e. the set of prevailing values and behavioral norms in the society, which are based also on the confessional views and norms. Some of the cultures, for example, such as based on the protestant and Confucian values and behavioral norms, are more favorable for development, than others, for example, based on Islamic or orthodox Christian values. There are also intermediary societies, mainly belonging to Judeo-Christian type of societies, and which publicly declared values and norms (formal values and norms), are as a rule borrowed from the developed western cultures, and are not coincided with publicly acknowledged and accepted values and norms (non-formal values and norms). Those are the majority of Latin American and Christian Africa countries. In such a type of societies it is possible to provide a purposeful cultural change by government policy, aimed at bringing non-formal values and norms in accordance with formal ones, thus making it favorable for western type development. In our opinion, Armenia belongs to this type of intermediary societies with significant real chances of bringing non-formal values and norms in accordance with the western type of formal norms and values.

low-income countries to the category of the high income countries, in a maximum possible short period of time (for example, during the life of one generation) and interactions between integration processes and processes of economic development.

5. Analysis of macroeconomic, structural and social policy in 1994-2002 should be made by taking into account the following goals:

- The qualitative (favorable, neutral, impedimental) and, if it is possible, quantitative evaluation of policy success by taking into account the creation of institutional structures and contemporary market economy mechanisms, their influence on the processes and mechanisms of economic development and integration in world economy. This evaluation should be made by taking into consideration as many different policies, as possible.
- The same type of policy assessment should be applied for the social processes and employment as well; if it is possible, by taking into account interrelations between the mentioned processes and economic growth.
- As a result of the analysis, all policies should be divided into 2 groups. The first group includes the policies which are constant despite of the change of corresponding factors and determinants of social and economic development, i.e. fundamental systemic political decisions, the change in which is able to transform the social and economic organization of society in the direction of moving away from liberal market economy, or international obligations of Armenia to international organizations, different countries or group of countries (WTO or Council of Europe). The second group consists of decisions on those mechanisms of economic and social policy, which could or should be changed in order to provide long-term sustainable economic development, or to increase their effect on social processes in the desired direction for society.

Here are the preliminary results of the analysis of economic development of Armenia in 1994-2002.

After Armenia became independent, the processes of economic development can be divided into 2 stages:

1990-1993 – early transition period, characterized by a deep system crisis, which was expressed in economic (GDP level in 1993 – the lowest point of the crisis, comprised 36,2% of GDP level in 1989, which can be considered one of the deepest and transient crises in world history) and energy crises, decrease in living standards, malfunctioning of financial system and hyperinflation, involvement in Karabach conflict, blockade of transportation routs.

1994-2002 – period of continuous economic growth, which was determined by three groups of factors:

1. Stabilization of starting conditions, which was a result of overcoming the energy crisis in 1995, declaration of ceasefire in Karabach conflict in 1994 and its further observance, alleviation of blockade of transportation and energy routs. All mentioned factors made it possible to restore the adequate conditions for proper functioning and production,

2. Implementation and further maintenance of macroeconomic stability in 1994-1995 by introducing control over inflation, sharp decrease and, starting from 1997, further abolition of inflationary financing of budget deficit, introduction of the floating exchange rate of the national currency, elimination of most budget subsidies, including bread subsidies, etc.

3. It is worth mentioning, that compared with other post-soviet countries the most “open” model of economy was formed in Armenia. Blockade of the transportation routs and, consequently, significant increase in transportation cost, led to the emergence of “natural” protectionism for domestic producers, because of their “natural” competitive advantage-ground against the importers and, thus, there was no need for protectionist barriers. Moreover, because of geopolitical and resource specifics, including the absence of the “danger” for export of capital, which could be generated from the sale of natural resources, as for example export of “Russian oil dollars”, the liberal legislation in the sphere of external trade operations and currency regulation and control was formed in Armenia in the mid-90s of the previous century.

Among other significant factors worth to mention is the beginning of considerable external financing from two sources. These sources are – official foreign and international assistance, which comprised approximately 7% of GDP of the country, and was given as grants and concessional credits, and also considerable flow of non official transfers, which comprised approximately 8-9% of GDP⁹, basically from people who emigrated in 1980-1990, or who were temporary working abroad (based on some estimates approximately 600-700 thousand people emigrated from Armenia during 1989-2001)¹⁰.

As a result of structural changes, that started during the crisis period, and continued during the growth period in 1994-2002, the share of industry in GDP decreased from 60% in 1989 to 25% in 1994 and 20,1% in 2001. At the same time, the share of service sector in GDP increased from 30% in 1989 to 44,7% in 1994 and 54,6% in 2001. During the process of economic growth the share of agriculture also decreased from 30,1% in 1994 to 25,2% in 2001 (in comparable prices of 1999). This decrease will amount much more in current prices – from 43,5% to 23,5%. The difference is explained by unfavorable comparative dynamics of prices for agriculture. The index of consumer prices increased by 177,5% in 1995-2001, while the index of prices for agricultural production increased only by 136,2%.

One of the important peculiarities of economic growth in Armenia was, that based on the data of official statistics, the number of jobs did not increase; on the contrary, it decreased substantially. Consequently, after significant increase of employment in agriculture during the crisis period in 1990-1993 it stabilized on the level of 550-570 thousand people and every 1% of growth in non agricultural sector led to the decrease in employment by 0,6 percent point in 1994-2001.

Other negative tendencies, which continued in 1994-2001, were steady decline in of productivity in agricultural sector, constant (not increasing) ratio between productivity and wages in nonagricultural sector, deterioration of the ratio between average pension and average wage from 33,4% to 19,1% in 2001, and absence of growth in the share of social expenses in GDP and budget expenditures.

The main finding of the analysis is that the economic growth in Armenia can be characterized as a cluster based one and is concentrated in few clusters, which are based either on external investments (grants and concessional credits, for example in construction), import substitution (food and light industry), or on the export of processed imported raw materials (jewelry and diamonds cutting).

Combined with inherited low productivity in economy, this is the main reason why the economic growth does not increase the level of employment. The number of working places created in developing clusters still cannot surpass the number of layoffs in non-competitive sectors, especially in the large and medium-size industrial enterprises inherited from the FSU, and the pressure of hidden unemployment in the agricultural sector. On the other hand, employment in the inflated and poorly paid social infrastructure sector remain comparatively

⁹ Based on other estimates the existing volume of non-official transfers is higher, approximately 350-450 million dollars annually, or 20-25% of GDP. We are more inclined to the second estimate.

¹⁰ Growth Challenges and Government Policies in Armenia. A World Bank County Study. The World Bank. Washington D.C. 2002, pp. 31-32

stable. This factor does not allow to adequately increase payments for those who are employed in this sector, because the considerable and fast increase in budgetary expenses intended to maintain this sector and in the share of resources, which population may spend on social infrastructure, objectively is not possible.

Other major problem of economic growth is its territorial discrepancy. Basically, the development processes are concentrated in Yerevan, where 33% of total population of Armenia live. In 2001 50% of industrial production was produced in Yerevan, 80% of registered trade turnover and 76,3% of services¹¹ was realized here and the poverty rate in Yerevan was one of the lowest in Armenia¹².

Therefore, the number of people, whose welfare is increasing as a result of economic growth, still does not exceed the number of people, whose welfare is not increasing, or even decreasing.

While discussing factors providing economic growth, two periods can be singled out – 1994-1998 and 1999-2002.

The first period can be characterized as a recovery period, which became possible as a result of simultaneous introduction of four groups of factors, namely:

- Creation of necessary material and economic conditions for resumption of growth, the most important of which were overcoming of the energy crisis and restoration of twenty-four-hour energy supply starting from 1995, which became possible due to the structural reforms in the energy sector, transition to the united tariff system and resumption of activities of the Armenian Nuclear Station, macroeconomic stabilization policy, as a result of which in 1995 it became possible to decrease substantially and in 1998 stop the inflation, to stabilize the level of prices, to decrease the budget deficit, to restrict, and completely cut budget deficit financing by the Central Bank and mainly eliminate budget subsidies to economy.
- Significant weakening of external restrictions. The declaration of ceasefire in Karabach conflict in 1994 and its further observance till nowadays, created an opportunity to re-distribute the limited resources to support the non-military goals. The ceasefire also allowed weakening of the blockade of the transportation and energy routs, thus making the export and import of resources relatively safe and in predictable prices.
- The large-scale privatization of the state property. The privatization of industrial enterprises and agricultural lands provided an opportunity to expand the private sector, which had already been producing 70% of GDP in 1998 and to activate trade and commercial services, which became practically private, as a result of “small” privatization.
- The abovementioned three factors provided conditions for normal functioning of the economy and society and formed the basic structures of market economy. Nevertheless, the main factor, that provided economic growth was the expansion of the internal demand, so-called *Demand Push*, due to the external sources of financing, such as grants and concessional credits from international organizations, as well as, bilateral credits which in aggregate comprised approximately 7% of GDP and non-official transfers, basically from the Armenian diaspora, which, according to different estimates, comprises \$350-450 million annually. Table 1 shows that the economic development in 1994-1998 really took place due to the external sources.

¹¹ Armenia 2002. Statistical Booklet. Yerevan 2002. p.88

¹² According to the data of 2001 household budget survey, the poverty level in Yerevan comprised 46,7%, compared to 50,9% nationwide, and 56,7% in other cities of the republic. Social Snapshot and Poverty in Armenia. Statistical Analytical Report. Yerevan. 2002. p.37

This period is also characterized by insignificant investments in production for several reasons. The first reason is that the satisfaction of internal demand in a country with the "open" regime of external relations in the period of overcoming the crisis can be met on the base of either import, or restoration of internal production, which needs much more time. At the same time, satisfaction of increased demand by import can be met instantly. Another reason is that, because of short duration of crisis (3-4 years), the production recovery is based on the reserve of non-used production capacities. In this period, investments were directed to sustain industrial infrastructure, trade and commercial services.

The second period of economic growth started in 1998 and continues till nowadays. This period can be characterized as economic growth, based on import substitution. Besides, the above-mentioned factors, the new factor in this period was the significant growth of investments in production, which was financed by foreign investments (privatization to strategic investors, started from 1998, credit lines for production development (World Bank, Lincy Foundation, German government credits, other credits and grants for development), which were distributed through local banking system) and internal savings (Table 2).

In average the volume of investments in fixed capital in 1998-2001 comprised \$116,2 million (excluding private expenses on housing construction), which is 1,4 times more than the average level of investments in fixed capital in 1995-1997, which was \$82,6 million in average.

Table 1. Investments and savings in Armenia (as a percent of GDP)¹³

	1995	1996	1997	1998	1999	2000	2001	2002 (proj.)
Gross internal investments 18.4	20.0	19.1	19.9	17.9	19.7	19.2	21.4	
Public 1/	6.8	4.1	3.5	4.9	4.6	3.8	3.9	5.5
Private	11.8	15.9	15.6	15.0	13.3	15.9	15.3	15.9
Gross national savings	2.7	6.2	1.5	-1.3	1.3	5.1	9.8	13.4
Public	-1.6	-2.0	-1.4	0.8	0.1	-1.0	1.3	2.5
Private	4.3	8.2	2.9	-2.1	1.2	6.1	8.5	10.2
Foreign savings 2/	-15.7	-13.8	-17.6	-21.2	-14.6	-9.4	-8.0	
Public (savings-investments)	-8.4	-6.1	-4.9	-4.1	-4.8	-2.6	-3.0	
Private (savings-investments)	-7.3	-7.7	-12.7	-14.5	-9.8	-6.8	-5.7	

Source: Data provided by National Statistical Service. Data for 2002 is based on information for first 9 months.

1/ Including grants from Lincy Fund as capital investment in 2002

2/ Deficit of current account of balance of payment, including transfers

Table 2. Investments in fixed capital in Armenia in million \$

	1995	1996	1997	1998	1999	2000	2001
Total investments, of which	88,3	126,2	115,6	150,2	147,4	187,2	192,3
FDI	34,4	50,5	63,6	41,4	53,2	44,5	49,5
State budget	16,8	27,7	10,4	28,5	26,5	31,8	8,6
Private housing construction	29,1	25,2	27,7	66,1	42,7	33,7	69,8
Corporate sector	5,3	22,7	13,8	13,5	25,1	76,7	53,9
Investments without housing construction	59,2	100,0	87,9	84,1	104,7	153,5	122,5

Source. Data provided by National Statistic Service.

The next feature of economic growth, based on import substitution, is a relative reduction of import (Table 3). In 1995-1997 import in average comprised 53,4% of GDP and in 1998-

¹³ G.Iradian, G. Minassian, Armenia. Toward a Dynamic Market Economy: Policy Challenges to Sustainable and Rapid Growth, IMF, Yerevan, Armenia, September 2002

2001 – 44,7%, i.e. decreased by 16,2 percentage points. Taking into account critical import (i.e. import which cannot be substituted for domestic production) and import, which is connected with the export of production, which is basically import of mineral and nuclear fuel and uncut diamonds, precious and semi-precious stones, which are not produced in Armenia, it can be assumed that 30-60% of economic growth of Armenia was provided by import substitution.

The process of import substitution provided an opportunity to create several clusters of development, the basic one of which is food industry, which produces 53% of processing industry's gross output. In the lesser extent import substitution promoted the restoration of textile and shoe industry. If the right policy is implemented, the import substitution can also assist in export development.

Table 3. Commodity import in Armenia in 1995-2002 in million \$

	1995	1996	1997	1998	1999	2000	2001
Total import	673,9	855,8	892,3	902,3	811,2	884,7	874,3
Mineral fuel	224,3	183,8	208,3	203,0	175,0	178,5	183,0
Uncut diamonds, precious and semi- precious stones	62,5	129,7	47,4	45,5	86,7	113,2	106,7
Nuclear fuel	38,6	22,9	54,2	50,0	49,2	50,1	47,9
Total critical import	325,4	336,5	310,1	298,6	310,9	341,8	337,7
Critical import as a percent of commodity import	48,3	39,3	34,7	33,0	38,3	38,6	38,6
Non-critical import	348,5	519,2	582,1	603,7	500,3	542,8	536,6
GDP	1286,8	1599,2	1638,8	1892,9	1845,3	1915,2	2118,8
Import as a % of GDP	52,3	53,5	54,4	47,6	43,9	46,1	41,2
Non-critical import as a % of GDP	27,0	32,4	35,5	31,8	27,11	28,3	25,3

Source: Data provided by National Statistical Service.

Nevertheless, in Armenia's conditions the import substitution cannot serve as the main factor of economic growth for a longtime perspective, because its possibilities are restricted to 50% of non-critical import, which currently comprise 12% of GDP. The other reason is that total demand exceeds GDP nowadays, but this ratio is steadily decreasing simultaneously with economic growth. In 1995 total consumption comprised 117,4% of GDP, in 1998 – 111,5%, in 2001 – 105,4%. Provided that, the economic growth will continue with the average annual rate of 6%, which corresponds to average rate of development in 1994-2001, in 2004 GDP will exceed the volume of total consumption. This means that beginning from this period the expansion of internal consumption cannot any more serve as a main factor of economic growth, and particularly determine the possibilities and volumes of import substitution.

The structure of Armenian export was basically developed in 1998-2002. Export of commodities in 2002 comprised \$507 million, which is considered to be the highest in the whole period of economic growth (**Table 4**).

The table shows that the biggest export clusters in the examined period are diamond cutting and jewelry industry. In spite of good perspectives of further development, this cluster creates low value added, approximately 12% (the value of imported raw materials comprises in average 88% of the value of export) and there are limited possibilities to create additional workplaces in this cluster.

Table 4. Commodity export of Armenia in 1995-2002 in million \$

	1995	1996	1997	1998	1999	2000	2001	2002
Total export	270,9	290,3	232,5	220,5	231,7	300,5	342,8	225,3
Diamonds, precious stones and metals	89,5	140,2	55,2	53,1	99,9	121,5	122,8	122,1
As a % of commodity export	33,0	48,3	23,7	24,1	43,1	40,4	35,8	54,2
Other exports	181,4	150,1	177,3	167,5	131,8	179,0	220,0	103,2
Including food and tobacco								
Metals	13,8	11,3	28,5	18,1	17,3	28,9	48,1	23,2
Mining	21,8	29,3	42,2	27,8	19,2	27,8	30,3	19,2
Light industry	6,3	17,0	14,6	11,7	5,4	16,0	12,9	21,6
Total	23,4	10,7	11,3	14,6	14,6	14,1	24,0	13,4
As a % of total export	65,3	68,3	96,6	72,2	56,5	86,8	115,2	77,5
As a % of total export without diamonds	24,09	23,52	41,53	32,76	24,38	28,89	33,61	34,39
All mentioned clusters as a % of export	35,98	45,5	54,46	43,14	42,85	48,49	52,37	75,07
	57,14	71,82	65,28	56,82	67,49	69,31	69,43	88,58

Source: Data provided by National Statistic service

The second export cluster in 2000-2002 by volume was the food industry. Based on 2000 data, approximately 23% of gross production of the sector was exported, compared with 60% of exports in 80s of the twentieth century. In the med-term perspective, this sector compared with other sectors of economy has the best possibilities for significant increase in exports, although, it will not lead to the direct increase in workplaces, considering a relatively high level of productivity in the sector (the volume of production per one employee exceeded \$ 10000). On the other hand, there will not be a necessity in significant investments to increase the production in this sector, and it will provide the growth of the level of monetization in agriculture, because it uses local raw materials and had the highest level of the value added.

Table 4 shows that from the point of view of export-based economic development, the existing structure of commodity export is vulnerable for several reasons. First, the commodity export list is very limited and five commodity groups, presented in this table, provide approximately 70% of all commodity export, where only diamond cutting and jewelry production comprised more than 30% of all exports. Second, export of certain commodities, which currently have a significant share in the export structure, is not based on comparative competitive advantages of the country, or is not connected with the production and, consequently, it cannot be continued and expanded in the future. For example, exports of ferrous and non-ferrous metals scrap comprise 30-40% of the volume of metal export. Third, a large part of production capacities do not participate in export, as they do not participate in economic growth, especially large and medium size industrial enterprises inherited from the FSU. Fourth, it may be stated, that the tendencies of formation and expansion of Armenia's new markets are absent except perhaps, diamond cutting and jewelry, the evidence of which is also the absence of growth trends and significant fluctuation in annual export volumes of different groups of commodities.

In general, as a result of the analysis of the current tendencies of internal and export development, we may come to the conclusion that the level of integration of Armenia into the world economy is absolutely inadequate.

The main conclusions of the analysis are as follows:

- In 1995-2002 Armenian economy was developing on the basis of external financing of the total demand, and starting from 1998 also on import substitution. During the analyzed period of development, the total demand was higher than GDP, and the total investments exceeded the total internal savings. Export had subordinated role and participated in the economic development much less than external financing and import substitution.
- The continuation of 1998-2002 tendency of import substitution, when beginning at about 2004, GDP will exceed total consumption and possibilities of import substitution as one of the main growth factors will expire in few years, is possible only with the further substantial increase in the volumes of external financing. It can be done either via the increase in external borrowings, or by increase in the volume of non-formal transfers. Though current external debt of Armenia is in the safe zone by all parameters, its substantial increase without corresponding permanent enlargement of the capacity of internal markets may turn to become very dangerous and may result in payment crisis. On the other hand, the economic growth and increase of well-being will result in sharp decrease in current volumes of concessional credits from international organizations – main creditors of Armenia, and in corresponding transfer to the commercial borrowing, which will also increase the borrowing risks. Taking into account the tendency of the export of workforce in the last years, it is barely possible to drastically increase the volume of non-official transfers.
- Therefore, it can be stated, that the continuation of the current type of economic development in the long- and med-term perspective is hardly possible without substantial increase in the volume of external financing, which, in our opinion, is not realistic.

B. Basic tendencies in the world economy

The analysis of the indicators of economic development of world economy shows the deep gap between rich and poor countries, which is increasing. In 1998 \$28,8 trillion of world GDP of \$24 trillion was produced in developed countries, with only 20% of world population (so called "gold billion"). The rest 80% produced only \$6,2 trillion. In 1960 one fifth of the world population on one development pole was 30 times richer than the rest four fifth of the population on the other development pole. In 1993 the gap was 61 times, in 1999 the gap already increased to 74 times.

Based on PPP per capita GDP data¹⁴ for 1999, all countries can be divided into three major groups:

- High- income countries, with \$15 thousand and more GDP per capita;
- Middle-income countries – with \$4-15 thousand GDP per capita (I "league" -- \$7-15 thousand, II "league" -- \$4 -7 thousand);
- Low-income and developing countries – less than \$4 thousand GDP per capita.

Based on the most optimistic estimates, the possible result of high economic growth can be the catch up with the first league of middle-income countries during the next 10-15 years. It is much more difficult to catch up with developed countries, for example, to do so, there is need

¹⁴ World development Indicators 2001

to increase per capita GDP five times to achieve the current development level of Portugal and Greece (which are at the end of the list of developed countries).

Although the list of countries, which belong to one or other mentioned groups, is different in different sources, we can assume that there are 3 major groups of developed countries:

- High-income countries: USA, 20 countries of Europe, Canada, Israel, Australia, New Zealand – democratic countries of European culture with liberal market economy. Beside them, the members of the "first league" are Japan and "Asian Tigers" -- Korea, Taiwan, Singapore, Hong Kong, which successfully implemented the model of "catching up" development in last decades. The major factors of wealth and fast development of countries in Europe and North America are market economy with functioning institutions, democratic society, promoting innovations, which provide the main part of GDP growth. Japan and "Asian Tigers" were able to become the members of the "first league" first of all due to the intensive borrowing of western technologies and knowledge, cheap labor and high level of savings. The governments of these countries supported the export of cheaper commodities to the US and European markets and sustained the unusual high level of savings. The limits of "catching up" development model were disclosed when in the beginning of 1990 in Japan and in 1997 in the most countries of South-Eastern Asia the growth factors were almost exhausted. To overcome the crisis, the transition to the internally based development is needed by liberalizing the economy and substantially increasing the quality of human capital. Although, it should be mentioned that, "catch up" development model can be used for at least another 10-15 years in poorer countries such as China, Indonesia, Vietnam.
- The members of the "first league" are also countries, which are rich in natural resources, but institutionally undeveloped and they are based on the traditional institutions, which become even stronger because of accumulated wealth and high level of consumption of goods produced in the developed world. Such countries are Kuwait, UAE, Bahrain and, in lesser extent, Saudi Arabia (\$11 thousand per capita).
- The "First league" of middle-income countries include Czech Republic, Hungary, Poland, Slovakia in Central and Eastern Europe, Argentina, Uruguay, Chilly, Mexico in Latin America, Malaysia in Asia and South African Republic in Africa, with the total population of 300-500 million people (the list of countries is not complete).
- The "Second league" - except Russia in the beginning of the list, is represented by Turkey, Brazil, Baltic countries, Byelorussia, then, Thailand, Romania, Bulgaria, Tunisia, Venezuela, Iraq, Alger, i.e. Based on different sources, the total population of the mentioned countries comprises 1-1,5 billion people. However, many of these countries still have a chance to catch up with the contemporary postindustrial society. This assumption is more realistic for the countries with higher culture, more developed human potential. Other countries, which development level is heavily dependant on oil and other natural resources, have, in our opinion, much lesser chances. The threshold for the "second league" may be lowered to \$3000 per capita. In this case, countries like Egypt, Morocco, Jordan, Philippines and China with total population of 1,5 billion will be included in the group. Starting from the late 70s of the twentieth century, China made a giant stride: based on data of Institution of Economic Development, its per capita GDP increased from 5% of the US GDP level in 1985 to 9,7% in 1995, almost two times in comparative figures. Based on the

World Bank data, in 1999 China's per capita GDP comprised 11,5% of American level, in 2001 – almost 15%.

- More than half of the world population live in low-income countries (India – \$2230 per capita, Pakistan – \$1860, Bangladesh – \$1530, Indonesia – \$2260, Vietnam – \$1860)

It is necessary to mention the fact, that the gap between poor and rich countries is increasing and only few countries were able to fill the gap and catch up with developed countries during the past decades (using the “catch up” development model).

Nevertheless, it is obvious that the world development tendencies show the emergence of a new situation, connected with relatively new development tendency, which may be named globalization. It creates major changes not only in the development technologies, but also in possible consequences of development. In this connection, filling the gap in IT, which became the base of the globalization process, is of paramount importance. Based on the World Bank data in 1999 from 6 billion of the world population only 241,9 million people were using Internet. The pattern of distribution is as following:

High-income countries	191,6 million people
Including USA	74,1 million people
European Union	41,3 million people
Japan	27,1 million people
Middle-income countries	45,2 million people
Including I league	27,3 million people
II league	17,9 million people
Low-income countries	4,8 million people

There is a concept in the world economy, according to which it is the aggregate of national economies, including trade and financial links. This concept emerged when the mentioned links reached the level when processes within the national borders became dependent on their transformation. The process of intensification of these links, strengthening of interdependence is called integration, either within the regional borders, or on the world level. But this is not global economy yet. This concept appeared recently, during the last 10-15 years. Manuel Castels characterized it as “...economy, which is able to function as a united system in real time frame...¹⁵. Only at the end of the twentieth century the world economy became truly global, built on the new infrastructure, which is based on IT and communication technologies”. The Chairman of USA Federal Reserve, Alan Greenspan, considers, that globalization leads to increasing interaction between national economic systems, provided that they are compatible at least in some important aspects. For example, national economies, which participate in globalization, should be market oriented. It is impossible to integrate together incompatible or “closed” economies. Supposing that the world consists only of homogeneous or only command economies, the globalization, as a result of action of free market forces outside of the national borders would be impossible¹⁶.

Governments gave up sovereignty for the increase in the volume of commodities given by the total openness and integration; finally this is called global economy. But we can give

¹⁵ Castels M. Informational age.

¹⁶ Global Economic Integration: opportunities and challenges. A Symposium Sponsored by the Federal Reserve Bank of Kansas City. 2000

another definition: global economy is the part of world economy, where the obstacles in the free movements of goods, people and capital are removed or brought to certain minimal levels, so it can be said that globalization is a high level of integration. This is the level of integration within European Union. Countries of the “big three” (European Union, USA, Japan) are also approaching this definition of global economy.

Thus, it is possible to define globalization as a process of integration of national economies into the new entity, which is expressed in intensification of intergovernmental flows of goods, people, capital and information, which is accompanied by the reduction of national barriers on their way, including forming of supranational institutions and restriction of national sovereignty in favor of supranational structures. Such structures can be regional structures (European Commission, European Parliament), international intergovernmental organizations (UN, IMF, World Bank, WTO, OECD), which are established by governments, and also non-governmental supranational structures, such as transnational corporations (TNC), which are created by private capital.

Globalization processes are considerably strengthening by the increase of technical, technological and informational possibilities, sometimes are even determined by them, but these processes are outside of the limits of the definition of the globalization processes. The most important thing is that globalization processes together with technological innovations decrease transactional and information costs, promoting intensification of connections and exchanges. Trade and competition field are increasing. The allocation and use of resources are also improving. The transfer of advanced technologies is speeding up, which is the reason of faster spread of innovations, including in the low-income countries.

Trade and investments are traditional venues of integration, which are accelerated and given the qualitatively new dimensions by globalization. World trade data shows the increase in world trade by 60% in 10 years, compared with increase in world GDP by 42%. The increase of external trade, as a rule, creates production growth. During 1990-1998, 12 fastest growing countries provided in average 14% growth in trade of commodities and services annually; and their annual GDP growth was the highest – 8% annually.

The biggest share of trade belongs to developed countries. Their share decreased from 81% to 74% basically as a result of faster development of “catching up” economies of Eastern Asia (without Japan), which are increasing the level of their export, first of all to the markets of developed countries. The ratio of volume of trade to GDP – is one of the main indicators of globalization. Based on the World Bank data, that ratio throughout the world comprised in average 22,5% in 1989 and 27,4% in 1999 (taking into account PPP).

The main patterns of international trade growth are as follows:

- The rate of growth of the share of finished goods in trade export is faster than the rate of export of raw materials and fuel, and latter is faster than the growth of agricultural export. During 1950-1998, the trade in foodstuff and agricultural materials increased 4 times, fuel and mineral resources – 6-7 times, finished goods – 35 times.
- The export of services is growing faster than export of commodities. In 1980-1990 the export of commodities was increasing by 5,5% annually, export of services – by 7,5%. In 1991-1999 – by 5,6% and 6,2% respectively. About 40% of exports of service are IT and services in technology sphere.
- High technology products are getting increasingly high share in commodity export. The division of labor and operational links between countries are becoming much deeper in this segment. Therefore, the greatest opportunities for trade growth are concentrated in commodity and service export. That is why there

is a tendency towards the increase of the role of this sector in the trade of developed countries, which are leaders in the production of those goods, and the increase of interest of these countries in further liberalization of trading conditions.

- Widespread of TNC, for which trans-boarder trade between their subdivisions is becoming intercompany trade.

Lowering of trade barriers – is a phenomenon, which is one of the principal features of globalization. To increase its benefits, especially in developed countries, it is essential to minimize the impact of the national borders. It means that it is necessary to eliminate quantitative (quotas, licenses) and tariff restrictions, and to lower custom tariffs on import. In countries with relatively low competitiveness, the strengthening of barriers is more beneficial for producers to protect them from foreign competition. But at the end, lowering of barriers and free trade is beneficial for consumers, governments and producers to stimulate competitiveness and to increase opportunities. Starting from 1948, when GATT was founded, and till 1990 the average level of tariff protection of national markets of industrial countries diminished 6,4 times, from 40% to 6,3% of the cost of imported commodities and services. Non-tariff barriers also decreased. Based on World Bank data, in 1999 the level of tariff protection in developed countries comprised 2,6%, and 13,3% in developing countries. Nevertheless, barriers are still of great importance. Based on the same data, the total worldwide expenses on getting over the tariff barriers for businesses in 1999 comprised more than \$252,4 billion: between developed countries (with high incomes) – 96,6, from developing to developed countries – 41,6, from developed to developing countries – 49,6, between developing countries – 65,1.

The cost of the barriers should be doubled if all barriers, including standards, certification and others are taken into account.

World Trade Organization (WTO), which was founded on the basis of GATT, already includes 145 countries. Armenia became the member of WTO at the end of 2002, although the level of trade barriers in the country during the last 6 years was lower than WTO requirements.

Migration. In the USA in 1990 the share of workers that were born abroad comprised approximately 12% of their total amount, compared with 7% in 1980, in Austria – 9%, compared with 7% and in Germany this indicator remain on the 10% level during these years. The essential characteristic of current migration flows is that, if in 19-20th centuries flows of migrants were directed from Europe to America, now they are moving from developing to developed countries, from South to North. People moved from Europe to begin new life in other countries, where there were more opportunities to work and earn, contributing an input in its development. Nowadays it is primarily the flow of guestworkers and migrants from poor countries with aspirations to use achievements of contemporary civilization, getting their place in new homeland. Usually they carry the works that are not prestigious for local population. Nevertheless, the report of World Bank shows that remittances of people working abroad comprises up to \$50 billion annually, which is a considerable indicator, determining the situation in many developing countries of the world. But the scope of migration is such that it cannot be considered as a distinct feature of globalization, except perhaps the “brain drain”. Nevertheless, this component of globalization process is considered to be probably the most important for Armenia, because the existence of considerable Armenian Diaspora in many countries makes globalization an actual problem for our country.

Foreign Direct Investments (FDI). FDI are one of the basic characteristics of the globalization process. First, by definition they are an element of international economic integration. Second, during the last 20 years, i.e. with the beginning of globalization process they grew faster than other indicators, such as GDP or trade volume. Based on estimates provided by UNCTAD, the world stock of FDI in current prices increased from \$719 billion in

1982 to \$1889 billion in 1990 and to \$6,3 trillion in 2000, i.e. they increased more than 12 times¹⁷.

The UNCTAD report on world investments in 2001 shows the following tendencies in this area¹⁸:

- Already mentioned fast growth. Only in 1995-2000 there was a 3,8 times more increase in the total volume.
- The main part of FDI is directed to developed countries: in 1989-1994 – 65,8%, in 2000 – 79%. The main recipients are the USA (\$281,1 billion in 2000) and the EU. The increase in the share of developed countries is mostly connected with financial crises in many developing countries, which led to the increase of investments risk in these countries and to the reorientation of the direct investment flows to more stable developed countries.
- The explanation of disproportionate high figures for the EU is the inclusion of mutual turnover of FDI among its members within the EU borders: external inflow of FDI comprised 47,1% of their total amount in 1995, and 27,6% -- in 1999, i.e. share of internal turnover of FDI increased by 19,5%. It is a result of European integration, removal of barriers, and unification of legislation.
- Cross-border mergers and acquisitions, i.e. investments in existing assets, which were increasing quickly during the last few years, represent the essential part of FDI turnover between developed countries. In 1990 the accumulated volume of such FDI in current prices comprised \$151 billion, in 2000 already \$ 1144 billion, in 1996-1999 its annual growth comprised 50% and more¹⁹. Cross-border mergers and acquisitions are considered to be the process of international redistribution of equity, which is definitely connected with globalization.
- The major sources of FDI are also developed countries. Their share in the total volume of FDI comprised 85,8% in 1995, 91% in 2000. The major source is the USA, which is the biggest recipient and supplier of FDI and starting from 1997 import of FDI is bigger than the export. In most EU countries (Germany, France, Netherlands, Sweden) with high tax burden and high social guarantee standards the opposite picture is prevailing, especially, if cross-border mergers and acquisitions are sorted out from the total volume of imported FDI.
- The same picture is in Japan, which practically does not get any FDI from abroad, although is providing a substantial amount of FDI to other countries: \$32,9 billion in 2000, before 1995 -- \$29-30 billion annually, under better internal conditions in economy. It can be mentioned that being a full-scale member of “triad” in trade, Japan compared to the size of its economy is not adequately participating in FDI turnover during the last decade, being not attractive for them, but still remaining a significant donor in its own region.
- The share of developing countries in FDI volume was increasing till 1997 (maximum point was in 1996 – 39,6%) and diminished to 19,5% after Asian crisis in 2000. But

¹⁷ UNCTAD. Trade and development report. 2001. Review.

¹⁸ United Nations Conference on Trade and Development, World Investment Report. 2001.

¹⁹ United Nations Conference on Trade and Development, World Investment Report. 2001. p.10

here the share of mergers and acquisitions is lower than in the turnover between developed countries. The major recipients of FDI among developing countries are 20 countries headed by China, which received from quarter to the half of the total volume of FDI directed to developing countries during the last decade of the twentieth century. Other major recipients are Brazil (\$33,5 billion in 2000), Argentina (up to \$24,1 billion in 1999 and further decline due to crisis up to \$11,2 billion in 2000), Mexico, Chili, Columbia, Venezuela, South Korea, Taiwan, Singapore, Thailand, India (\$2-2,5 billion annually). The FDI volume directed to Russia is too small for such a big country and 20 times less than FDI directed to China. Before the crisis in 1997, Indonesia was receiving up to \$6 billion (1996), but its balance of FDI flow became negative (after deep financial crisis). FDI were redirected to the USA and Europe.

- As a rule, FDI are directed to countries with stable political regimes, adequate taxes (lower than in the source-countries), and respectful attitude towards government and counteragent's liabilities, low labor cost and low social guarantees. For example, there is no mandatory pension system in China.
- International financial centers are very important part of FDI distribution. The major centers are the USA (New York), Great Britain (London) and Hong Kong. Great Britain received \$130 billion of FDI and exported \$249,2 billion of FDI, which comprised approximately 9% and 17% of GDP of that country. For comparison, the mentioned shares comprised 3% and 11,9% in France. Hong Kong imported \$63 billion of FDI and exported (mainly to China) \$ 64,4 billion of FDI. Great Britain is forming flows of FDI mainly for the USA, Latin America, Central and Eastern Europe. As it is demonstrated by the data, Hong Kong is a kind of a pump for supplying investments to China. China is getting tremendous inflow of foreign investments due to Hong Kong, partly Taiwan and Singapore with their Chinese population. No other countries outside first league have such financial agents. High and sustainable rate of growth of China during the last 15-20 years became possible mainly due to the flow of these investments.
- The share of Eastern and Central Europe, countries with transitional economies, in world turnover of FDI is insignificant – approximately 2%. The biggest recipients are Poland (\$10 billion in 2000), Czech republic (\$6,3 billion in 1999), Hungary (\$4,5 billion in 1995), Russia (\$6,6 billion in 1996, before crisis; \$2,7 billion in 2000).

The general conclusion is that there is a strong competition in the world market for FDI. Countries, which need “catch up” development, have limited resources at their possession and naturally they make tremendous efforts to attract them. With foreign investments these countries will have access to new technologies, managerial experience, markets, where investors have their share. The results of the last decades show that FDI contribute to the development and welfare of the countries that were able to attract them.

Financial markets. As we see, indicators of investments and capital flows grew faster than GDP and commodity turnover. The volume of operations with securities, especially with derivatives, grew even faster. Ten times increase in operations with debt securities in the last decade means a qualitative shift. The data on international financial flows presented by Manuel Castels²⁰ shows (in percent to GDP for countries of <big seven> in 1980-1992): the USA from 9,3% to 109,3%- 11,8 times and in 1996 – 16,4 times, Germany from 7,5% to 90,8%, i.e. 12,1 times, France from 8,4% (in 1982) to 122,2%- 14,5 times, Italy from 1,1% to 118,4%- 108

²⁰ Castels M. Informational age. 2000

times, Canada from 9,6% to 111,22% - 11,6 times. The peak of growth in Japan was in 1989, when international financial flows achieved 156,7% of GDP, i.e. 6,3 times increase in five years. Soon after the volume decreased to 72,2%, reflecting the economic crisis in 1992.

Great Britain occupied a special position, where the volume of international financial flows exceeded GDP of the country by the factor of 10 in 1992, against 3,66 times increase in 1985; those indicators show London's role as one of the traditionally most important international financial center.

Those same years are responsible for explosive development of information technologies, which undoubtedly contributed to the globalization of financial markets. Thus, the globalization at the end of the twentieth century is characterized by the significant increase in financial flows compared with much slower growth in production and trade. This is perhaps the nature of qualitative global changes; they are expressed in steep shifts in the most advanced parts of development, in advanced frontiers, not affecting or much less affecting traditional sectors, which on the previous stages of development probably played a role of development dominants, and now they become the base for the new processes. While expanding and capturing new territories, these processes are changing and restructuring their own base, not removing it, but decreasing its share in economy, its role in the life of society.

New information and telecommunication technologies create globalization processes, which form postindustrial society and substantially increase the role of financial markets.

In developed countries new strata are created based on the internal development processes. In other countries they are either borrowed, or does not emerge at all. In the latter case the previous strata remain as dominants, as a result, this countries are lagging behind. The more they are trying to isolate themselves aiming at protecting their independence or positions of the ruling elite, or to prevent losses connected with the inevitable break of traditional structure, or all this together, the more they are lagging behind.

The main conclusion of the analysis of the financial markets in the last years of the twentieth century is that international finance obviously are getting out of control of national monetary and financial authorities. Capital flows are practically out of control, probably controlled by market forces only. Moreover, it is the subjects of financial markets, their basic indicators that determine the policy of national authorities.

In the mid-90s the share of companies from developed countries in the international financial markets comprised approximately 93%. Developing countries and countries with transitional economies also have access to this market, but it should be taken into account, that borrowing (the base for active functioning in financial markets) here are more expensive, depending on ranking given to these countries and their companies by internationally acknowledged rating agencies.

There are many reasons to affirm that as the further globalization process goes on, the more mobile capital flows are becoming, the more individual hedging instruments are available, the less stable and reliable are the mechanisms of functioning of financial markets, the more often its influence brings to crisis in different countries, regions and even in world economy as a whole.

Let us consider the chain of crisis of the last several years: 1994 – crisis in Mexico; 1997-98 – chain of crises from Czech Republic to Thailand, Hong Kong and Korea, to Russia and Brazil; 2000-2001 – crisis in Turkey; 2001 – crisis in the USA, this event brought to the reverse wave of destabilization all over the world, and probably will still affect the situation in the world; 2001 – crisis in Argentina because of pegging peso to dollar, when there was devaluation in Brazil, and commodities that were competing with Argentinean goods became significantly cheaper.

Every time crises are explained by wrong internal policy of the mentioned countries, except for the USA. Nevertheless, neither governments of "big seven" nor IMF and IBRD want to discuss the established general rules of the game, to question dogma about the benefits from the liberalization of the capital markets. Nevertheless, the formation of the new system of

functioning of the financial market, which is more adapted to serve the world economy in the context of globalization, will probably become obvious tendency in world economy in the next years.

Transnational corporations (TNC). TNCs are real engine of globalization. It concerns trade, investments, capital markets and technical progress. 88% of TNC have headquarters in developed countries. But nowadays there are already TNC in Hong Kong, Singapore, South Korea, China and Brazil. Altogether in 1999 there were 63 thousand non-financial TNCs with 690 thousand foreign branches and global assets of \$17,7 trillion. Their total annual product comprised \$14 trillion, i.e. 50% of the world gross product. They owned four fifth of World patents and licenses. About 40% of cross-border flows of commodities and services are intercorporation flows of TNCs.

Transfer of technologies is a significant part of the TNC structure. In 1994 only American TNCs provided inter company export of technologies for \$17,5 billion, against \$10,3 billion in 1989, \$10,7 billion of which was directed to Europe, \$2,7 billion to Japan. All together developed countries received \$152,2 billion, and developing countries \$2,4 billion. TNCs play very important role in development of science and technologies and in spreading innovations.

Thus, TNCs today are the vigorous power and engine of the world economy, they are very important part of international trade and spreading advanced technologies. It is practically impossible to penetrate to the most important international markets without them, especially, for the products with high value added. That is why we should not be afraid of the appearance of foreign TNCs in Armenia, provided that they meet certain conditions. On the contrary, it is obvious that TNC attraction to Armenia have crucial importance in making up the gap. As the experience of the new postindustrial countries shows, mainly TNCs became the base of their break-through during the last few decades. The world practice contains more and more examples of effective agreements between TNCs and governments having a purpose to implement large-scale projects.

As the experience shows, TNCs are often significant and sometimes the only transmitter of the national companies on the world markets, not mentioning, that they are the important source of transfer of modern technologies. Governments of many countries are implementing programs to support the cooperation of TNCs and domestic companies. Thus, TNCs, considering all the problems connected with them, are the main link of the development, including for the countries that are concerned with the problems of their lagging-behind. It is worth mentioning, that TNCs are an influential supranational power, restricting the power of national governments and sovereignty of countries. Their influence is based not on the direct control, but on the ability to affect the condition of national economy. Foreign companies are the first to decrease production, fire workers and cut investments, when they are not satisfied with business climate and political situation in the country, or in the case of crisis, when considering the activities in their own country more important. TNCs attract and avert however, it is through TNCs our country can adequately participate in the processes of globalization.

Major centers of globalization processes. The main feature of the development of the world economy during the next 10-15 years is that the domination of the USA in the world economy will probably continue, which will determine the conditions of economy even in such countries as Armenia, which were not a part of the united process of globalization and integration before that. It is also possible that the USA will enter the period of long recession after 2002, which can lead to the slowing down of the growth rates of economy all over the world. Nevertheless, we may anticipate that the US government will try to provide rapid improvement of the situation, with the help of significant increase in public expenditures and monetary policy change. As a result of this, the US international activities will probably change its direction from the strategy type programs (support of democracy, freedom and human rights) to the more pragmatic tactical type ones, directed at providing concrete advantages for the American producers on the world markets. It is obvious that such possible change will have a significant effect on the volume of financial support and its structure, which is very

important for the projection of the development of economy of such small countries as Armenia.

Conditioned with this, there is a possibility of the significant increase of the role of other centers of the world economy, such as the EU and China, which will undoubtedly try to stimulate their role in the world economy in new situation. The recent changes, connected with the expansion of the EU, are the obvious confirmations of such a tendency. The inclusion of Central and Eastern Europe countries in the EU will undoubtedly lead to the transformation of Europe itself. Based on the opinion of analysts (report of CIA "Global tendencies 2015"), the mentioned expansion is a boundary line for the EU. The last time when the EU was expanding (in 1995), the possible candidates were only high-income countries like Sweden, Finland and Austria, which became members of the union without big efforts. It is necessary to revise the history of the accession of Spain and Portugal in EU in 1980-s, to draw an analogy of the expansion of EU to the East. Countries of Central and Eastern Europe (with total population of 64 million and total GDP approximately \$300 billion) are poorer, based on their income per capita, than countries of Pyrenean peninsula and Greece at the moment of their accession to the EU. The average GDP per capita, taking into account PPP of these countries, comprised approximately 63-64% of the average level of the EU, at the moment of their accession, while the same indicator is much lower for the countries of Central and Eastern Europe (Czech Republic – 60%, Hungary and Slovakia – 56%, Poland – 40%). The process of integration of these countries in the EU and the possibility to achieve the average level of the countries of Europe can last several decades, even if the high growth rates are maintained. It is worth mentioning, that the main problem of European integration is agriculture. In Central and Eastern Europe 20-30% of population is concentrated in this sector (in Poland – more than 27%). While examining the budget of the EU, It becomes obvious that the paramount problem of the EU is agriculture. Although only 4% of the population of the EU is concentrated in this sector, subsidies to farmers are one of the biggest items of its budget. Approximately 40 billion euro, granted annually to provide united policy in agriculture – comprise approximately half of all the expenditures of the EU. The report of OECD shows that if indirect subsidies (such as the support of prices and tax benefits) are added to the sum of direct payments to farmers, it becomes obvious that agriculture in the EU received 104 billion euro in 2001. For comparison, subsidies to agriculture in the USA comprised 50 billion euro. Subsidies comprise 35% of the income of farmers in the EU, while the same indicator in the USA is – 21%, in New Zealand – 1%. Thus, it is apparent, that the integration into the EU of the countries of Central Europe, which have a relatively high level of agriculture in GDP structure, will probably lead to the increase of already substantial volumes of financial subsidies from the EU budget to support agriculture.

It is worth mentioning, that one of the main features of the EU during the next 10-15 years will be the process of integration of Turkey in the EU, which, despite its belonging to Islamic culture, is trying to become a part of "western" civilization for almost 80 years.

One of the centers of the world economy during the next few years may become China, which already pretends to be an economic superpower (at least from the regional point of view). Practically, during 23 years of reforms (1978-2001) the real income of population increased more than 5 times. Other countries – the USA, USSR, Western European countries in all historical periods needed almost century to increase the real income per capita 5 times. From all the big regions of the world, only countries of Eastern Asia were able to decrease the gap in the level of economic development between them and western countries; the other regions either lagged behind even more (Africa, South Asia), or were able to keep the gap on the same level (Latin America, Near-East, Eastern Europe).

Countries, which changed its development stage from developing to developed, are located in Eastern Asia – Japan, South Korea, Taiwan, Singapore, Hong Kong. These mentioned countries provided the level of average annual economic growth of 7-10% during several decades. There are no precedents of such impetuous economic growth in history.

Practically, all Eastern Asia is the part of united "Chinese" civilization, which probably became the base of achieving of such tremendous growth rates of the region.

In 2001 PPP per capita GDP in China comprised approximately 15% from the level of the same indicator in the USA, moreover the gap will decrease two times every 15 years, if we assume that the current economic growth in the USA and China will remain at the same level, i.e. these mentioned indicators will become equal in 2045. Nevertheless, it is obvious, that the preservation of such high growth rates is impossible in long-term perspective.

It is obvious, that the emergence of the mentioned center of world economy will be restricted geographically by the limits of spreading of so called "Chinese" civilization, which will undoubtedly become one of the most important parts of world economy.

Tendencies in the development of the world economy show few alternatives of the development of Armenia. Naturally, Armenia's belonging to so-called "Christian" civilization (this problem arose while discussing the possibility of inclusion of Turkey in the EU) and its geographic location practically restrict the possibility of choices of different development scenarios: either integration into the EU, or development based on the formation of effective model of economic collaboration with the EU and other countries (first of all Russia and Iran), which are not included in the EU, but within the borders of the united "European" civilization.

Practically, elaboration of different scenarios of economic development of Armenia leads to the examination of different choices of development of Armenia. Based on this statement, the necessity to evaluate basic advantages and disadvantages of integration into the EU becomes obvious.

From the other side, the basic characteristic of the integration process of Armenia into the world economy is the access of TNCs to Armenia, which will transform the model of development and will provide rapid overcoming of the gap. It is obvious that the successful model of economic development depends on successful implementation of the model of attraction of TNCs to Armenia.

C. The type of economic growth and the choice of a new strategy of development

Based on the results of analysis, the problem of the change of the type of economic development and adoption of the development strategy for provision of sustainable long-term economic growth is becoming the highest priority. The next essential question is the problem of right choice of corresponding policies and institutions, which should ensure the achievement of the main goal – the jump in the first world in a possibly minimal period of time.

From conceptual point of view the economic growth means permanent expansion of the capacity of the internal market. There are two successful models of this expansion in the contemporary world – European and Asian. The European model is based on deep economic and following political integration of countries into one united structure with free access to the markets of other countries, without restrictions on commodity, capital and human flows and with united currency system. Nowadays the EU, based on these principles, is one of the largest markets in the world. The Asian model is created on the basis of independent "catching up" development, where the major factor of expansion of capacity of internal markets is economic growth based on export.

Integration, together with investment growth, acquisition of knowledge and technologies, will lead (in the much easier manner than during the independent development process) to the adoption of values, forms of implementation and organization of business, ethics and discipline of western civilization. This in turn will lead to the decrease in the level of corruption, improvement of public and corporate governance and business environment.

Integration into supranational structures assists in neutralizing the factor of small internal markets increases the possibilities of import and the use of knowledge and technologies and, consequently, increases the possibilities of own production of competitive knowledge and technologies. The higher is the level of integration, the more benefits country can gain from integration into such structures. The most successful integration structures are those where either the developed countries, or developed and less developed countries are integrated together. As the experience shows, the integration of under-developed countries with each other is not efficient, because the effect of imparting knowledge, technologies, production culture, the carriers of which are developed countries, is absent. The absence of overwhelming advantages of one of the countries is a necessary condition for the effective integration, because the rest of the countries do not have effective mechanisms of the influence on decision-making processes, even if those mechanisms are provided by the integration structure. The other important condition is the prioritization of the economic goals over the political ones, i.e. the increase in economic power should lead to the increase in political influence, and not vice versa. Integration with more developed countries also have some negative consequences – the necessity for implementation of serious and painful structural and financial changes, the initial noncompetitiveness of the certain sectors of economy, the increase of the structural unemployment, agricultural problems, etc. However, in our opinion, all this is fully compensated by the advantages of integration.

From the point of view of economic integration, Armenia, in our opinion, is not a member of any integration structure. Membership in the CIS, which has not formed as an effective structure of economic integration yet, is determined by political reasons and strategic partnership with Russia. Russia is the biggest economic partner of Armenia and, which on the other hand, determines the one-sided dependency on Russia, as the biggest supplier of energy resources. The economic relations with other CIS countries of are not critical for development. The Black Sea Economic Union, where Turkey is expecting to play a dominant role, also can not be considered as an organization, based on economic cooperation, i.e. integration goals are not clear, and Turkey itself is trying to become the EU member, where its main economic interests are concentrated.

The possible regional associations, where Armenia may become a member, for example such as South-Caucasian, cannot be formed before the final settlement of the Karabach conflict. Even if such an association is created it cannot solve the problem of small internal markets (total population of the three countries of the region comprises approximately 15 million people – equal to the population of the Netherlands, and total GDP is less than \$10 billion, i.e. 30 times less than in the Netherlands). It also will not allow development on the basis of knowledge and technology exchange, because the mentioned countries do not possess them. Nevertheless, the experts who elaborate the strategy should pay special attention to the prospects of regional cooperation, especially, from regional security and infrastructure development aspect.

The possibilities of bi- tri- or quadrilateral coalitions or axes like Iran-Armenia, Russia-Armenia-Iran are purely theoretical, and, as in the case of Iran, the integration is hardly possible, because of cultural and confessional differences.

The major task of choosing the new development strategy is as follows: based on what model it is possible to achieve the strategic development goal – Is it possible based on independent development prioritizing bilateral relations, or the right choice is the integration into economic and political unions, with certain loss of independence in political, financial and economic decision-making. Being the most important strategic question, this problem needs a thorough consideration and it should be the one of the main subjects of development strategy itself.

The next step should be the choice of the model – independent development, or development in the framework of some economic integration system.

The third step is the choice of the mechanisms and institutions of economic and other policies, which should provide the achievement of strategic goals.

The choice of an independent way puts forward several issues, which should be solved, such as – change of the current development type to an export growth oriented one, implementation and development of the internal structure for production of knowledge and technologies, investment and TNC attraction in conditions of severe competition, identification of the strategic partners and establishment of reliable bilateral relationships with them, and finally, finding own place in the world, securing and strengthening it. For a small and poor country the concept of self-reliance, in the situation when it is practically impossible to have influence on the processes that are taking place in the world economy and have their reliable forecast, may make it possible that the strategic goals are not achieved. This is often proved by the world experience, and there are less success stories of getting into the developed world than those of failure, including the countries, which starting conditions were not worse than those of Armenia.

The path of integration, significantly diminishing the possibilities of independently solving the complicated problems, creates a task to ensure compliance of development goals and corresponding policies to the requirements of integration structure, minimizing, from this point of view, the possibility of a wrong policy choice.

Currently and in the predictable future, the only such a structure is the EU, the integration in which is the main explicit or implicit goal of almost all countries in transition in Europe and European part of the FSU, except Russia (has too large territory, the status of the former superpower, and possible status of the future superpower, i.e. a non-economic motivation in decision-making) and Belarus -- for well known reasons. On the other hand, the EU is an open structure for those European countries, which satisfy the accession criteria, which are well known. Third, the EU is a structure, where the economic reasons for integration are dominating. Fourth, the membership in the EU should be certainly considered as the realization of the strategic goal of entering the developed world. After that, the policy and growth will be determined by general policy of the EU. Taking into account its huge critical mass (total GDP is the largest in the world), the possibilities of mistakes and crises would be minimized.

The choice of such a model has also certain risks. In a predictable future there are two types of such risks: the termination of the EU enlargement and acceptance of the new members,

and the rejection to admit Armenia because of different reasons, including the non-economic ones. Nowadays, based on the EU policy and official declarations, such risks are minimal, which do not exclude that they may appear in the future. Nevertheless, even in this case, taking into account the level of expertise and preparation of decisions made in the EU, following their recommendations is less dangerous than an independent decision-making. On the other hand, as a compromise or temporary solution, there are also possible options of the associated membership, customs union (as in the case of Turkey), etc. that can be taken into consideration if the mentioned risks emerge.

Thus, the development model, based on the declaration by the country of intent to enter the EU, as the basis for the long-term development strategy, and such a choice of policies that meet the EU accession requirements, is a more preferable alternative for strategic development, than the concept of independent development prioritizing the bilateral relations.

Nevertheless, to start the EU accession negotiations the country should have a certain level of economic development, and also satisfy a whole range of requirements, which will be examined below. Based on the analysis of the minimum level of economic development necessary for the EU accession as it is set by the proposed enlargement, is the level of Bulgaria and Romania with PPP per capita GDP of \$6000 – 6500, which is twice higher than the level of PPP per capita GDP of Armenia. On the other hand, GDP per capita in these countries comprises approximately one third of GDP per capita of the EU poorest countries– Greece and Portugal, and about 20-25% of the EU average. In our opinion, to actually begin the integration process, Armenia should have PPP based per capita GDP of approximately \$6000 in the 1999 constant prices. Based on most optimistic forecasts, 12-15 years will be needed to reach that level.

That is why the choice of a long-term development strategy, by taking into account long-term goal of integration into the EU, should consist of the following stages:

- The stage of independent development –switching to the model of growth, which is based on the major factor of economic development-export expansion. . The major goal is to achieve the \$ 6000level of per capita GDP per capita (in 1999 prices) in a maximum possible short period of time. Another goal is the preparation of conditions and structures, and also implementation of such reforms for gradual introduction of the institutions and elements of innovative development and subsequent enlargement of the field of innovative development.
- General integration requirements of EU should be considered as restrictions for the development processes. The choice of policies and the distribution of measures in time should be made by taking into account the priority of high development rates. Therefore, the measures, which are necessary for the EU accession, but may negatively affect the growth rates, should be postponed till the end of the mid-term period or should be undertaken in the course of the accession negotiations.
- This also means that transition to a model of growth based on export expansion, can bring to fundamental changes in the basis of the existing socio-economic policy. However, the liberal and open characteristic of the economic policy should be preserved.
- Parallel with the transition to a model of development based on export expansion, in the framework of Partnership and Cooperation Agreement, the measures aimed at harmonization of Armenian and European legislation should be undertaken. Then, so-called Copenhagen accession criteria should be analyzed and their different components should be drafted. These are:

- Political – stability of institutions guaranteeing democracy, the rule of law, human rights, the respect and protection of the minority rights, etc.
- Economic –functioning market economy and capabilities to withstand the market competition within the EU.
- Accession criteria – capabilities to fulfill the EU membership obligations, including the obligations to follow the goals/objectives of the political, economic and monetary union ²¹.

D. The growth based on export expansion and innovative development

Asian experience of “catch up” development based on export may be summarized in following major principles. Depending on a unique combination of internal and external conditions, these principles were successfully applied in different countries with different intensity and in different proportions:

- Direct government control of economy to ensure the necessary level of mobilization of internal savings, and attraction of internal and external investments.
- Periodical identification of clusters of export development and the use of internal and external financial resources, including acquisition of contemporary western technologies and/or licenses with the support or guarantees by government to organize export oriented production.
- The formation, or assistance in formation of large non-governmental multi-sectoral companies, a part of which subsequently will evolve into TNCs, for organization of export oriented production on the basis of imported technologies and/or licenses, creation of concessional financing mechanisms for them, and application of different mechanisms for export promotion, temporary restriction of foreign competition in internal markets, to provide growth possibilities for these companies (this model was used in Japan and South Korea).
- The application of mechanisms for attraction and promotion of foreign investments in the clusters identified as export oriented (in countries, which have diaspora, mainly for account of diaspora capital; in the countries of South-East Asia it was mainly the capital of Chinese diaspora), and also attraction of TNCs by providing them certain privileges and, as it is in many countries, via creation of a corresponding infrastructure (free economic, industrial and duty-free zones) and even by making public investments or guaranteeing the investment risk.

The major long-term competitive advantage of the successful Asian countries was the cheap, disciplined and functionally literate labor force. To preserve this advantage, Asian countries were paying priority attention to and were investing or encouraging private investments in the development of education, starting from primary and secondary education, and continuing to higher education and vocational training; much less attention was paid to research and development²². In the early stages of growth the significant role was played by such short-term competitive advantage, as cheap labor force, which has gradually been losing its importance with the increase in the level of welfare.

²¹ TOWARDS THE ENLARGED UNION. Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries. Brussels, 9.10.2002

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The Asian experience showed also the objective limitations of the export-based growth. On the certain level of development the direct government involvement are becoming an obstacle to development and the need to liberalize the economic and financial system arises, which was demonstrated by the Asian crisis of 1997. The reliance on imported technologies and knowledge creates a dangerous dependency of an importing country from the countries exporting technologies and knowledge, and on the other hand does not allow the countries which are using the “catch up” development model to fully integrate into the developed world due to absence or underdevelopment of the internal system of production of knowledge and innovations.

The type of development, based on the priority of innovation and knowledge production, became prevailing in the developed world in the 1980s. The main characteristic of this type of development is, first, that the production of commodities is based on the own system of production of technologies, knowledge and innovations, and second, that information and technology are gradually becoming the main production of these countries, replacing in certain extent, the material production, which in turn, is transferred to the less developed countries and are performed on the base of western knowledge and technologies. The transfer of the developed countries to the innovative type of development resulted in unprecedented concentration of the knowledge and technology production in the developed world. For example, 98% of the registered patents are originated in the OECD countries, accounting for only 15% of the world population²¹.

The competitive advantages and disadvantages of Armenia are different depending from the type of growth – export-based or innovative development.

From the point of view of the export-based growth the competitive disadvantages of Armenia are rather obvious. It is the landlocked position of the country, the absence of the direct access to the sea and the main transportation routes and transportation restrictions because of political reasons, which, according to some estimates, costs the country about 1-1.5% of GDP compared with the countries which have direct access to the sea. The small capacities of the internal market does not allow to provide efficient mass production for the internal consumption, and from this point of view, Armenia does not have significant investment attractiveness. This, in turn, is dictating a necessity to preserve the openness of economic and financial policy in the predictable future. The other obvious competitive disadvantage is the structural inadequacy of economy, in particular, of the industrial structure, to the geoeconomic conditions of Armenia. The existing energy and transportation restrictions does not allow to efficiently use a whole range of large industrial enterprises in accordance with their former specialization.

The existence of unsettled territorial conflicts in the South Caucasus region, including Karabach conflict, substantially increases the political risk of investments in the region, and particularly in Armenia. The widespread corruption, the absence of the efficient system of public and corporate governance, inefficient and corrupt court system are increasing the economic risk of investments.

The competitive advantages are mainly three – the economically powerful and active Diaspora, comprising, according to different estimates, from 5 to 7 million people, with approximately half of them living in Russia and USA, practically 100% functionally literate labor force, including highly qualified professionals in some of important specializations, although, as a result of permanent emigration, the number of them is decreasing, widespread higher education (with the enrollment rate about 25%) and very low, by western standards, labor cost. The last advantage is a temporary one and, as in other countries, the importance of this advantage will diminish with time.

As the Asian experience shows, for the long term preservation and development of the competitive advantage of literate labor force, one of the main priorities is the educational

²¹ ? , ??????????. ?????????? ??????????. ??????, 1999

reform and the corresponding substantial increase of investments in education to considerably enhance the quality of education, including higher education, as well as the integration into the united European educational field, which is currently under creation.

The rather liberal financial and trade regimes may also be considered as competitive advantages.

From the point of view of innovative development, the objective and subjective geoeconomic conditions of Armenia cannot be considered as competitive disadvantages. The competitive disadvantages are determined by other, different factors, mainly dependent on the fact, that transfer to the innovative type of development demands much higher level of integration into the world economy, particularly, in the spheres of higher education, research and development, than Armenia currently has. Such integration first demands bringing these spheres in accordance with the western organizational and other standards, and second, much more investments, than country currently can afford.

For transition to export-based growth model and the parallel implementation of the innovative development institutions one of the government priority tasks should be the identification of existing and potential growth clusters which have export potential, as well as, for innovative development.

From the export-based growth point of view, four types of clusters may be identified:

- Clusters, which are or may be formed based on the principle of maximization of the value-added produced in Armenia. They should be based on the processing of local raw materials to finished products. The development for already formed clusters may take place through the increase in the volumes and nomenclature of production, the increase in quality (food processing, furniture and timber, construction materials, etc.) or by adding up the processing chains (for non ferrous metals, for example, the chain increase by construction of a copper refinery).
- Clusters based on availability of qualified labor, production traditions and existing technologies, which usually use imported resources and materials (diamond cutting, jewelry, textiles and shoes industry, etc.)
- Clusters, which are forming on the basis of export of services. They are also based on the qualified labor and modern technologies and should provide quality services with competitive prices. These clusters may be some health, higher and vocational education services, as well as, the IT sector.
- Clusters based on mass production and export of commodities, which should use the main competitive advantage of the country – functionally literate and cheap labor cost. These clusters as a rule should be formed anew and based on the imported technologies and knowledge with the attraction of TNC. Here, government will be forced to implement a set of measures to substantially decrease political and economic risks for investments, including participation in them, and in certain special cases – making them itself.

The clusters of innovative development may be divided into the two types –production of fundamental knowledge and applied research and development.

The identification of the first type clusters, which, as a rule, cannot be put on commercial grounds, should be performed parallel with the fundamental reform of the scientific field of activities, which along with the education reform, is one of the most important integration measures.

The need for the reform arises from the fact, that, despite the sharp decline in the volumes of funding and the employment in the science field, the mechanisms of organization and functioning in this sphere remained, with the possible exception of the implementation of the principle of thematic funding of research and development, practically unchanged from the Soviet Union times and are absolutely inadequate to the requirements of modern market economy. The clusters of applied research and development should also be optimized and organizationally changed with the concentration on activities of the first, second and third types of clusters aiming at production of knowledge and technologies for them, with the further expansion on the clusters of the forth type. On the first stage, the commercialization of these clusters will be rather difficult. Here, in the beginning, probably, the public financing should be used with further implementation of commercial realization of successful research.

The other important task for government is to identify the depressed clusters. As it is well known, a large number of large and medium-size industrial enterprises, the legacy of the FSU, did not get any investments for more than 10 years and become technically and technologically obsolete. Besides, because of the sharp increase in energy and transportation tariffs and lost of traditional markets of the FSU and Eastern Europe, they become noncompetitive.

However, their production spaces as well as the part of the equipment may serve as a base for the organization of new production in perspective clusters. Besides, the substantial part of the enterprises are using only a fraction of their capacities and need to rationalize the volumes of productive spaces and fixed capital. From this point of view, the reorganization and restructuring of the depressed clusters, as well as, the optimization of the productive capacities and equipment may become an important factor of the economic growth and the enlargement of the perspective clusters. The restructuring activity contains a certain commercial risk, and which is more important, the depressed enterprises usually lack financial resources for restructuring; the restructuring activity in the beginning should be organized by state in the form of restructuring agencies. For the whole range of the depressed enterprises the restructuring is more convenient to perform parallel with the bankruptcy procedure, which, first demands the simplification of the bankruptcy procedures, and second, the combining of these two functions in the same restructuring agency.

It is worth mentioning that the processes of development in the first three export clusters are possible mainly due the increase in the volumes of investments and improvements in the business environment. The institutional structures, which are necessary for that are, in our opinion, guarantee or insurance agencies for exports (in case of imports of technologies, knowledge or licenses – also for imports) and small businesses. The other necessary measure is introduction of the public system of assistance to local companies to obtain international certificates for local products and technologies (ISO and other internationally acknowledged standards) as well for patenting local research and developments in developed countries.

One of the important obstacles for the increase in the exporting capabilities of Armenian enterprises, the main part of which are small by international standards, is the discrepancy in potential volumes and timing of supply with even minimal requirements of the majority of importers, which substantially reduces interest in Armenian products and impedes the cooperation with large importers and customers. This problem is of great importance especially for agriculture, food processing, light and shoe industry. Its solution demands the emergence of the specialized export companies or integrating and distributing structures (co-ops in agriculture) that will allow to significantly increase the volumes and frequencies of supply, to implement quality control according to the requirements of the importers, and to operate with the larger importers and customers.

To enhance the role of the Armenian diaspora not only as actual and potential source of investments, technologies and knowledge, but also as a transmitter and customer of Armenian products, the important issue is the creation of a trading system or network to provide the

movement of Armenian products to the centers of the diaspora concentration. Here, substantial government assistance is also needed.

The creation of the fourth type clusters will demand much more government involvement, especially, for the TNC attraction to Armenia. Here the mechanisms of funding, co-funding, guarantees and investments in production infrastructure may be used.

The formation of the elements and structures of innovation economy will demand with the reform of educational and scientific activities elaboration of a special government program for introduction of the structures of innovation economy – venture and leasing companies, investor networks, business incubators and development centers, etc.

The Structure of the Strategic Program of Economic Development of Armenia

Summary

Summary should present the main findings and recommendations of the program according to the structure presented below.

1. Introduction. The place of the Strategic Program of Economic Development of Armenia.

In this part of the program the main functions of the program in providing the sustainable long-term economic development should be described. Also the linkages and division of the functions with the existing and prospective programs such as PRSP, MTEF, PRGF and sector development programs should be described.

2. Part 1. The Main Goals of the Economic Development of Armenia.

This part is dedicated to the main qualitative and quantitative goals of the program, which will characterize the levels of economic development. According to the **Concept Paper**, the main qualitative goal is determined as **the jump into the developed world in 20-25 years**. The set of qualitative goals should be determined as a two-level one. At the first level is the goal of the maximization of the rate of economic growth in order to double per capita GDP (PPP based) in 10-12 years. The second level is the integration goals – to meet the current EU accession criteria within the period of the program horizon. According to the first level goal, the processes and targets of meeting the accession criteria should be distributed in the program time-frame to do not to hamper the high rates of economic growth. At the second level are also the targets, which should be determined outside the program frame – such as poverty and reduction of inequality, millennium goals, etc. These goals in the program either are the derivatives of economic growth, such is poverty reduction, or considered as restrictions on the growth processes, which should be taken into account, such as reduction of inequality or second level goals to meet the requirements of the EU accession criteria.

3. Part 2. The analysis of the factors of economic growth of 1994-2002.

As it is provide in the **Concept Paper**, the basic goal of this analysis is to display and quantitatively evaluate the major factors and restrictions of economic development and further evaluation of opportunities and limits for continuous economic development by taking into account the factors and restrictions, which determined economic development in 1994-2001.

If during the analysis it becomes obvious that there is a possibility that factors and restrictions, which were the main determinants of the development in the past are exhausted, or the continuation of development, based on its past determinants may substantially restrict growth rates in mid-term and long-term perspectives, the analysis should display the moment, when it is necessary to change existing determinants and enter new factors, which will provide sustainable economic development in the long-term perspective.

The analysis should cover the following topics.

- the period of crisis in 1990-1993, to display and quantitatively evaluate the starting conditions in the beginning of the economic growth and the level, intensiveness and duration of their affect on processes of economic development.

- Qualitative and quantitative analysis of the main factors of the economic growth of 1994-2002. Main characteristics of the growth and linkages with the essential indicators of social and economic development on macro and sector levels - external and internal investments, savings, labor productivity and employment, external and internal debt, poverty and inequality, incomes of the population, etc. Sector distribution of the growth, growing and depressed sectors and clusters of economy. As a result of the analysis of the factors of growth, the main factors should be identified, their input in growth should be estimated and the possibilities of the continuation of the growth based on these factors should be evaluated.
- Qualitative and quantitative analysis of the level of integration of Armenia into the world economy, to display real and potential place of Armenia in the world, her existing and potential comparative advantages and the level of their utilization, role of the integration in achieving the basic qualitative goal of the development: the transition from the category of low-income countries to the category of high income countries, in a maximum possible short period of time and interactions between integration processes and processes of economic development. The main strategic trade partners of Armenia based on the analysis of exports and imports markets should be identified.
- Analysis of macroeconomic, structural and social policy in 1994-2002 should be made taking into account the following goals: The qualitative (promote, neutral, hinder) and, if it is possible, quantitative evaluation of policy success by taking into account the creation of institutional structures and contemporary market economy mechanisms, their influence on processes and mechanisms of economic development and integration into the world economy. This evaluation should be made by taking into account as many different policies as possible including, but not limited to, monetary, fiscal, budgetary, insurance, including social insurance, financial system and banking, business environment.
- The same type of evaluation of policies should be elaborated for social processes and employment as well; if possible by taking into account the interrelations between mentioned processes and economic growth.
- As a result, all the policies should be divided into 2 groups. The first group includes the policies which are not changing with the change of corresponding factors of social and economic development, i.e. fundamental systemic political decisions, the change in which is able to transform the social and economic organization of society in the direction of moving away from liberal market economy, or international obligations of Armenia to international organizations, different countries or group of countries (WTO or Council of Europe). The second group consists of decisions on those mechanisms of economic and social policy, which could or should be changed in order to provide long-term sustainable economic development, or to increase its influence on social processes in desired direction for society.

4. Part 3. The analysis of the future potential factors and policies of growth and possibilities of their implementation in Armenia (based on international experience)

As the Concept Paper suggested, it is highly possible, that the possibilities of the current type of economic development conditioned by externally driven expansion of aggregate demand and import substitution will expire in the next few years to come. To this end this part will deal with the identification of the success stories of the fast economic development in other countries, mainly, “catch up” growth and on the factors and mechanisms of innovation economy. The reasons and factors of success or failures of the “catch up” growth should be systematized, the main features, conditions and restrictions identified, and comparisons with Armenian situation made.

The same approach should be presented in the policy analysis. The list of possible policies may include but not limited to:

- investment attraction (including TNC attraction), internal savings mobilization, pricing and credit policy, Diaspora factors (if applicable);
- knowledge, technology and licenses, certification and patents, etc.
- industrial policy issues, including but not limited to identification of development clusters, fostering their development, identification of depressed clusters, issues of their restructuring;
- export promotion policies, including but not limited to institutional structures, operational issues and financial support and promotion;
- tax and tax exemption policies, especially connected with local and foreign investments and TNC attraction;
- institutions of the innovation economy, their description and conditions, when they emerge. Government policy to promote the emergence and implementation of these institutions;
- education system as one of the main engines of the innovation economy. The necessity of the educational reform and its main features based on the experience of developed countries;.
- Research and Development structures as another main engine of the world economy. The necessity of the R&D reform and its main features based on the experience of developed countries.

As the result of the analysis of this part, the policy and institution building recommendations on the transition to the export-based growth should be obtained. The recommendations also should be made on the introduction of the institutions of the innovation economy and implementation of the education and R&D reform. The recommendations should take into account that 1994-2002 liberal policy basis should remain unchanged.

5. Part 4. The Forecast of the Factors and Conditions of Growth

This part is devoted to the forecast of the external and internal conditions and factors of growth from medium and longtime perspective and divided into the two parts.

The first part deals with the issues of forecasting the external factors and conditions, including, but not limited to:

- the economic development of world centers and regions with the assessment of the possible impact of economic crisis, changes in exchange rates and trading conditions for the development conditions of Armenia by taking into account the necessity of the establishment of a national economic security system;
- the economic development of EU, in particular, the consequences of the expansion, possible economic recession, increase in the role of the EU as the European State, prospective of Euro and the role of the European Central Bank to forecast the future EU accession criteria for Armenia
- the economic development of the countries which are and, in principle, may be the main strategic partners of Armenia – both from the import and export point of view and the possible share of Armenia in the markets of these countries. This forecast should be made by taking into account the need of diversification of suppliers of the strategic import components to avoid the unnecessary dependence from their suppliers.
- The forecast of flows of international financial means to Armenia, including official assistance (possible changes in the IMF and World Bank policy), concessional and commercial credits, both publicly and privately borrowed, non-official transfers and remittances.
- Forecast of diaspora participation (financial potential, involvement in businesses, including in TNCs, and in public governance, potential investments, potential consumption of Armenia produced commodities, etc.)
- The trends of the world technological developments (main directions, markets of traditional and high-tech products) with identification of the future niches that may be suitable to Armenia.

The second part deals with the issues of forecasting the internal conditions and factors, including, but not limited to:

- Forecast of the human capital and its relevance to the needs of the sustainable development (demography, employment, including sector division, estimates of the volumes of migration, enrollment rates in the educational system, etc.)
- Assessment of natural resources of Armenia by taking into account the available volumes and the trends of price change in the world market.
- Assessment of the existing infrastructure and forecast (energy, communication, transport systems, the rate of moral and physical depreciation, needed financing, etc).

- Macroeconomic forecasts (consumption, including private and public spending, investments, public and private, internal and external, internal savings, incomes and their structure, exports, imports, BOP, etc.)
- Forecasts to identify the funding needs from internal (domestic savings) and external (FDI, external borrowing, non-formal transfers) sources, potential funding gaps and forecast of the volumes of the external debt that are needed to fund the economic growth.
- Sectoral forecast of production, including export and import forecast by the main commodity groups.
- Forecasts of the activities in the existing and potential development clusters, identification of the possible depressed clusters.

In this part, depending of the quality and availability of data, economic models (econometric and balance type) should be used where possible to obtain the qualitative estimates of the factors and conditions and avoid the inconsistency between different dynamics.

The result of this part (especially for internal factors and conditions) should be a consistent set of dynamic values of different indicators, characterizing the factors and conditions of growth

6. Part 5. The policies for sustainable economic growth

This part presents recommendations for the policy change and institution building necessary to achieve high and sustainable rates of economic growth. The part is based on the analyses in **Parts 2** and **3** and forecasts, made in **Part 4**. The policies should be divided into four groups:

- The set of policies, which should not be changed taking into account their fundamental nature for liberal market economy and the EU accession criteria. If there is need for strengthening of a policy, strengthening measures should be presented.
- The set of policies and institutions that should be changed or implemented anew to provide high export growth rates, promote the necessary amount of investments and savings mobilization, strengthen business environment, etc.
- The set of policies and institutions, which should be changed or implemented a new for introduction of the elements and structures of innovation economy.
- The set of policies and institutions, which should be strengthened or implemented a new to meet the EU accession criteria.

7. Program Annex 1.

Program Annex 1 should present the main policy and institution building measures indicating the tentative timing for implementation, government and other bodies responsible for implementation, funding estimates and sources, and when possible, the short description of the proposed measure. If the program is able to give only a general description of a measure, the measure should be implemented after drafting a corresponding subprogram, which also should be indicated in the Annex with possible timing and funding estimates.

8. Program Annex 2.

This annex should contain suggestions on the program monitoring, its linkages with the other strategic development and social programs (PRSP, MTEF, sectoral programs, etc.) and mechanisms of updates based on the monitoring results and updates or new drafts of the other programs.