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Conceptual Approaches to the Strategy of Armenia's Economic Development

Armenia is facing the challenge of maintaining its high economic growth which has been achieved today primarily due to private transfers. This does not create sustainable competitive advantages for the Armenian economy and will not secure Armenia's long-term economic growth. New approaches for the country's development are required.

International practice suggests several successful examples of economies which managed to transform the initial acceleration into sustainable economic growth. This was mainly achieved by the countries which adopted consistent strategy of formulating a distinctive value proposition (e.g. Singapore, China, Ireland).

A value proposition points out to the specific role the country plays in the world or regional economy. What can constitute Armenia's distinct value proposition?

Global Positioning of the Armenian Economy

The current situation in the country does not provide grounds for confirming the existence of a certain value proposition of Armenia. However, Armenia has two options.

First – complete annihilation as an independent player in the global arena, second – transforming into a supplier of highly qualified human resources for certain sectors of the global economy.

At present, the strongest obstacle for the first option is the Armenian-Azerbaijani conflict. Paradoxically, this very issue makes Armenia significant in terms of foreign geopolitical interests. Hence, the complete settlement of the conflict without creating preconditions for formulation of a distinctive value proposition could turn Armenia into a “regional appendix.” The second alternative implies shifting from a temporary exporter of high-quality workforce for Russia into a location of high quality human capital for narrowly-specialized fields with high value added.

The claim for such a specific regional and in future global role is quite an ambitious yet fully achievable objective, requiring a real breakthrough. Scarcity of resources, the unfavorable geopolitical situation and transportation problems do not allow Armenia to develop other propositions (for instance, becoming a base for expansion to developed and rich regions, as

Ireland positioned itself in relation to Europe, and Singapore in relation to the Far East). On the other hand, the suggested positioning will enable Armenia to compete in creation and offering of specific values and to accumulate notable competitive advantages. But for creating such an advantage Armenia will have to compete with economies based not on exploitation of resources (China, Russia, Turkey), but with high value added (Estonia, Israel, Taiwan, Korea). This means that Armenia's concept of competitiveness must be targeted on achieving best international standards in the field of human resource education and training, applied science, management systems, services and work requiring special competences and creative skills, as well as globally competitive business environment in general.

Moving to the Next Stage of Competitive Development

In the framework of the economic development paradigm based on the concept of competitiveness, three stages of development are identified:

- Resource-based economy: competitiveness is achieved through the use of cheap production factors;
- Investment-driven economy: competitiveness is achieved through high effectiveness of managing large-scale, massive investments;
- Innovation-driven economy: competitiveness is achieved through creating a unique value for the global market.

Today Armenia's economy is considered to be in the resource-based stage. This refers not only to the structure of the economy but also to the principles of creating added value. During the last five years, private transfers from Diaspora have been the main driving force of the economic growth. Except for a few industries (agribusiness, restaurant business), it does not stimulate the creation of globally competitive companies, but instead, contributes to turning Armenia into a "consuming zone". The sectors that compete in the global market (IT, jewelry business) at the moment play secondary role in the economy and even these industries maintain their competitiveness mainly thanks to exploitation of cheap labor while investments in these sectors remain insignificant.

Accordingly, the main challenge Armenia faces in the current stage is providing with large-scale foreign investments in the existing and new sectors of the economy in order to be able to move into the next stage of development. The strategy of increasing large-scale investments must become the main priority of the economic policy in the period of 2008-2015. This will prepare a firm basis for shifting into the innovation phase of development.

The Armenian IT sector until recently was competing exceptionally on cheap mid-quality labor and not on locally designed products. Foreign companies were buying groups of programmers here. With some reservations, this also refers to the main exporting sector of the economy – diamond & jewelry.

Basic Instruments of the Breakthrough

1. Focus on International Investments

The implementation of the above-mentioned strategic economic goals is impossible without attracting productive foreign capital, especially large transnational corporations. Only they can

provide resources of necessary scale and make available conquered export markets, channels of distribution, management skills, technologies and world class business practice.

Until recently Armenia has attracted FDI in its economy mainly due to politically motivated large infrastructure privatization deals. However, these sources will exhaust within the coming 2-

During the period of 1998-2004, about 45% foreign direct investments (FDI) were made in the infrastructure and 25% investments were connected with large privatization deals.

3 years because although the sphere of infrastructures continues to possess great potential of absorbing capital, it may become stagnant given the domination of monopolies. The new areas of attracting foreign capital will require extremely huge and focused efforts from the Armenian government for design of attractive value propositions for multinational corporations. In this regard, the Armenian government will have to move away from its current role of an administrator to become an active and effective initiator.

The competition for FDI on the global market is becoming fierce; new attractive countries appear and offer their services to multinational corporations. Success needs consistent policy based on a clear understanding of needs of multinationals that should be initiated on the highest level of government administration.

The priority of attracting FDI has to be implemented in reality and not on the level of slogans. The implementation of this strategy must be consistent in every level – starting from the global positioning of the country down to closing concrete deals with concrete companies.

The institutionalization of FDI attraction policy in Armenia that was initiated in the past did not yield significant results, firstly because of poor understanding of target audience, the lack of an integral strategy, extremely ineffective human resource policy and, as a result, passive and spontaneous efforts. Under new conditions, potential investors must receive coordinated and effective signals from the country which must be reinforced with equivalent actions.

There are three key spheres that require active institutional policy.

- **Formation of a globally competitive business environment.** Transnational companies are only interested in the countries where total expenses of conducting business are lower than in comparator countries or where there are unique opportunities of creating new values. Most of these opportunities are conditioned by the business environment of a given country; this is why persistent improvement of the business environment is so important.
- **Creation of new sources of growth.** Even with the presence of a really favorable business environment, business expansion will require special resources and competences in certain sectors. For Armenia, with its limited natural resources, this may be compensated by technological, managerial and creative competences in the sectors where the rapid accumulation of these competences is achievable.

Costa-Rica's example: In 1996, *Intel* opened a microprocessor assembling and testing factory investing around \$300 million. This investment "put the country on the map" in the sphere of high technologies. Hunt for *Intel* started long ago in Costa-Rica. CINDE (analog of our Armenian Development Agency) started active lobbying of the country. However, the key factor of the success was personal involvement of President Figueres in the process. He conducted 15 personal meetings with the representatives of the company and every week the issue was discussed in the Cabinet.

- **Attracting the Diaspora resources.** The third key element for Armenia with its large and globally integrated Diaspora, is the active attraction of Diaspora resources for breaking the information and reputation vacuum around the country; creating additional incentives for multinational companies (including those with Diaspora capital) for choosing Armenia as an investment destination; as well as extensive expansion of the resource base for economic growth.

Implementation of such an institutional policy will require new skills, experience, commitment and professional trust which today's Armenia lacks. Armenia may achieve a breakthrough only by mobilizing its best managerial resources including those temporarily located abroad, as well as by attracting high-quality managers and business leaders from abroad and Diaspora. In the above-mentioned three spheres, they will have to address a number of issues for reforming the economic environment and mobilizing its resources.

2. Formation of a Competitive Business Environment

The most fundamental and serious competitive disadvantages of Armenia are rooted in the microeconomic realm. With the level of development of the business environment and especially some of its critical components, Armenia is behind its main countries-competitors, including Azerbaijan. Improvement of the microeconomic business environment in Armenia prompts to take active steps in the following spheres:

- Considerable improvement of the human resource quality through reforms in healthcare and education by direct government investments and formation of quasi-governmental specialized institutions with the active involvement of the private sector;
- Targeted modernization of main physical infrastructures (combination of private foreign, international and state resources), especially in the areas of targeted foreign capital;
- Consistent liberalization of economic life, relief from bureaucratic regulatory mechanisms. Armenia must have a regulatory environment comparable to offshore zones.
- Increasing the efficiency of government administration, turning most of the government functions into transparent, paid services to be provided to population and companies;
- Promoting competition in particularly monopolistic spheres of economy for increasing the effectiveness of capital allocation, reducing the costs and improving the quality of services;
- Creating equal competitive conditions, elimination of preferential regimes (excluding specific cases where there is a reasonable need).

These actions are important not only for direct economic benefit but will also be perceived as effective signals on real intentions of the authorities. Such signals are much appreciated by the market and by international players, in particular. However, if no real changes take place in the country, the efforts aimed at the outside audience will not produce the desired results.

3. Creation of Sources for a New Growth

Sources for a new growth in Armenia can be created through offering resources and competences in certain sectors which may be integrated into global value chains of international companies. In the case of Armenia, the desired elements of global value chains may be research and development, product testing, production of technological components requiring disciplined workforce of medium and high qualification, strong creative skills as well as specific managerial

resources capable of integrating into international companies and securing the expansion of their businesses in Armenia.

These competences and resources must reach a critical mass in a certain sector in order to attract the attention of transnational companies, and therefore, they may be created and modernized through focused investments.

Such investments may be directed to special education (connected with certain sectors) and creation of training and educational centers, specialized laboratories, obtaining of technologies and their adjustment, hiring highly-qualified (in some cases globally-recognized) foreign specialists as well as creating experienced producers. The key function of the government must be the role of a catalyst and coordinator of the process. However, coordination and active involvement of the business sector, educational institutions, professional associations and interested representatives of Diaspora is the precondition of a real success. The scale and novelty of these efforts require active attraction of foreign sources of competence and capital, in particular those of Diaspora, and not only. At the initial stage, they themselves can become autonomous sources for economic growth and, as a consequence, they will stimulate growth supported by private investments. At the same time, these efforts will be productive only with a distinct focus on certain sectors (in some cases - even on certain transnational corporations); otherwise they may be not demanded by the market.

Finally, the objective of those initiatives will be the creation of strong and effective clusters (geographically close, interconnected groups of companies and supporting institutions). The very presence of clusters, and not separate companies, makes the given industry attractive for transnational companies. On the other hand, the entrance of a large transnational company may stimulate the entrance of others and the development of the entire cluster. Taking this into account, in some cases it will be reasonable to create special infrastructures for certain large transnational corporations. Special strategies are necessary for companies seeking geographic diversification of development and production and striving for a region in the CIS and the Near East. For attracting such important players, the government may act as a co-investor providing land, buildings, infrastructures, and in special cases - tax privileges.

4. Attraction of Diaspora Resources

Given the increasing pace of globalization, unprecedented development of communication technologies and the exceptional role of business networks, the Armenian Diaspora may become a unique competitive advantage for the Armenian economy. In the transition period the role of the Diaspora was mainly providing humanitarian aid, private transfers, lobbying of Armenian interests abroad, and cultural connections. Despite the FDI policy of the Armenian government was heavily relying on Diaspora, however, the latter has not become a large-scale investor in the Armenian economy. Diaspora played a big role in the reconstruction and development of the Armenian economy but its potential is greatly underutilized.

For comprehensive deployment of the Diaspora factor in transformation of the Armenian economy, Armenia must fundamentally change its policy towards Diaspora. Diaspora must be seen not only as a source for material resources but also as an important global commercial network supporting the Armenian economy with critical highly skilled human resources.

The competitiveness of an economy can not be local; it is measured and achieved globally. This suggests a new mental paradigm in relation with active elements of Diaspora and a set of coordinated actions.

- Armenia itself must invest in Diaspora, especially in maintaining and development of its national identity. Although at the current stage these investments will be mainly cultural, they will result in consolidation of Diaspora and prevention of its quick assimilation.
 - Transforming the current national structures into large-scale and effective tools of investing in infrastructure.
 - Creation of institutional and collective forms of investments such as “development bonds or Diaspora bonds”, investment and venture funds.
- In the 1950s, “the development bonds of Israel” became one of the main sources of financing Israel’s economy. They were allocated among wealthy Jews of America.
- Attraction of transnational companies leveraging the influence of Diaspora on decision making of transnational companies.
 - Direct investments in the Armenian economy. The total potential of free investment resources of the active part of Diaspora is estimated to be in the range of \$10-20 billion. Although in 1998-2004 about 70% of foreign investors in Armenia are Diaspora Armenians or Diaspora-connected companies, their total investments make up only 24% of all FDI, amounting to \$260 million. The main reason is the low level of attractiveness of Armenian business projects for commercial investments, and the unfavorable business environment. The overall improvement of the business environment and the quality of business projects may bring to a considerable growth in investments of Diaspora capital seeking for new spheres of investment.
 - Repatriation of Armenians. Repatriation may become a powerful instrument for stimulating the economy due to emerging of additional sources of human and financial capital as well as expansion of the domestic market and, accordingly, a raise in its attractiveness for transnational corporations. Chances of repatriation are bigger among Armenians living in the Near East, Iran and the CIS countries. In case of proper coordination of ideological and financial dimensions within the next 50 years, Armenia is able to repatriate around 10-30 thousand people annually, without creating too much pressure on the labor market and effectively integrating them into the Armenian society.

National Leadership

The economic challenges that Armenia faces are difficult to overcome; however, they give Armenia a historical opportunity. The realization of that opportunity requires not only thoroughly worked out long-term strategies and their consistent and effective implementation, but also an inspiring leadership capable of consolidating, motivating and leading the people and the process itself. The long-term nature of the strategy requires that the leadership sees the perspective of the Armenian nation hundreds of years beyond, instead of short political cycles. The leadership should transcend not only the narrow party interests and boundaries but also the boundaries of the present day Armenian state to expand its influence on the active elements of the Armenian nation who are interested in Armenia's revival.