

INTRODUCTION

This is the third year in a row Armenia has been included in the Global Competitiveness Report (GCR) of the World Economic Forum. First published in 1979, the GCR has, throughout the years, become one of the world's leading and most comprehensive tools for measuring the competitiveness of countries. Today, it covers 131 countries, and measures competitiveness based on 110 indicators derived from a very broad set of databases.

Despite being included in the GCR, this first annual **National Competitiveness Report of Armenia (ACR)** is the first attempt to take a broader and deeper analytical look at Armenia's international competitiveness standing and the factors influencing it, by using contemporary conceptual frameworks for competitiveness. Many other countries have prepared such National Competitiveness Reports; Ireland and the U.S. prepared two of the earliest, and most rigorous reports. National Competitiveness Reports can be viewed as "analytical and synthesis mirrors" that reflect a country's realities in the global context and, thus, are useful tools for designing future development strategies.

The National Competitiveness Report of Armenia is the fruit of the efforts of the research team of the **Economy and Values Research Center**. The authors of this report hope that the ACR will help foster more in-depth dialogue and analysis on how to improve Armenia's competitiveness, and will make an important contribution to Armenia in several ways.

First, it will inform Government and business sector leaders and will help to benchmark Armenia's progress. It will help Government leaders understand Armenia's strengths and weaknesses and point out policy priorities and monitor the effectiveness of measures that are implemented to boost competitiveness. Private sector leaders will find in the ACR, a report card on the strengths and weaknesses of Armenia's companies. Companies, both Armenian and international, need a competitive business environment in which to thrive. Many of the results of the ACR come from a survey of executives, so they will be able to see an assessments of their peers.

Second, it will provide a tool for private-public dialogue around competitiveness priorities. The ACR will stimulate a healthy debate on the best policies and initiatives to achieve competitiveness, while informing that debate with objective data.

Third, it can help reaffirm the statement to the international business community that Armenia intends to become a highly competitive country through maintaining its impressive rate of growth well into the future. The ACR provides them with an ongoing objective assessment of progress in that direction.

Fourth, teachers, university professors and students from Armenia's business, economics, law, engineering, and social studies faculties will find in this report, a wealth of data and analysis which will enrich their understanding of the current legal, economic and business environment in a rapidly changing country. It can serve as a point of departure for further research. University leaders will find in these pages an endorsement of the importance of their institutions and their contribution to the Armenian economy. The ACR encourages closer linkages between Armenia's universities and the private sector. Students will find excellent reference material which may serve as the basis for articles, studies and dissertations.

Civil society organizations will find in this report an excellent tool for private-public dialogue regarding the agenda for reform. Research institutes will be encouraged to utilize this report. Regional and local leaders can find in these pages ideas for improving competitiveness. Those concerned with building civil society can contribute to this dialogue.

The ACR addresses a number of key questions:

- How competitive is Armenia among the world's nations today? How competitive are Armenia's business environment and businesses in the global context?
- What are Armenia's competitive strengths and weaknesses, how can the strengths be further developed and the weaknesses be addressed?

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- What is behind and in front of Armenia's economic growth rate, and can these growth rates be sustained? Will the average Armenian citizen be more prosperous in the next five years?
 - Can current economic performance patterns ensure progressive development of the nation?
 - How can competitiveness best be built, and what should be the top priorities for private-public dialogue over the next years? What is the role of the private sector, public sector and civil society in the development process?

To address these questions the structure of ACR is based on the following logic and consequence.

Chapter I - introduces **the concept of competitiveness** and stresses the importance of competitiveness for the development of a nation, firm or individual.

Chapter II - reflects a deeper look at **Armenia's economic achievements** in order to see the anatomy of Armenia's competitiveness position, reveal key realities of Armenia's situation and understand its underlying factors and causal links. Armenia's economic performance is viewed in the international context, i.e. in comparison with neighbor countries in the region as well as with other competitor/peer countries and benchmark countries.

Chapter III - presents a quick glance at **Armenia's competitiveness position**, and analyses **key determinants** of such a position. It portrays Armenia's **business environment** as well as depicts the level of sophistication of Armenian companies and describes how Armenian businesses operate in that environment. This chapter uses contemporary tools for analyzing both macro- and micro-levels of the business environment.

Chapter IV - is a **"synthesis" chapter that looks to the future**. It summarizes and puts together key pieces of the "analysis-puzzle" from the other chapters, and thus forms a picture with highlighted major constraints and opportunities for Armenia. The chapter, then, attempts to emerge with thoughts and recommendations on the future development of Armenia, and covers such issues as the context of future policies, frameworks and mechanisms for setting priorities and designing short- to long-term development strategies; approaches for positioning Armenia in the region and globally.

CHAPTER I: ARMENIA'S COMPETITIVENESS CHALLENGE

Importance of Competitiveness

Currently, competitiveness is a major challenge facing Armenia's decision makers in both the private and public sectors. While Armenia's economic growth rate is exceptionally high, it has only recently recovered to GDP levels seen in 1990 and wage levels are still less than half of levels seen in 1990. Economic performance has been largely dependent on external factors (e.g. remittances, assistance from international financial and donor organizations). Large and increasing regional disparities and continued poverty among some segments of the Armenian population create a sense of urgency to bring economic dynamism to all geographic areas and to all segments of the population. Armenia's disadvantage as a landlocked country increases the need for repositioning Armenia towards high-value products and services that are less subject to transportation cost disadvantages. Attaining higher levels of competitiveness will determine whether Armenia can achieve sustainable and harmonious economic growth beyond that bolstered by remittances, foreign assistance and resource exploitation.

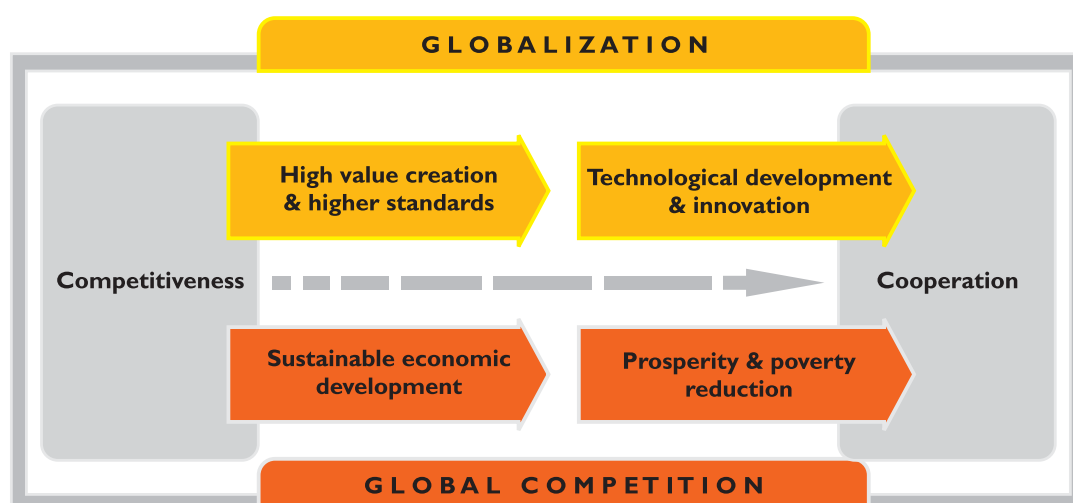
The tendency to compete is in human nature and we live in a world where competition is one of the main forms of interaction between humans, firms and nations. They compete to attain greater benefits or advantages, more power, higher market share or profits, better living conditions and higher levels of prosperity. In this day and age, with increasingly higher levels of mobility, technological development and wider and faster communication, competition has become more intense and complex. The forces of global integration and technological change are putting additional pressures on countries and their citizens. No country, landlocked or not, can escape the influence of globalization. Attaining competitiveness is the key to benefiting from globalization instead of becoming its victim. In the long-run, the prosperity and economic self-determination of Armenia depend on its ability to achieve higher levels of competitiveness.

Competitiveness, which we define here as high and rising levels of productivity, is determined more by created factors than its resource endowments. It is a function of the nation's ability to develop an environment enabling firms and individuals to utilize the nation's resources and factors effectively and efficiently. It is about the ability of the nation, its firms and citizens to design, adopt and implement sophisticated strategies and operations which allow efficient utilization of available resources and factors. In other words, competitiveness is about the ability to be productive; **competitiveness is all about productivity**. Thus, competitive advantage is different from comparative advantage in that the former is not based on raw material abundance, cheap labor or locational advantage. Rather, it is the efficiency by which these factors are transformed into value that sets one entity apart from its peers. It is about the ability of businesses to understand the need for and deliver goods and services with high value-added rather than undifferentiated commodities, and for which customers are willing to pay premium prices. It is also about a government's ability (and willingness) to remove roadblocks, lower transactions costs and ensure supportive regulations, infrastructure and platform services.

Competitiveness eventually brings prosperity to the citizens of a particular country and creates the foundation for future development. It leads to sustainable economic development, increases the well being of "average citizens" and reduces poverty. Therefore, there is a strong moral purpose and social objective behind a focus on competitiveness.

The aspiration of competitive nations and/or firms for innovation and continuous development enhances international competition, leads to rising international standards, upgrades product and service quality, and contributes to technological development worldwide. Competitiveness drives global technological development and global value creation, hence, creating better frameworks for cooperation.

Figure I: Competitiveness is Grounded On and Leads to Cooperation



Defining Competitiveness

There are numerous definitions of the term “competitiveness”. The ACR will base its analysis on the following two complementary definitions:

According to *Harvard University Professor Michael Porter (1998, 1990)*, “Competitiveness is determined by the productivity with which a nation, region, or cluster uses its human, capital, and natural resources. Productivity sets a nation’s or region’s standard of living (wages, returns on capital and returns on natural resources)”. This definition stresses the microeconomic foundation as a key driver of competitiveness.

Professor Xavier Sala-i-Martin et al. (2004) and the World Economic Forum (2005) define “Competitiveness as a set of institutions, policies, and factors that determine the level of productivity of a country, and that, therefore, in turn, set the sustainable level of prosperity that can be attained by an economy currently and in the medium-term (3-5 years).” This definition takes into consideration, both macro- and microeconomic factors as drivers of productivity and hence prosperity that the given nation could attain in a dynamic process. This definition is used by the World Economic Forum in its Global Competitiveness Report.

We will also stress a key feature of national competitiveness, which is the country’s **ability** to produce and market goods and services, particularly in international markets (Scott and Lodge, 1985).

Additional discussion on the notion of competitiveness and some selected definitions are presented in Annex I.

Measuring Competitiveness

The best measure of competitiveness is that of productivity. However, productivity statistics are notoriously difficult to obtain for all countries, limiting comparability. An easy proxy for competitiveness is often that of income per capita. However, very often it does little to explain competitiveness or predict future performance.

Various benchmarks of competitiveness exist. Those generally considered most authoritative are provided by the **World Economic Forum (WEF)**, **International Institute for Management Development (IMD)**, and the **Institute of Industrial Policy Studies (IPS)**. However, only WEF currently

includes Armenia in its reports. Therefore, in this report we will heavily (but not exclusively) rely on WEF's indexes for assessing relative competitiveness.

The World Economic Forum's **Global Competitiveness Report (GCR)** has become the leading source for assessing a country's competitiveness. It is one of the most comprehensive tools for assessing the competitiveness of countries, since it relies on both hard data (from databases of the IMF, World Bank, ITU, EIU, etc.) and soft data (from Executive Opinion Surveys, conducted by partner institutes of the WEF in each country).

The GCR has two benchmarks: the **Global Competitiveness Index (GCI)** and the **Business Competitiveness Index (BCI)**. The GCI – the main indicator of competitiveness - is a composite index based on 110 sub-indexes grouped under twelve “pillars” that include a broad set of indicators spanning from macro economy to health and education. The BCI measures the national business environment and the sophistication of company strategies and operations and, thus, highlights important details of the microeconomic foundations of competitiveness with special focus on company-specific factors.

Detailed discussion on the GCR methodologies of assessing competitiveness and on Armenia's rankings under the GCR can be found in Chapter 3 and Annex 2.