This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at http://www.bti-project.org.


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Executive Summary

Despite the reelection of President Serzh Sarkisian in February 2013 to a second and final five-year term, his Republican Party hasn’t managed to overcome the general distrust in the government and unpopularity among much of the population. Similar to all previous elections, 2013 was marred by voting irregularities, diminishing the country’s democratic aspirations. Nevertheless, the main challenger Raffi Hovannisian won the vote in almost all Armenian cities and lost in rural regions. The strong consolidation of power hasn’t helped to solve the main domestic problems of monopolization and corruption. The situation has become even more problematic since April 2014, when the prime minister and the cabinet were replaced and oligarchs strengthened their positions within the government.

The credibility of the Armenian government suffered after the unexpected about-turn toward the Russian-dominated Eurasian Economic Union (EEU) in September 2013. The successfully negotiated Association Agreement and the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU were not finalized in 2013. Armenia’s membership in the EEU in January 2015 is a major challenge for the economy. Armenian companies face a number of difficulties after the implementation of new EEU customs procedures. There is still some confusion regarding norms and standardization regulations in the EEU. Some of these regulations contradict EU norms. Although the government promised to promote small and medium-sized businesses, the authorities approved a set of amendments to the tax code that will significantly strengthen the regulation of tax reporting by small enterprises.

Since 2010, there has been a strengthening of Armenia’s activist groups and civic organizations. This period has also seen the emergence of assertive issue-based interest groups, ranging from environmentalists to social and youth campaigners. In recent years, there has been an increase in human rights activism, in particular against abuses in the army. Growing poverty and socioeconomic discontent has led to more clashes between the police and small social protest groups. The most violent clashes took place in January 2015, when residents of the second-largest
city Gyumri revolted against the inaction of the prosecutor’s office in the case of an Armenian family allegedly killed by a Russian soldier.

The Armenian-Turkish reconciliation process remained stalled between 2013 and 2015, and no significant progress has been achieved on the Nagorno-Karabakh issue. In August 2014, violence escalated along the line of contact in Nagorno-Karabakh, resulting in dozens of casualties on both sides.

Due to the fast growth of the mining sector in recent years, Armenia has continued to confront serious environmental challenges. The state lacks the control tools needed to ensure effective environmental management. The government has largely ignored civil actors’ criticism and tried to marginalize them, using patriotic propaganda and the strong influence of the TV channels on the public opinion.

**History and Characteristics of Transformation**

Although in principle the decline of the Soviet system in the late 1980s opened up new avenues for independence and a democratic and prosperous future, Armenia faced two significant and very threatening challenges. In February 1988, the majority Armenian population of Nagorno-Karabakh, an autonomous region in neighboring Azerbaijan, voted to unite with Armenia. Although the move conformed with existing Soviet legislation and constitutional avenues, and backers supported the reforms initiated by the Soviet leadership, Azerbaijan rejected the vote and the political conflict rapidly escalated into outright war. A second unexpected challenge came in December 1988, when Armenia was struck by a devastating earthquake. Both of these challenges imposed inordinate burdens on the Armenian leadership that emerged with the sudden independence of the country when the Soviet Union collapsed.

In addition to the lacking preparedness for independence, as in the case of each former Soviet state, the ongoing Nagorno-Karabakh conflict and the imperative for earthquake recovery only exacerbated the struggle for Armenian statehood. In the wake of some seven decades of Soviet rule, newly independent Armenia struggled to create resilient institutions necessary for statehood and sovereignty, introduce market-based economic reforms, and contain the paralyzing effect of a near total collapse of industry and a related breakdown in trade and transport routes.

Against that backdrop, Armenia’s political and economic transformation was largely defined by the specific circumstances of the time, which greatly impacted the trajectory of reform. More specifically, these factors included politics defined by strident nationalism that imposed informal limits to political discourse and tolerance, and which tended to reinforce a trend toward authoritarianism. A second factor was an economy deformed by “conflict economics,” in which the closed borders and blockade of the country led to a severe scarcity of goods, which, in turn, fostered widespread corruption and distorted market-based prices and economic activity.
Within this closed economic system, and without much state oversight or regulation, several commodity-based cartels emerged, bolstered by a powerful combination of criminal links and political influence. Their power also stemmed from the opportunities for power and profit inherent in exploiting “conflict economics” through monopolistic positions controlling scarce commodities, such as gasoline and heating oil, and basic staple goods. These cartels and semi-monopolies quickly eliminated competitors and secured dominant positions over the import and export of key consumer goods, raw materials and foodstuffs.

The emergence of these cartels was initially a consequence of the “conflict economics” of the Karabakh war, and they garnered political influence by generally supporting a feeble and war-weary state. The Armenian government was largely preoccupied with economic measures in other areas, ranging from the successful implementation of sweeping land reform and privatization to the introduction of a stable national currency. The power of these cartels quickly expanded beyond commodities, however; similar to those in other post-Soviet states, they leveraged their links with political power to acquire inordinate wealth and assets during the privatization process.

In political terms, the war years of the 1990s also thwarted early attempts at building democratic institutions and bolstering political reform, and the ongoing state of war shaped an already rigid political discourse, as a new vibrant nationalism crowded out more moderate voices within the Armenian political arena. This deterioration of political discourse was matched by a second trend involving the transformation of the country’s political hierarchy, as a new elite from Nagorno-Karabakh gained power and consolidated top leadership positions in Armenia proper.
The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Since independence, the Armenian state has enjoyed sound authority, with no challenges to the state’s monopoly on force. This trend has generally been strengthened by a powerful degree of ethnocentric nationalism within a highly homogenous society, matched by a consistent degree of respect for and popularity of the armed forces, which has never directly intervened in politics and is subordinate to civilian state control and oversight. Moreover, the state’s unquestioned monopoly on violence is bolstered by stable civil-military relations and the general absence of weapons in the possession of private citizens or groups.

Nevertheless, growing poverty and socioeconomic discontent has led to more clashes between the police and small social protest groups. After the September 2013 policy reversal and the president’s decision to join the Russian-led Customs Union, police brutality against peaceful protesters has intensified. The potential for internal unrest or political instability has increased in recent years. More specifically, the police force and security services are unpopular and enjoy very little trust, driven by a record of abuse of power and cases involving the excessive use of force against detainees and civilians. Given that popular demand for reform remains unaddressed, there is a growing risk of radicalization of political forces. The law enforcement bodies have been undertaking strong measures to neutralize any potential of a “color revolution”.

In terms of state identity, there is a generally accepted consensus on the issue of citizenship, mainly stemming from the country’s homogeneity and mono-ethnic Armenian society. There is little or no record of ethnic division or discrimination facing native, non-Armenian minorities (Kurds, Russians and some Jews). However, the ethnic minorities have limited representation in Armenian government. For example, the largest ethnic minority in Armenia, Yezidis, as of 2015, still has no representation in the National Assembly. In theory, all citizens are endowed with the same civic rights, and the Armenian state ensures equal access to education, the courts and public welfare. In practical terms, however, there are continued contradictions...
with legal safeguards, as there are signs of a growing discrepancy in rights between certain groups. This discrepancy manifests itself, for example, in both political polarization between supporters of the opposition and government, and on a class basis, with an obvious, widening division between a small, wealthy and politically connected elite and the larger, more impoverished general population.

The Armenian Apostolic Church holds a strongly entrenched position of dominance within Armenian society, mainly based on two factors. First, the church holds an informal but powerful relationship with the Armenian state, endowing the authorities with a degree of legitimacy and support. This legitimizing support has been especially helpful for the rather unpopular government, which has also sought to leverage the church’s regard among the ordinary population as one of the least corrupt and most respected institutions in Armenia. Formally, Armenia observes a policy of separation between church and state, with religious dogma barred from any direct role in politics. Over the past years, however, the church has adopted a much more assertive role in political discourse, ranging from debates over “family values” and other cultural issues to state-related issues of urban development and foreign-language education.

The second factor contributing to the dominant position of the Armenian Apostolic Church, to which nearly 95% of the country’s religious believers belong, is rooted in its historical standing as a defender of Armenian identity and cultural norms. However, according to the Caucasus Research Resource Centers (CRRC) 2011 survey, over 60% of Armenia’s population, despite emphasizing the importance of religion in their daily life, attends religious services only on special holidays or less often. This trend appeared to continue in 2013: according to the CRRC survey conducted for that year, over 70% of respondents announced that they attend religious services only on religious holidays or less often.

The church has traditionally kept a distance from partisan politics, but that distance has begun to narrow in recent years. Calls have emerged over the past two years for the church to play a greater political role, most notably in combating economic injustice and the country’s widespread corruption.

The protection of the fundamental freedom of religion is incomplete in Armenia, and over the past two years, there have been repeated cases of discrimination against nontraditional religious groups and sects such as the Jehovah’s Witnesses and the Mormon missionaries active in the country. All formal churches and religious groups outside the Armenian Apostolic Church are required to register officially with the government, and proselytizing is forbidden by law.
Civil servants are not sufficiently protected in Armenia. Despite a series of recent civil service reforms, corruption within administrative structures remains a serious challenge. Due to the low level of salaries, the administration system is confronted with corruption risks. Administration remains hindered by the legacy of Soviet-era practices, many of which are grossly inefficient and overly bureaucratic. Administration of justice functions reasonably well, although adjudication remains subject to political, personal or financial interference. This is largely related to a fairly weak and arbitrary rule of law, matched by a flawed system of law enforcement and a sometimes checkered record of justice.

In terms of basic administration, the Armenian system is fairly well-developed, with generally competent administrative structures operating on many levels of government. In 2011/2012, some improvements took place in law enforcement, in particular the adoption of a criminal procedure code in 2012. Also worth mentioning are the e-government services, which can be seen as a positive development toward reducing low-level corruption.

The inherent lack of professionalism and low level of efficiency are especially prevalent throughout the less developed rural regions, but such shortcomings are also evident in larger towns and cities. Similarly, the lack of an independent judiciary tends to weaken the efficacy of state administrative bodies and foster a general public mistrust in the system. Other areas of administration in specific need of reform include customs and tax revenue monitoring and collection, water and electricity utilities, and healthcare.

2 | Political Participation

Armenia’s first election in the early 1990s was the country’s last free and fair balloting without restrictions. Moreover, for much of the last decade, the Armenian population has grown accustomed to flawed elections, and has become increasingly disengaged from politics.

A year before the presidential elections in 2013, the government refused to accept a number of amendments proposed by the opposition parties to ensure better control of the electoral process. Despite some electoral reforms, the country’s political system remains rigid, closed and seriously impeded by entrenched corruption and political patronage. The electoral code has adopted repeated amendments, but these have not resulted in a significant improvement to the electoral process. The key characteristic of the new code was that the Central Elections Commission and district commissions would no longer be formed by political parties. Instead these commissions, with the approval of executive, would be organized by an ombudsman and the Chamber of Advocates.
The electoral campaign for the May 2012 parliamentary elections although dominated by controversy over the proposal to eliminate constituency seats in favor of a fully proportional system, which was eventually rejected by the parliament, was fairly smooth and uneventful. After some modest improvements in the parliamentary elections, the campaign for the 2013 presidential elections was marked by a number of irregularities: hunger strikes, an assassination attempt on a candidate, and appeals to postpone the election.

The elections themselves continued this negative trend, with the vote being marred by widespread irregularities and a broader problem of voter fraud and vote buying. The deeper problem stems from the common practice of the incumbent authorities’ habitual reliance on vote buying and voter intimidation. In addition, given the low voter turnout, authorities generally succumb to the temptation of resorting to the traditional practice of leveraging the so-called administrative resources of incumbency, coercing public servants to create an unlevel playing field.

Local self-governing bodies and other community organizations are tightly linked to the governing Republican Party and are actively conducting electoral fraud to manipulate the outcome. What was widely perceived as Armenia’s least competitive presidential election, the February 2013 election returned incumbent Serzh Sarkisian to office. Yet the severity of discontent and the appeal of second-place finisher Raffi Hovannisian were both seriously underestimated. Though Hovannisian has sought to become an agent of change in Armenia, much of the country’s diverse and divided opposition failed to unite behind him. But this post-election crisis was defined less by support for Hovannisian personally than by opposition to the government. The crisis affirmed the weakness and immaturity of the main opposition parties, which were unable or unwilling to unite. Currently, all parties are repositioning themselves in preparation for the next parliamentary elections in 2017. If the constitutional transition to a parliamentary system takes place, the upcoming elections may become crucial for the political parties.

Thanks in part to fundamental flaws in the country’s closed political system and the absence of free and fair elections, the Armenian authorities have typically held virtually unchallenged power and authority, despite public demands for change. Such power is often harnessed at the expense of democratization. According to the Freedom House report, Armenia’s democratic development has been regressing since 2012.

The incumbent president, Serzh Sarkisian, a chosen successor of the previous president Robert Kocharian, came to power after the flawed 2008 elections and solidified his rule with brutal crackdowns on opposition and the political dissent. Despite the government’s efforts to establish a political dialogue with the opposition in 2011, and despite a range of government concessions, the ruling regime has up to
now continued to rely on autocratic methods of rigging elections and intimidating the opposition.

In light of that, the ruling political elites, particularly the executive, could be described as veto players standing in the way of democratic reform. However, provided that Armenian political representatives were democratically elected, they could enjoy effective, constitutional power to govern, virtually unchallenged by other veto players such as the military or clergy. Therefore, the fundamental problem lies with elites who hinder democratization in favor of Soviet-style modes of governance.

Armenia has a vibrant civil society, comprised of a wide array of civic groups and NGOs. In contrast to the political parties, the civil groups had been perceived as harmless by the government. However, the rising influence of civil groups has harshened the authorities’ attitude. After the removal of the ban on rallies in Yerevan in 2011, a series of civil demonstrations took place during the period under review. In 2012, environmental campaigners succeeded in persuading the authorities to cancel the construction of a shopping boutique in the central Mashtots Park in Yerevan. In 2013, mass rallies and student strikes took place after the presidential elections. In 2013/2014, a series of protests were held against Armenia joining the Eurasian Economic Union.

Despite some progress on civil liberties in this period, including the lifting of restrictions on opposition rallies, the country’s authoritative approach to civic freedoms and civil rights requires more resolute reform. Although the constitution guarantees freedom of association and assembly, there has been a pattern of intimidation of civic and political groups, including such normally politically neutral groups as environmental activists and even groups fighting abuse in the military and defending historical monuments and architecture. Overall, the protection of civil rights in Armenia has remained incomplete and far too arbitrary, with deficiencies mainly due to the weak and arbitrary application of the rule of law. In some cases, for example, several incidents of blatant violations of civil rights have only reaffirmed the need for proper oversight by an independent judiciary. One exception has been the institution of the human rights ombudsman, which has actively challenged the state’s lack of protection and even violation of civil liberties.

The monopolization of the media has deepened. Private TV channels have been indirectly influenced by government institutions. The noticeable decline in basic civil freedoms in recent years has been matched by efforts to constrain the Armenian media, leaving the sector increasingly subject to a troubling pattern of state control and intimidation. In the period under review, there were signs that the state was retreating from more assertively restricting the media, despite a continuing pattern of self-censorship in which the media has backed away from producing bolder journalism.
In a broader context, lingering domestic tension rooted in political crises, sometimes accompanied by violence and intimidation, lessened in this period. Although the protection of civil rights in Armenia has remained incomplete and far too arbitrary overall, there have been signs of progress. The human rights ombudsman has actively challenged the state’s lack of protection for journalists, and even its violations of civil liberties and free expression. However, attacks against journalists have increased since 2013. Up to ten cases of harassment of mass media representatives were recorded in 2013, compared with four cases in 2012.

3 | Rule of Law

The Armenian constitution contains all necessary provisions to ensure the separation of powers. However, following the victory of Serzh Sarkisian in the 2013 presidential elections, the executive’s dominance over other branches of government has increased, reducing checks and balances. Currently, the president is using all administrative resources to concentrate power within the executive branch. If the governing party has an absolute majority of seats in the parliament, the opposition has no real means to counterbalance them. Despite this, four opposition parties successfully appealed to the Constitutional Court in 2014 to suspend some provisions of the new Pension Reform Law.

Given the lack of effective checks and balances or any clear separation of powers, Armenia’s democratic transformation remains both incomplete and inadequate. Moreover, there has been no progress in the past two years, with no attempt to reform or revise the current model of a strong presidency and the resulting subservient judiciary and ineffective parliament. This structural deficiency is compounded by the weak state of the rule of law. The closed nature of the system and the lack of an independent judiciary also tend to weaken the efficacy of the state administrative bodies and foster a general public mistrust of the system.

Officially, an independent judiciary does exist in Armenia, but it is still largely subordinate to the executive, and its effectiveness is undermined by widespread corruption and general incompetence. In the period under review, no significant progress toward strengthening the independence of courts was observed. Corruption and dependency of judges influences the quality of justice system. The powerful compulsory enforcement service exceeded its competencies in many cases.

In the face of a dominant presidency, with the executive remaining unquestionably the strongest branch of government, the judiciary can best be described as overly compliant with the demands of the executive. For instance, the president suspended a judge who issued verdicts against police and in favor of civic activists. According to the Commissioner for Human Rights of the Council of Europe Nils Muižnieks, the president plays too great a role in the appointment and dismissal of judges. There is
also a general problem of prosecutorial bias and dominance of the prosecution within the system. However, there have been some positive developments. For example, the World Bank started its Second Judicial Reform Project in Armenia in 2011, and a new Criminal Procedure Code was adopted in 2012.

A pattern of an abuse of power among Armenian officials remains rampant and unchecked. Such abuse manifests partly as entrenched corruption within state institutions. Over the past two years, however, there were several more cases of arrests and prosecution of officials and even law enforcement personnel for corruption-related crimes and abuse of power, confirming a trend toward at least seeking to limit and reduce the severity and number of more flagrant abuses of office.

The governor of Syunik region, who resigned 2013 for his alleged involvement in a murder, was reappointed to the post in 2014. Several officials were arrested on abuse of power and corruption charges. However, most of these purges are a result of internal power struggles and do not represent a long-term strategy.

The protection of civil rights in Armenia remains incomplete, with deficiencies mainly due to the weak and arbitrary application of the rule of law. Over the past two years, blatant violations of civil rights by the state have reaffirmed the need for proper oversight by an independent judiciary. Despite several restarts of investigations into the 2008 deaths of opposition members, no one has been brought to justice yet.

Since the beginning of 2013, dozens of civic activists have been beaten by unknown violent groups. Since the Armenian police are not willing to solve the cases, there is the strong suspicion that the authorities may have been behind the beatings. The victims of the beatings during the last two years were members of political parties and activists of civil movements.

After the 2011 amnesty for political prisoners, new politically-motivated trials took place. The latest prominent case was the detention of Shant Harutyunyan and his friends in November 2013, who organized a rally with revolutionary slogans and were sentenced to 2-6 years in prison. Colonel Volodya Avetisyan, a participant in social protests by veterans, was sentenced to 5 years in prison in 2014.

The lack of any real accountability for the abuses and excessive force by the police and security forces, as well as the dubious judicial processes and questionable investigations subsequently conducted by the authorities, magnifies an environment of public fear.
4 | Stability of Democratic Institutions

In theory, democratic institutions exist in Armenia. In practice, paternalism of ruling elites, corruption and patron-client networks render them inefficient. While most of the state’s ministries and departments are in hierarchical subordination to the executive and have little room in practice for independent institution-building, relatively liberal institutions exist at regional and municipal levels of administration. Public administration is characterized by low professionalism and lack of control mechanisms. As of 2015, there were over 915 self-governing communities in Armenia. Although in reality many of the community heads depend on patron-client relations with regional governors and other higher-ranking state authorities, self-governing communities hold potential for future democratic institution-building.

The Armenian government has delayed the merging of self-governing communities several times. The reforms aimed to increase the budgets of communities and improve their organizational structure, but faced also certain resistance in communities. In addition, an e-government system was launched in 2011. However, most of Armenia’s institutions still remain under the patrimonial control of the executive, which continues to pose a challenge for democratic reform and institution-building. The dependency of the judiciary is an obstacle to effective implementation of public rights. In consequence, the quality of democratic governance has notably deteriorated since the 2013 presidential elections. The reduction in national and local democratic governance has been reflected in most international reports.

Armenia’s commitment to democratic institutions is limited and largely superficial. More crucially, the deeper flaws in the political system itself, most notably the weak rule of law, a compliant judiciary and an ineffective parliament, suggest that the current political system is incapable of sustaining itself in the face of mounting pressure from an unresolved political crisis and a lingering crisis of confidence. More specifically, since a post-election crisis that culminated in a violent confrontation between the Armenian authorities and the opposition on 1 March 2008, Armenia has been plagued by lingering political tension driven by a profound degree of political polarization and exacerbated by widening economic disparities.

The authorities have also been hindered by a lack of legitimacy and a crisis of confidence that have undermined its political mandate and impeded its reform program. For the past several years, the Armenian government has remained fairly unpopular and unable to fully overcome these challenges, and neither the authorities nor the opposition was able to resolve the political crisis or to reach any constructive compromise.
As a result, the function of democratic institutions is impaired by both the government’s lack of legitimacy and the continuous interference of the executive branch in the work of institutions. Furthermore, the presidential office kept actively interfering in the work of institutions throughout 2013-14, limiting their independence.

5 | Political and Social Integration

The political parties are mainly organized around strong personalities, with no real choice between party policies. This was again confirmed when, in 2015, President Sarkisian managed to completely put an end to the second-largest party, Prosperous Armenia, by exerting pressure on its leader. The parties are not socially rooted. Regional and local branches of parties become active only before the elections. Clientelism and political support in exchange of benefits are widespread. Voter volatility is high, but also predictable, especially for the ruling party. The last presidential campaign was also marked by a rather primitive, low level of political discourse, with little debate and even less of a choice among the candidates between competing visions or strategic alternatives. Several new civil groups have tried to build political organizations and have made their first steps.

The authoritarian structures within the political parties have allowed the executive power to manipulate them. All six parliamentary parties lack popular support and have made efforts to strengthen their positions through negotiating with the incumbent president. The deep intense competition between President Sarkisian and his predecessors Robert Kocharian and Levon Ter-Petrossian has weakened because of the resignation of the Prosperous Armenia leader, as the party was their main political ally and an obstacle for president’s constitutional reforms.

Since 2010, there has been a strengthening of Armenia’s activist groups and civic organizations. This has been sparked by a political awakening among interest groups and other politically active groups such youth and student clubs, which are no longer content to be politically disenfranchised. This period has also seen the emergence of assertive issue-based interest groups, ranging from environmentalists to social and youth campaigners.

In 2012, the Mashtots Park Movement was one of the highlights of civic protests, continuing with the Yerevan transport initiative and the Dem.am movement against the privatization of pension system. In recent years, there has been an increase in human rights activism, in particular against abuses in the army.

Among the most notable protests which occurred during the reported period were protests against Armenia’s membership in the Russian-led Customs Union, protests against new pension funds and protests by Karabakh war veterans.
The overwhelming majority of the population seems in principle to be strongly committed to democratic norms and procedures. According to the Caucasus Research Resource Centers (CRRC) 2011 survey, 62% of Armenians approve of democratic governance. However, the institutions of the state are mostly distrusted; 49% distrust courts, 50% distrust the parliament, and 42% distrust the president. The latest CRRC survey data from 2013 determined that over 50% of respondents are supportive of democratic forms of government.

Commitment to democratic norms and procedures has remained stable despite widespread political apathy, frustration at the flawed 2013 presidential election, and growing disillusionment associated with the slow pace of democratization. Despite the country’s evident political shortcomings, the public seems more committed to the constitutional system than most of the political parties do. However, this confidence in and approval of democracy as a system has not translated into public faith or trust in specific Armenian institutions.

Social capital has been an increasingly significant factor in the last years of Armenia’s transformation. Armenian society is characterized by high levels of social capital “bonding” and low level of “bridging,” which means that most social capital remains “locked” within family and close social groups. As a result, popular participation in organized civic activities is low. The Caucasus Research Resource Centers (CRRC) 2011 survey reported that 97% of the Armenian public does not participate in civic volunteerism or other social organizations. Trust in people is similarly low. For instance, the CRRC 2011 survey found that only 10% of Armenians trust other people. By contrast, over 40% said that they have enough people to rely on.

II. Economic Transformation

6 | Level of Socioeconomic Development

The Armenian economy has still not fully recovered from the deep recession resulting from the global financial crisis in 2008 when GDP fell by 14.1%. Armenia reached its pre-crisis level in 2013 and demonstrated growth in 2013 and 2014 (4.1% and 5.2%).

In recent decades, statistical two-digit growth has been overemphasized and the problematic structure of growth has been underestimated. Armenia hasn’t done enough to address overall poverty, the closed nature of the market and widening disparities in wealth and income, which have led to a serious socioeconomic divide.
The government has also missed the opportunity to promote the export-oriented IT and diamond-cutting industries.

According to official data, the total poverty rate stood at 32% in 2013. Poverty increased by 17.4% between 2008 and 2012. However, the data reported by the Armenian State Statistical Service doesn’t reflect the real picture of poverty in the country. In real terms, more than 1.2 million Armenians are now impoverished, living on approximately $3 a day. In comparison, the minimum basket of consumer goods and foodstuffs is estimated to cost an average of 56,000 drams (or about $130) a month, with prices for food and utilities steadily rising.

The dramatic decline in investment and over-reliance on the inflow of remittances has made the economy structurally vulnerable. The central bank reported that around $1,728.5 billion was sent to Armenia in 2014 as private money transfers for non-commercial purposes through the banks, stating that the amount represented a 7.5% or $141.1 million drop from the previous year. These weaknesses have aggravated social discrepancies in recent years. According to official national statistics, consumption inequality, as measured by the Gini coefficient, increased from 0.242 in 2008 to 0.269 in 2012. Gross income inequality increased from 0.339 in 2008 to 0.372 in 2012. In addition, socioeconomic barriers have been exacerbated by increased social pressure, driven by rising costs for food, basic goods and energy. The state budget, while reflecting concern for the socioeconomic situation by increasing public spending, lacks adequate budgetary measures to counter widening wealth disparities and deepening poverty.

Decentralization and sustainable development are the key challenges for the Armenian economy. The socioeconomic divide also has a rural-urban geographic aspect, marked by an over-concentration of economic activity and opportunity in urban centers and the capital. This division has fostered more pronounced regional and rural income inequalities, and has been exacerbated by the wide variance in the quality of and access to essential public goods such as healthcare, education and other social services. The infrastructural divide between regions and urban centers has also encouraged greater migration to urban capitals from outlying rural areas.

### Economic indicators

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<td>Unemployment (%)</td>
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### Economic Indicators

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<td><strong>Foreign direct investment</strong></td>
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<td><strong>Public expnd. on health</strong></td>
<td>% of GDP</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>R&amp;D expenditure</strong></td>
<td>% of GDP</td>
<td>0.26</td>
<td>0.24</td>
<td>-</td>
</tr>
<tr>
<td><strong>Military expenditure</strong></td>
<td>% of GDP</td>
<td>2.9</td>
<td>4.3</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

### 7 | Organization of the Market and Competition

In the period under review, the foundations of a market-based, competitive economic system have continued to develop and strengthen, as can be seen in the steady growth of the private economy, which accounts for over 80% of GDP. Armenia is consistently rated as having one of the most open economies among the former Soviet states, and it is praised for its positive trade and investment policies as well as its lack of restrictions on capital.

However, over the longer term, the country faces a daunting set of problems, stemming from the powerful influence of several commodity-based cartels and monopolies that restrict free trade and market-based competition. The inherent dependency on the informal market and the involvement of political actors in business continue serving as obstacles to a free market. For example, a multinational
retailer company experienced serious obstacles entering the Armenian market, and it took four years to overcome the resistance of oligarchic networks.

The Armenian parliament has underperformed in this area, having rejected a proposal from the opposition to introduce new sweeping anti-trust measures to curtail monopolies and improve competition. The proposed legislation would have required a new government strategy to implement “urgent measures aimed at the elimination of illegal monopolies” by imposing a new ban limiting companies from owning more than one-third of shares “in all areas of economic activity other than public utilities.” A second element would have imposed fines on any company determined to hold a “dominant position” in any specific sector of the economy.

According to a recent study by Abdih and Medina (2013), the informal economy accounts for over 40% of GDP in Armenia. Further evidence from CRRC surveys indicates that over 60% of the Armenian population relies on informal (kinship) networks in socioeconomic transactions.

The involvement of high-ranking government officials in big businesses creates negative conditions with respect to the implementation of anti-monopoly laws. Although the Armenian constitution prohibits business activity by MPs, the majority of MPs from the ruling party are oligarchs or businesspersons. Commodity-based cartels and monopolies continue to pose a serious problem for the country’s economic development, especially as the government has failed to introduce a more effective application of anti-monopoly mechanisms, as well as for reduced administrative costs for small and medium-sized enterprises.

Despite having one of the most advanced regulatory systems among the former Soviet states, Armenia needs to improve transparency. As things stand, Armenia lacks the necessary combination of critical laws and effective enforcement, particularly in the area of anti-monopoly and anti-trust law. This weakness is exacerbated by excessive state control over some key sectors of the economy.

Against the backdrop of generally weak state regulatory institutions and a pronounced lack of political will to confront corruption and break up cartels and semi-monopolies, the entrenched power of the oligarchs now stands as a direct threat to reform and an indirect threat at least to the state itself. The oligarchic system has had a devastating impact on Armenia, eroding the authority of the state, which can neither tax the oligarchs nor police their business interests. The state faces an uphill battle to regain control of the economic system.

The Public Services Regulatory Commission sets prices for certain public services on the basis of calculations made by dominant companies or monopolies. This process is often not transparent and does not sufficiently reflect public interests. The Armenian currency is convertible, but the central bank interferes with foreign
currency inflows and other non-formal mechanisms to stabilize the exchange rate. There are informal barriers for new small and medium-sized companies.

The real danger for Armenia stems from complacency. For Armenian business, especially given the small size of the national economy, there is a serious need for the state to tackle monopolies and to further open the economy through transparency and competition. Although the emergence of monopolies in the Armenian business sector has not been as profound or as powerful as it has been in other former Soviet states, the net result is an overall weakening of economic growth, a barrier to competition and a serious disincentive for foreign investment. The second economic impact of these commodity-based cartels or monopolies is their role in obstructing the rise and expansion of new firms and businesses. This too harms overall job creation and maintains the closed and limited nature of the national economy. In Armenia’s case, this not only reinforces the landlocked and blockaded limits on the Armenian economy, but creates a reinforcing cycle in which the monopolies become vested interests in maintaining closed borders in order to reinforce their control over key sectors of the economy. The only effective way to tackle this problem has been to introduce anti-trust legislation strong enough to counter and contain the monopolies and cartels. But here, as demonstrated in the experience of other countries, it is the implementation and enforcement of the laws that matter most.

Armenia has been a WTO member since 2002. Despite its liberalized trade regime with very low customs duties, the country has several very serious economic vulnerabilities. Becoming a member of the Eurasian Economic Union (EEU) in 2015, Armenia will gradually introduce much higher customs tariffs. The government has negotiated a transitional period of 2-8 years for approximately 700 commodities. Customs procedures have been simplified for the internal trade of the EAEU countries, but several bureaucratic problems have arisen for the companies trading with non-EEU member countries.

Closed borders and limited links to the broader global economy have produced a kind of incubation effect, but an inherent structural vulnerability can be attributed to three elements: the country’s dangerous dependence on the influx of remittances from Armenians working abroad; its narrow reliance on the country’s service, commodity and construction sectors as the main drivers of economic growth; and, most distressing, the closed oligarchic economic network centered on several informal commodity-based cartels and semi-monopolies.

Despite not signing the Deep and Comprehensive Free Trade Agreement (DCFTA) with the European Union, which would have offered an important new opportunity to overcome Armenia’s geographic blockade and closed borders, including expanded access to European markets, Armenia still enjoys a preferential generalized system of preferences (GSP) + trade status with the EU and some Armenian companies are successfully exporting into the EU. The Armenian government is seeking a new
format of relations with the European Union, which would be compatible with its current EEU status. The Armenian government is also actively promoting bilateral commercial and investment ties with several European countries. According to the Global Competitiveness Index (GCI) for 2014-2015, it occupies 85th place among 144 countries.

According to the International Monetary Fund (IMF), the banking sector has remained robust and well capitalized for over a year. The banking system is building on its positive reputation. As a result of the crisis in Russia, a strong outflow of foreign currency from Armenia was observed, putting a certain amount of pressure on the Armenian currency. Positive developments in recent years include better availability and affordability of financial services, ease of access to loans, and venture capital availability.

Nevertheless, interest rates remain very high. The sector needs serious reforms and development, as the banking and financial services sectors are fundamentally limited by the small size of the country’s financial sector (total assets are still well below 20% of GDP), with small and undeveloped capital markets.

Armenia’s central bank conducted a banking reform aimed at improving and enlarging the banking system. According to the central bank’s decision in December 2014, banks will have to increase their capital from 5 to 30 billion drams (over 60 million USD) by 2017. This decision was made to increase local currency demand as part of the measures against dram depreciation. Although there have been some advances in terms of strengthening creditor rights and improving banking supervision, there is still a lack of adequate corporate governance.

8 | Currency and Price Stability

The Armenian central bank has consistently followed a strict policy of fiscal discipline, and has continued to maintain prudent monetary policies aimed at ensuring macroeconomic stability. The 2015 state budget includes an almost 5% increase in state spending, set at 1.31 trillion drams ($2.9 billion), and projects a fiscal deficit-to-GDP ratio of 3%.

According to the state budget, the government has also pledged to reduce the deficit by increasing the level of overall tax collection by a planned 13%, targeted at a total of 993 billion drams in new tax revenue. The draft 2015 budget is based on a projected 4.1% rate of growth in the Armenian economy. The International Monetary Fund expects a lower growth rate of 3.3%. The sanctions against Russia, a key trading partner of Armenia, have already had a negative impact, causing a nearly 30% devaluation of the Armenian currency in December 2014.
Yet there are some unresolved problems, as Armenia has been subject to increased money demand and a flexible exchange rate regime, which requires steady capital infusions, although it has been important for mitigating the adverse impact of external shocks. Over the past two years, the steady appreciation of the national currency (the dram) has raised questions about how appropriate it was for the state to intervene in supporting the currency’s value well beyond normal market considerations.

Armenia’s economic performance has remained stable over the past three years, with 3.4% growth in 2014, low inflation, a low fiscal deficit, and improvements in the agriculture and services sectors. Armenian imports are more than four times higher than the exports, making Armenia significantly exposed to external shocks. Armenia’s general government debt increased in 2013-2014 to 44.1% of GDP, as compared to 39.4% in 2011-2012.

But there is a deeper structural problem in the Armenian taxation system. Specifically, state revenue has traditionally relied on proceeds from the value-added tax (VAT), most of which is generated from imported goods. Accounting for a little more than half of all state revenue, the VAT has now become the leading source of state revenue, far beyond the meager level of corporate profit tax collection. Yet after several years of double-digit economic growth, such a discrepancy between a dangerously high reliance on the VAT and a meager rate of corporate tax income is worrisome for two reasons. First, such an over-reliance on the VAT for overall tax collection is not sustainable over the long term and, as the low level of corporate tax revenue shows, has only deferred more serious budget shortfalls while tax evasion and underreporting has gone unpunished. In addition to that structural problem, the high dependence on VAT-related tax revenue, rather than more significant corporate and import taxes, tends to impose an unfair tax burden on the country’s lower and still-emerging middle classes, as individual consumers are increasingly forced to endure even higher sales and value-added taxes than medium- and large-scale business enterprises.

The International Monetary Fund (IMF) supported Armenia with a program, which included EU macro-financial assistance of 100 million USD in 2014-2015. EU macroeconomic financing is unlikely to continue. Despite optimistic forecasts of the government, the country could fall into recession in 2015. Even more significant, in terms of the dangerous linkage between the state budget and tax collection, the Sarkisian government already faces a new, looming economic crisis. The crisis stems from the combination of a possible downturn in economic growth with a potential rise in inflation set off by significant price rises for food, gas and other basic commodities. Further negative factors are the declining international reserves and private remittances. Armenia’s gross international reserves as of late November 2014 decreased by 7.2% from January 2014 to 1.68 billion USD.
9 | Private Property

Armenian property rights and the regulation of property acquisition are adequately defined and soundly defended. This stems from an initial focus on private property during the country’s early stages of privatization and transformation, although incidents of privileged control and corrupt practices undermined the efficacy and integrity of the overall privatization program. The government has continued to make progress by reducing state interference in business formation and strengthening property rights. For instance, Armenia’s procedures to start a business and to register a property have been further simplified in 2012: Now it takes only three procedures and eight days, in contrast to six procedures and 15 days in 2011.

Armenia has a flourishing private sector that has expanded over the last two years. A number of successful local and outsourcing companies in the IT, textiles, jewelry and other sectors operate in Armenia. The government has recognized the role of the private sector as the engine driving sustained growth, and has improved the business environment by reducing regulations, improving the bankruptcy law and the administration of customs, and strengthening the banking system. However, burdensome bureaucratic procedures still tend to hamper private-sector commerce.

Although the government promised to promote small and medium-sized businesses, the authorities have approved a set of amendments to the tax code that will significantly strengthen the control over tax reporting by small enterprises. Due to mass protests of small business representatives, the government delayed the implementation of this law. According to the amendments to the law on turnover tax, which came into force in Armenia on 1 October 1 2014, the tax rate for businesses in the country has dropped from 3.5% to 1%. However, now businesses will have to submit documents on their commodity circulation. Until now, the government offered important incentives for smaller firms with an annual revenue of less than 58.3 million drams ($144,000), including a reduction in the number of financial reports that they are required to file with the State Revenue Committee.

10 | Welfare Regime

Armenia has one of the highest social inequality rates in the region and formal (state-provided) social safety nets account only for a small share of welfare provision for the population. Although the state provides the basic elements of a social safety net, the general overdependence on (decreasing) external remittances has reduced the value and adequacy of the social safety net for most families. Structurally, social assistance in Armenia is based on the provision of limited cash benefits as well as some limited state subsidies for energy (e.g., the “lifeline” utility tariffs). Social insurance (e.g., unemployment and pension pay) are both flat-rate benefits. In Armenia, social safety nets are also based on family and kinship structures, on which individuals often rely for support in moments of emergency and need.
Over the last two years, inequality of opportunity in Armenia has worsened. Social divisions distort access to state benefits and services and result in uneven availability of opportunity. Although some elements of the country’s economic reform and poverty-reduction strategies seek to correct this inequality, there are no practical or direct avenues for doing so. Moreover, the return of a significant number of migrant workers after the onset of economic crisis in Russia has exacerbated the lack of economic opportunity.

A number of legal acts include anti-discriminatory provisions, but there is no anti-discrimination law. Party electoral lists are required to have a minimum of 30% women. There is also a geographic aspect of this socioeconomic divide along urban-rural lines, which is marked by an over-concentration of economic activity and opportunity in urban centers and the capital. This division has fostered more pronounced regional and rural income inequalities and is exacerbated by a wide variance in the quality and accessibility of essential public services, such as healthcare and education.

11 | Economic Performance

Following the launch of economic reforms, Armenia’s economy posted an impressive record of double-digit economic growth, making Armenia one of the fastest-growing former Soviet states. This growth was matched by low inflation and an increasing level of real per capita income. Investment levels also continued to rise, accompanied by a substantial expansion of the private sector, which currently accounts for over 80% of GDP.

The growth was mainly concentrated in the construction and service sectors. Most economic assessments warn of the dangers posed by an overemphasis on statistical growth, without sufficient attention paid to overall poverty, the closed nature of the market, and widening disparities in wealth and income, which have led to a serious socioeconomic divide. According to the official data, Armenian GDP posted an increase of 3.4% for 2014.

Armenia’s membership in the Russian-led Eurasian Economic Union (EEU) as of January 2015 poses a major challenge for its economy. Armenian companies have faced a number of difficulties since the implementation of new EEU customs procedures. There is still some confusion over norms and standardization regulations in the EEU and some of these regulations contradict EU norms. The parliament has adopted a number of legislative amendments to promote the export of Armenian goods.

According to the World Bank’s 2015 Doing Business report, Armenia very much improved its tax reform indicators. The country advanced 32 points from 2014 and
now ranks 41st among 189 countries in the category “Paying Taxes” category. Tax revenues totaled 23.2% of GDP in 2013, compared to 18.6% in 2012. Total external debt stood at nearly $4.588 billion for 2013, up roughly $216 million from the 2012 level of $4.372 billion.

The government has set a 5-5.7% GDP annual growth target for the period of 2015-17. However, the International Monetary Fund (IMF) forecasts much lower growth rate for 2015. The IMF has warned of the need for a “radical improvement” in tax collection and the business environment, noting that doing business in Armenia continues to be difficult due to the country’s geopolitical isolation and closed borders, governmental corruption, and an overall absence of clear and predictable government regulations. The IMF also remains concerned about the government’s failure to reduce tax evasion and enhance competitiveness. The government needs to neutralize the unfavorable external factors through the implementation of major structural reforms. Although more power was granted to the State Commission for the Protection of Economic Competition (SCPEC), some market players still enjoy unfair advantages.

As the IMF has noted, the economic environment has become more complex, particularly due to adverse external developments. Geopolitical developments in the region (Russia, Ukraine and Nagorno-Karabakh) are key risks. Continued capital budget underexecution is a concern. Fiscal reforms are advancing, but further revenue gains are needed to address pressing social and investment needs.

12 | Sustainability

Due to the fast growth in the mining sector in recent years, Armenia has continued to confront serious environmental challenges. The high level of corruption has created favorable conditions for companies to bypass the environmental legislation. Numerous protests were held against the expansion of mining companies and the opening of new big mines (such as the Teghut copper mine and Amulsar gold mine). Many communities have opposed the construction of small hydropower plants. Environmental considerations have been increasingly taken into account as part of the government’s overall reform program. The government has identified specific concerns relating to overexploitation of natural resources, including the depletion of the water supply, soil erosion and the loss of biodiversity. The Armenian constitution mandates that the state protect the environment and ensure the rational use and exploitation of natural resources. Yet despite this overall record of environmental recognition, the trend has been toward polices promoting growth rather than policies of conservation.

The state lacks control tools to ensure effective environmental management. The Armenian government’s priority of developing and even expanding the country’s
mining sector will pose coming challenges to the balance between economic growth and environmental planning, with little practice of conducting environmental impact studies. The population in the regions where mining industry is located benefits very little from the revenues of the mining sector. Although the World Bank helped to reform the mining code and several conferences on responsible mining were organized, international actors were not able to build trust between the mining companies and critical elements within the environmental movement. In January 2015, the Ministry of Energy and Natural Resources spoke about major violations by the mining companies. It is yet unclear how the government plans to solve the issues of biodiversity, which are of crucial importance for the tourism sector. As a result of the fall in global prices for key metals in 2014, including copper, molybdenum and other base metals, the volume of Armenian exports of metals and metal ore concentrates, which now account for the country’s main export item, declined.

Armenia has three main challenges in developing its education and R&D sectors: an inability to sustain adequate levels of investment and state spending, aging facilities, and the severe effects of the country’s brain drain during the early to mid-1990s. The decline in state investment in education has predictably led to a decline in the overall quality of education. Nevertheless, Armenia has succeeded in maintaining its system of universal basic and secondary schooling. Enrollment rates at both levels remain high, and over 99% of the population is literate. The Global Competitiveness Index (GCI) for 2014-2015 placed Armenia at 105th place among 144 countries with regard to quality of scientific research institutions.

Although R&D has long been recognized as an area of strategic importance in Armenia, annual state funding for this purpose has rarely surpassed a ceiling of 1% of GDP. The government has created a strategic plan for research and innovation focusing on the following sectors: information and communications technologies (ICT), life sciences, food security and quality, environment and energy, and nanotechnology. The information technology sector has also attracted some investment and continues to serve as a strategic priority for the state.
Transformation Management

I. Level of Difficulty

Since the collapse of the Soviet Union, independent Armenia has struggled to forge new institutions of statehood and overcome a daunting set of economic, political and social challenges. Economic and political reform has been especially difficult, as the country experienced a severe earthquake, a war with neighboring Azerbaijan and the imposition of a virtual blockade. Armenia still faces serious challenges today, including incomplete democratic reform and uneven economic development. Yet it is the lack of overall good governance that remains the most fundamental obstacle to political and economic transformation.

Over the last two years, the Armenian government has been unable to sustain its traditional reliance on economic growth as the sole source of legitimacy. Internal weaknesses due to a lack of popular support and an unresolved domestic political crisis have made it increasingly difficult for authorities to manage the country’s structural fragility. Entrenched corruption and incomplete reform now threaten the economic system, compromising its ability to sustain itself in the face of mounting challenges.

More serious is the emergence of cartels and monopolies that flourish within closed economies, averting the transparency and competition that dominate more open marketplaces. These cartels and monopolies also become entrenched through their negotiations with state actors. In Armenia, given the small size of the national economy, transparency and competition are rather easy to avoid. And despite the most well-intended anti-trust legislation and bodies empowered to limit or breakup monopolies, without a strong rule of law, and political will, very little can be reasonably expected. In larger economies, such as in the East Asian region, such cronyism has resulted in state policies aimed at restricting foreign and domestic competition, in return for providing an avenue for lucrative shares to the state elite.

In both cases, however, there is a high transaction cost to such arrangements. It fosters and promotes widespread corruption, even to the point of actually weakening the state by depriving it of much-needed tax revenue. It also limits economic growth in the short run, and constrains competition in the long run, which, in turn, leads to higher prices and slower innovation. Thus, the cumulative effects are devastating for
the national economy and the society. For Armenia, with its small, infant economy still engaged in a difficult transition, such a situation threatens to further destabilize and isolate the country.

More than seven decades of communist rule resulted in virtual elimination of most pre-Soviet forms of civil association in Armenia. As a consequence, present-day Armenia has no deeply-rooted civic traditions. Formal civil society, represented by the NGO sector, is a post-communist phenomenon. Although Armenian society is characterized by vibrant social capital, formal civil association, in particular membership in civil society organizations, continues to be unpopular. The public trust toward civil society, according to recent surveys, remains markedly low, and NGOs are often associated with political actors. Levels of interpersonal or social trust are also fairly low.

The influence of Armenian civil society is generally constrained by the state’s failure to engage it in constructive dialogue or to grant it a role in public debate or the formulation of policy. There is also a second challenge, stemming from a demonstrable lack of equal opportunity. There has been continued progress in both the number and activity of civil society groups, with a greater breadth of civic and non-governmental organizations (NGOs) dealing with a wide range of issues. Nevertheless, only a handful of these groups operate with any consistency.

Internally, there is no real evidence of ethnic, religious or social conflict. Yet over the last two years, confidence in the government has eroded to the point of political crisis unprecedented in Armenia’s recent history. In this way, the Armenian government’s most basic challenge stems from a distinctly new political context, insofar as the population has emerged from years of apathy to voice fresh and insistent demands for change. This is rooted, at least in part, in the opaque nature of the Armenian political system, in which dissent is seen as a direct threat to the state rather than as a characteristic element of a healthy democracy.

II. Management Performance

14 | Steering Capability

In 2013, the Republican Party secured its positions in the executive and legislative branches of power. Since the key opposition parties have refused to participate in the presidential elections and haven’t supported the opposition candidate Raffi Hovannisian, the strategic priorities of the political forces have concentrated on the policy areas of civil society interest. In late 2013, the four main opposition parties formed a block, formulating a 12-point list of demands for the government to fulfill.
This agenda included taxation issues, pension reform amendments, environmental problems and many other important points of public policy.

The government has fulfilled only few opposition demands. This was achieved mainly by means of strong pressure through civil society actors. However, no notable transition in the government’s strategic priorities occurred during that period. In early 2015, the opposition block of four parties collapsed, mainly because their agenda was based on civil society demands and special interests dominated.

In 2014, under the incumbent president Sarkisian, the government took the initiative of making constitutional changes a priority. Despite the government’s position that transition to a parliamentary system would be a progressive step, there are many suspicions that president Sarkisian intends to secure the power of his Republican Party for the period after 2018. In terms of external economic policy, the priorities of the government are questionable and are seldom consistently pursued. The overnight decision on integration into the EEU, for instance, was made due to security priorities driven by Russian pressure. There was no proper consideration of economic expediency – not to mention that no concerns were raised in the extended negotiation process with the EU prior to the turnaround.

Although Armenia has established the basic framework for a modern market economy and has demonstrated sound macroeconomic policymaking, the sustainability of these previous achievements now depends on carrying out the next generation of reform. Moreover, if sustainability is to be attained, a greater degree of political commitment to the implementation of these reforms must be shown with the government withstanding political pressures in pursuit of its strategic economic objectives. The two areas most glaringly in need of further reform are the banking sector and the social sector, each of which demands policies designed to correct widening disparities of income and wealth. Also critical are improvements in the judicial sector that would foster greater efficiency and effectiveness in enforcing contracts and regulating commerce.

The Armenian government has not been particularly effective in implementing its anti-corruption agenda during the reported period. In 2013-14, no high-profile corruption-related arrests were made. Only several lower-ranking public officials were dismissed on corruption charges in 2013. Up to 2013, Armenia was ahead of its South Caucasus neighbors in adopting EU legislation in numerous sectors. Many of the new laws were connected with the Association Agreement and the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU which Yerevan negotiated up to the summer of 2013. However, the Armenian government hasn’t been effective in implementing its policies. In many cases these laws conflicted with oligarchic interests and remained on paper.
Over the past two years, public interests have increasingly conflicted with oligarchic interests. Ministers running businesses are not willing to reform the old structures, which give rise to a number of benefits for themselves. One of the most startling lessons of the past two years is the fact that the Armenian state can no longer maintain its economic system. If the state is to weather the current economic crisis, it must put an end to its reliance on the twin evils of corruption and oligarchic cartels and monopolies. Faced with an already apparent shortage of political legitimacy, the Armenian state can no longer sustain the closed economic system that has deformed and distorted the country in recent years.

In contrast to the government’s constructive response to the 2011 opposition rallies, over the past two years, president Sarkisian has elected to suppress numerous street protests or weaken them by means of administration. The quantity of clashes between citizens and police forces has increased. In part due to his low popularity, the incumbent’s strategy in the wake of the 2013 presidential elections was to take a softer approach with respect to political dissents. The situation changed in late 2013. Instead of including the positive energy of social protests in the public policy agenda, the government started to ignore or suppress the rising civic activism. Nevertheless, the government is aware of the importance of reform-oriented and critical civil society groups, so as to maintain a certain level of independence in the context of Armenia’s balancing act between Russia and the West.

As a result of mass protests against pension reform, the government made some concessions and excluded the private sector from pension reform. There were several signs suggesting a newfound political will within the Sarkisian administration, however, aimed at reforming and bolstering the tax and customs services and seeking to combat the oligarchs’ permissive approach to tax evasion. President Sarkisian used administrative power and unverified information to warn oligarch Gagik Tsarukyan not to radicalize his party and to exit from politics. The new prime minister has reiterated his commitment to defeating the power of the oligarchs by attacking the economic monopolies and cartels that fuel and finance the oligarchic system and fostering the greater transparency and competition that are characteristic of an open marketplace. However, in addition to the need for greater anti-trust legislation and stronger state regulatory bodies empowered to break up monopolies, stronger rule of law and political will are needed to overcome this cronyism. There has been no significant increase in the government’s efforts to tackle corruption.
15 | Resource Efficiency

In 2013, the Armenian state budget deficit, still struggling with residual effects of the economic crisis, increased from 1.5% of GDP in 2012 to 2.7%. Public debt reached its highest level since independence at 44% of GDP in 2013-2014. With no significant improvements in the organization of public administration, the government has similarly made no notable progress in the decentralization of state institutions. Tax revenues increased from 17.1% of GDP in 2012 to 23.2% in 2014. This was achieved through efficient administration, however this level of tax revenue is still very low in regional comparison.

Positive developments in public organization include policies to merge self-governing communities with the goal of increasing their financial and organizational potential. Another notable development was the adoption of the Law of Public Service, which requires all government officials to regularly submit statements on income and property. This law is to be regulated by the new Commission on Ethics of Senior Public Officials.

Although the Armenian government has developed a fairly effective resource base and has made some gains over the past two years in implementing broad civil service reforms, the state must utilize a new generation of dedicated and skilled personnel more effectively. To date, the most fundamental shortcoming in resource management has been the lack of merit-based advancement. Positions and benefits have flowed to those with connections, and an inadequate pay scale has fostered greater cronyism, which together limit the state’s ability to effectively utilize its resources.

The closed nature of the system is offset by fairly well-developed administrative competence at many levels of government. Despite some recent reforms in the last four years targeting the civil service, corruption within these structures remain a serious challenge, however, and civil administration remains hindered by a legacy of inefficient and burdensome Soviet-era practices. Additionally, although there is a reasonable administration of justice, adjudication remains contingent on political, personal or financial interference (such as bribery). This is related to a fairly weak rule of law, matched by a flawed system of law enforcement and a sometimes checkered record of justice, primarily in the less developed regions of the countryside, but not excluding incidents in the major cities. Similarly, the lack of an independent judiciary also tends to weaken the efficacy of state administrative bodies and fosters a general public mistrust of the system.
Dominated by hierarchical bureaucracy and high reliance on informal power networks rather than formal institutions, the Armenian government is not very efficient at reconciling conflicting objectives. During the review period, one of the most glaring deficiencies in policy coordination has been the lack of a coherent government policy in the face of a new domestic political crisis and the onset of serious external economic pressure. For the Armenian authorities, the past years have only reaffirmed the overwhelming need for good governance, including better transparency, ethics and accountability and more competent administration. These prerequisites are notably lacking today, exacerbating the danger of the fresh crisis.

The Armenian government also had difficulties in making the appropriate choices in its foreign policy. The decision to choose the Eurasian Customs Union over the European Union DCFTA is just one example of the government’s inability to effectively reconcile conflicting policy options.

In the beginning of 2015, the government decided to set up a new anti-corruption council. Interestingly, the head of this council is the prime minister. Another high-ranking official with conflicts of interest, two civil society representatives and one member of each opposition faction of the parliament are members of this body. Shortcomings in Armenia’s anti-corruption policies have been most clearly demonstrated by the powerful role of Armenia’s small wealthy political elite, the so-called oligarchs, who exercise not only commercial and economic power through commodity-based cartels and monopolies, but who have also acquired political power after becoming parliamentary deputies. Left unchecked, their ill-gotten wealth and political power threatens democratization and the rule of law and allows them to further consolidate and protect their informal networks of power.

Some improvements in the fight against corruption have taken place over the last two years. In 2011, the Law on Procurement and a new criminal code were adopted. The same year, e-government services were launched to reduce low-level government corruption. Procedures for issuing business licenses were also simplified in an effort to tackle corruption. In 2014, the government started consultations on the draft Anti-Corruption Strategy 2014-2018.

Apart from directly tackling corruption, the government also introduced measures overseeing the ethical and financial status of high-ranking state officials. For instance, the Law on Public Service requires all state officials to submit declarations of their income and assets. Indirect efforts at reducing corruption also included the establishment of the Commission on Ethics of Senior Public Officials, which is tasked with monitoring declarations on income submitted by high-ranking officials.

In 2013, despite material evidence published by Hetq (an online newspaper published by the Investigative Journalists NGO), prosecutors failed to charge Prime Minister Tigran Sarkisian and Ararat Archbishop Navasard Kchoyan with corruption-related offenses. This indicates a general unwillingness of the government to pursue corruption investigation against high-ranking officials.
There is a general consensus on the twin goals of democracy and market economy. More recently and more problematically, this consensus also extends by and large to the planned constitutional reform, essentially meant to tailor the constitution to the needs of the president serving his (constitutionally) final term. Having neutralized its main political rival (the Prosperous Armenia Party), the ruling Republican Party has removed practically all obstacles to the planned constitutional reform. The president invited all other political parties to issue a proposal for the draft concept. Only the Armenian National Congress (ANC) refused to take part in this process. The ANC, a coalition of opposition parties, emphasized democratic values as the core of its 2012 campaign. Democratic reforms were also the priority for the presidential candidate, Raffi Hovannisian. Electoral irregularities and claims of fraud repeatedly emphasized by the opposition further reduce the credibility of the incumbent in promoting democratic reforms. The crisis of political parties has increased the role of extra-parliamentary forces and semi-criminal structures.

No significant distinctions exist between the government’s and the major opposition parties’ views on market economy. Their positions slightly differ in few particular areas. Nearly all political parties represented in the parliament criticized the failed economic policy of the governing party, demanding that the social dimension be strengthened and free competition ensured.

Anti-democratic actors include criminal structures within the political parties, which are often interconnected with the ruling elites. Governors or officials who commit crimes and enjoy impunity are also a threat for the free democratic order and rule of law. Since the incumbent government is mostly satisfied with the status quo, it shows no determination to jumpstart the country’s stalled democratization process. The ruling elites’ failure to hold free and transparent elections make it the strongest veto power to democratic reforms.

A power competition is underway between political and economic elites. This struggle may devolve or expand to include some new form of actor capable of confronting the reformers outside the confines of the existing system. Some politicians and media representatives use anti-democratic rhetoric to create false dichotomies between democratic values and security issues.
In the period from 2013 to 2015, the authorities refused to meet the opposition halfway and include their political demands in government agenda and so depolarize the political landscape, and hence faced more conflicts with different social groups. The growing polarization of society has generated substantial unrest, primarily on the local level but in June 2015 also on a large-scale national level. As a rule, government officials and the police use conflict management tools primarily in the final phases of protests.

Dominated by the incumbent and marred by the intimidation of opposition candidates, the 2013 presidential campaign deepened cleavages between the largely unpopular president and polarized opposition actors. In 2015, the incumbent president threatened serious consequences and used the language of ultimatum to stop the political career of the Prosperous Armenia Party leader and put an end to the opposition movement.

Armenia has slipped into a political crisis rooted in deadlock between the authorities and the opposition. The deadlock is driven by an unpopular government that refuses to recognize the country’s new political reality and an opposition movement that seems devoid of any clear policy alternatives. The government’s lack of legitimacy and absence of any popular mandate have exacerbated its tendency to favor authoritarian rule over accountable governance, and it has retained a myopic view that sees dissent only as a direct challenge to its authority. Overall, many conflicts within society are no longer controlled by political parties.

No significant progress has been achieved on the Nagorno-Karabakh issue. In August 2014, violence escalated along the line of contact in Nagorno-Karabakh, resulting in dozens of casualties on both sides. There have been no changes to the line of contact since the 1994 ceasefire agreement. Calls to recognize the independence of Nagorno-Karabakh were often exploited by both the incumbent and opposition during the parliamentary elections, as well as in the 2013 presidential campaign.

The period from 2012 to 2014 was marked by an intensification of street protests and formation of new civic initiative groups. This activism was capped by a successful campaign of the Dem.am movement for amendments to pension reform, as well as the “We pay 100 drams” movement against the planned increase in public transport fares in Yerevan. Inspired by the successful struggles of environmental groups for the protection of Mashtots Park and Trchkan Waterfall, the activists secured a number of concessions from the government.

After this active phase of street confrontation, some civic groups are becoming radicalized and others are rethinking their strategies or finding political agendas. While the government does not overtly impede civil society organizations, it continues to exclude civil society from participation in the political processes. Although civil society in Armenia has been both vibrant and vocal for many years, the new upsurge in civic activism stems from a wave of grassroots, youth-led momentum over issues including the environment and urban planning.
The most violent clashes took place in January 2015, when residents of the second-largest city Gyumri revolted against the inaction of the prosecutor’s office in the case of an Armenian family allegedly killed by a Russian soldier. A wave of angry street protests were also sparked following the fatal beating of a military doctor in 2012 at a Yerevan restaurant owned by a notorious businessman, Ruben Hayrapetian, who was later forced to resign as member of parliament. That incident only exacerbated an already deep-seated sense of outrage at the arrogance and abuse of power and position by the class of so-called oligarchs, and businessmen-turned-politicians.

The government has largely ignored civil actors’ criticism and has tried to marginalize them using patriotic propaganda and the strong influence of the TV channels on public opinion. The government also ignored various civic protests held throughout 2013-14, including a 1,500 strong demonstration against pension reform and rallies against Armenia’s membership in the Eurasian Customs Union.

The Armenian-Turkish reconciliation process remained stalled between 2013 and 2015. In February 2015, President Sarkisian withdrew the Armenian-Turkish protocols from parliament as Turkey had not taken any steps to ratify them.

Many heads of states are expected to visit Yerevan for the 100th Anniversary of the Armenian Genocide on 24 April 2015. Remarkable Armenian-Turkish rapprochement is taking place at the civil society level.

17 | International Cooperation

Armenia is still undecided about the future framework of EU-Armenia relations. Despite this, many common reform projects continue to be implemented. In recent years Armenia has made notable progress in reform, and Armenia has performed well in specific policy areas, in terms of fighting inflation, maintaining monetary stability. The successfully negotiated Association Agreement and a Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU were not signed and ratified in 2013.

In addition, Armenia stepped up its cooperation on anti-corruption efforts and judicial reform with both the European Union and the World Bank. Armenia’s collaboration with the Council of Europe was focused on electoral reforms. Yet, due the uneven and slow pace of reform, Armenia’s cooperation with international partners on democratization remains inconsistent.

On 1 January 2014, the EU-Armenia visa facilitation agreement came into force. The agreement covers simplified procedures for processing short-stay visas for the Schengen area. The new visa liberalization agreement grants new categories of travelers, such as university students, academics and state officials, easier eligibility rules for long-term and multiple-entry Schengen visas; and it brings Armenia and the European Union a step closer to a wide-ranging association agreement. For its part,
Armenia has also unilaterally lifted its visa requirements for EU nationals, effective 1 January 2013, offering EU citizens a visa-free regime good for up to 90 days per visit to Armenia.

The credibility of the Armenian government suffered after the unexpected about-turn toward the EEU in September 2013. Nevertheless, the Armenian government’s commitment to democratic reforms, although not always realized into practice, is recognized by international actors. For instance, Armenia continues to actively cooperate on democracy-building projects with USAID, UN agencies and other international promoters of democracy.

However, the irregularities observed during the 2012 parliamentary and the 2013 presidential elections have caused international concern on the part of the European Union and the Organization for Security and Co-operation in Europe (OSCE), among others. The access to justice, impunity, violations of human rights and freedom of speech were highlighted in the European Neighbourhood Policy recommendations paper for Armenia (published in March 2014).

The lack of commitment from the Armenian government in cooperating with the EU on mutual projects and its indecisiveness with regard to choosing between closer cooperation with the European Union or Russia is just one example of the somewhat limited credibility and reliability of the incumbent government in its commitments to the international community.

Although Armenia seeks greater cooperation with its neighbors, seeking to overcome the effects of closed borders with Turkey and Azerbaijan, there has been no real change in the period under review. The blockade is particularly damaging for the landlocked country. After the failed attempts to ratify the protocols on normalization with Turkey, the 100-year anniversary of Armenian Genocide in 2015 may present a challenge, but may also offer new opportunities for a new approach to normalization. Despite differing geopolitical orientations, relations with Georgia and Iran remain good.
Strategic Outlook

Currently, all parties are repositioning themselves in preparation for the next parliamentary elections in 2017. If the constitutional transition to a parliamentary system takes place, the upcoming elections may become crucial for the political parties. After the September 2013 policy reversal and the president’s decision to join the Russian-led Customs Union, police brutality against peaceful protesters has intensified. The potential for internal unrest or political instability has increased in recent years. The police force and security services are unpopular and enjoy very little trust, driven by a record of abuse of power and cases involving the excessive use of force against detainees and civilians. Given that popular demand for reform remains unaddressed, there is a growing risk of radicalization of political forces. The law enforcement bodies have been undertaking strong measures to neutralize every real threat of a “color revolution”.

The period from 2012 to 2014 was marked by an intensification of street protests and the formation of new civic groups. Inspired by the successful struggle of environmental groups for the protection of Mashtots Park in Yerevan, activists secured a number of concessions from the government on various issues. After this active phase of street confrontation, some civic groups are becoming radicalized and others are rethinking their strategies or finding political agendas. While the government does not overtly impede civil society organizations, it continues to exclude civil society from participation in political processes.

The quantity of clashes between citizens and police forces has increased. Instead of including the positive energy of social protests in the public policy agenda, the government has started to ignore or suppress the rising civic activism. Nevertheless, the government is aware of the importance of reform-oriented and critical civil society groups, so as to maintain a certain level of independence in the context of Armenia’s balancing act between Russia and the West.

Many heads of states are expected to visit Yerevan for the 100th Anniversary of the Armenian Genocide on 24 April 2015. The Armenian-Turkish rapprochement has major potential at the civil society level. A peaceful settlement of the Nagorno-Karabakh conflict can be achieved when all involved parties are able to speak with the same language of democratic legitimation. However, during the reported period, all efforts to peacefully resolve the conflict were unsuccessful. Instead, the number of armed confrontations increased in 2014.

The Armenian government must demonstrate a new sense of political will and commitment to reform. Legitimacy and free elections, as well as dialogue with civil society actors are the keys to development. The government’s lack of legitimacy and absence of any popular mandate have exacerbated its tendency to favor authoritarian rule over accountable governance, and it has retained a myopic view that regards dissent only as a direct challenge to its authority. Overall, many conflicts within society are no longer controlled by the political parties. Decentralization and sustainable development are the key challenges for the Armenian economy.