A New Model for Job Creation in Armenia: Promoting More Effective Accumulation, Competition, and Connectivity

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KEY MESSAGES

- In Armenia, more effective accumulation, together with greater competition and better connectivity with the rest of the world, will increase pressures on firms to compete and innovate and will thus reinvigorate job creation.

- In order to more effectively channel savings into investment in those industrial sectors with the best potential for growth and employment creation, a more sophisticated financial system is required.

- A recently released World Bank report\(^1\) finds that Armenia’s State Commission for the Protection of Competition (SCPEC) needs to be given better tools to carry out its work, and it also needs to shift its focus from price levels to more vigorously pursuing anticompetitive conduct.

- A liberalization of aviation would boost growth and job creation by better connecting people, ideas, and markets.

A New Growth Model for Armenia

As the Armenian economy has now essentially recovered from the global financial crisis, a look at medium- to long-term growth drivers is in order. Despite double-digit growth and important progress in poverty reduction, the boom of the 2000s failed to solve Armenia’s employment problem. The boom was based on a foreign-financed expansion of the construction sector and domestic services while exports lagged behind, which created vulnerabilities to the global crisis in 2008–09. Coming out of the crisis, a different growth model is required.

A new World Bank study, entitled “Republic of Armenia: Accumulation, Competition, and Connectivity,” outlines four key areas that are crucial for sustainable growth and employment creation in Armenia.

Supporting High Investment

Investment thrives on macroeconomic stability and a predictable business climate. However, channeling savings into investment in the industrial sectors with the best potential for growth and employment creation requires a developed financial system that intermediates between savers and investors.

Armenia’s financial system is dominated by banks, while equity and bond markets are rudimentary. The country’s banks have room for efficiency gains and innovation and small businesses in particular face difficulties accessing loans. Private bond and equity issues suffer from weak corporate governance and inadequate transparency. The successful implementation of pension reforms would help to create significant long-term funds for investment in the capital markets, funds that will look for paper to invest in and thereby hopefully push the development of the bond market.

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\(^1\) This Knowledge Brief is based on the study by the World Bank, “Republic of Armenia: Accumulation, Competition, and Connectivity” (Washington, DC: World Bank, 2013). The report was produced by a team initially led by Souleymane Coulibaly (ECSP1) and then by Ulrich Bartsch (ECSP1). The team consisted of Tania Begazo (CICIS), Mohamed Diaby (Oxford University), Gohar Gyulumyan (ECSP1), Artsvi Khachatryan (Consultant), Tigran Kostanyan (ECSP1), Yevgeny Kuznetsov (Consultant), Martha Martinez Licetti (CICIS), Vilas Pathikonda (Consultant), Iulian Pop (Consultant), Georgiana Pop (CICIS), Siddhartha Raja (TWICT), Sandra Sargent (TWICT), Daniel Saslavsky (PRMTR), Erwin Tiongson (ECSP3), and the staff of EV Consulting (Yerevan).
Changes in regulation and the financial infrastructure would facilitate access to credit, in particular for micro, small, and medium-sized enterprises (MSMEs). This would include improving the rules for registering and repossessing collateral (foreclosure, seizure, and sale of collateral) and developing facilities for lease finance.

With regard to equity and securities markets, initiatives should focus on generating competition and innovation in the sector. These may include several spheres of intervention to generate more liquidity and competition in securities markets, such as: i) exploring securitization options for pooled MSME business revenues and receivables; ii) developing a private equity framework; iii) deepening the government debt-management program; and iv) financing major public infrastructure projects with semi-private bonds secured with project cashflow (e.g., road tolls or fees) rather than budgetary resources.

Providing High Employment

Armenia’s labor market faces challenges that affect demand (number of jobs), supply (number of workers), and the connection between the two. Given the current high unemployment, the emphasis should fall squarely on the first challenge. Job creation will respond to the removal of impediments to firm entry and business start-ups, because new firms are more likely than existing firms to be innovative and resourceful and therefore to create more jobs. Improvements to the business environment enhance competitiveness and help all firms. Crucially, more competition in the Armenian market for goods and services and the economy’s better connectivity with the rest of the world will increase pressures on Armenian firms to compete.

Figure 1. Armenia: Labor Force Participation and Employment, 2000–10

a: Employment by Sector, thousand

Source: World Bank, World Development Indicators (WDI); International Labour Organization (ILO); and Republic of Armenia, National Statistical Service (NSS).

b: Participation and Employment Rates, percent, 2009

Source: World Bank, World Development Indicators (WDI); International Labour Organization (ILO); and Republic of Armenia, National Statistical Service (NSS).

Enhancing Competition

Competition in Armenia’s markets for goods and services is hampered by a weak market structure, intrusive regulation, uneven state aid, and the presence of strong state-owned companies. According to the Global Competitiveness Index (GCI), Armenia ranks lowest among Europe and Central Asia (ECA) countries in the effectiveness of its antimonopoly policy and the intensity of local competition. This low ranking goes a long way toward explaining the lack of dynamism of the Armenian economy, which leads to low employment and low incomes. Key sectors are dominated by one or a small number of firms to a stronger degree than in other, comparable countries. In addition, state regulation and government contracts create barriers to entry for new firms and therefore to competition in these sectors, including, crucially, aviation, railways, and professional services.

Properly enforced competition policy does not target firm size but instead threatens to and actual distortions of the competitive process and resource allocation. Competition policy becomes important in cases where a firm that exhibits significant market power (defined as the ability to raise prices above marginal costs) acts in ways that distort the playing field, with potential harmful effects on consumers. Competition policy must take into account the technological characteristics of markets, as there can be instances in which, due to network externalities, consumers prefer concentrated markets with a small number of firms.

Armenia’s State Commission for the Protection of Competition (SCPEC) faces several important institutional challenges. Some aspects of the legal framework limit the effectiveness of the agency’s efforts, particularly concerning its assessment of market dominance and the structure of fines, mergers, and concentrations. The SCPEC also has an undue focus on price levels rather than on anticompetitive conduct, and lacks investigative powers.
There is significant scope to achieve efficiency gains from pro-competitive sector policies and more effective economy-wide competition policy enforcement. The removal of barriers to entry and competition is particularly warranted. In addition, competition principles need to be fully mainstreamed within broader government policies, as improvements to the antitrust and state aid framework would complement measures to reduce restrictive product market regulation.

Figure 2. Concentration Levels for Selected Armenian Food Products, HHI

The 2010 Competition Law introduced important provisions for dealing with economic groups, but secondary legislation will need to introduce a number of additional details:

i. The treatment of economic groups. This should involve the assessment of direct and indirect control of firms with ownership links and a definition of an economic entity.

ii. A definition of independence. Any such definition should include that the economic entity is entitled and has powers to define its competitive strategy without interference or influence from another economic entity.

iii. The concept of control. The concept of a group of persons in the Competition Law does not explicitly contemplate the notion of control as the basis for the existence of the group.

iv. Access to information. In order to be able to define economic entities for the implementation of the Competition Law, the SCPEC needs to have access to ownership information for the companies under investigation. This will require maintaining information channels with the State Registry, Credit Registry, and Central Depository. Memoranda of understanding that define protocols for gaining and granting access to information managed by other entities could be a useful tool in this regard.

v. Merger control policy. Merger notification procedures should be simplified and current thresholds for merger notification should be revised.

vi. Enforcement authority. The current structure of fines and sanctions and SCPEC’s investigative powers are too limited to deter anticompetitive conduct.²

vii. Constructive agency focus. The SCPEC’s implementation of competition policy should refocus on market contestability (including during public procurement) rather than on price monitoring.

viii. Promotion of competition. The effectiveness of SCPEC’s advocacy of competition principles vis-à-vis sector regulators and other government bodies and government policies needs to be further strengthened.

Better Connectivity

Armenia has few options for transporting goods over land. With closed borders with Turkey and Azerbaijan, exports can use transit corridors only to the north through Georgia and to the south through Iran. On both routes, Armenia’s mountainous terrain poses additional challenges, and roads become impassable at times in the winter. In addition to the roads, a railway line extends to Georgia and the Black Sea coast.

There is little Armenia’s policy makers can do about the country’s landlocked status, but until recently, it was “policy locked” as well through restrictive policies in aviation. As a result, the frequency and capacity of air links between Armenia and the rest of the world are relatively low, while prices are relatively high because of the constrained environment in which the sector operates. Different restrictions were in force for different markets, giving a confusing picture of Armenia’s aviation policy.

Despite recent moves to liberalize aviation, the restrictive aviation environment is largely determined by how the sector is regulated. Currently, all decision making, monitoring, and regulation is concentrated in one agency, and intrusive practices protect the two Armenian airlines against competition. All governmental matters regarding aviation are handled by the General Department of Civil Aviation (GDCA), making it the de facto policy maker and regulator. It negotiates air services arrangements (ASAs), designates Armenian carriers, and defines all market access rules for airlines (frequencies, number of allowed destinations, etc.). It also carries out the functions of a technical regulator (licensing, monitoring, and enforcement of safety and security) and manages the public-private partnership (PPP) contract with the company that won the airport concession in 2001. However, the recent bankruptcy of Armavia, the national flag carrier which ceased operations in April 2013 has removed an unofficial but nevertheless large player in regulatory decision making, as well as in discussions on bilateral ASAs. Armavia’s bankruptcy has thus opened the way for the liberalization of aviation in Armenia.

The liberalization of the aviation sector in Armenia will boost growth in air passenger and cargo traffic and promote economic growth. Yet this liberalization requires a clear policy statement outlining the government’s commitment to a competitive environment; a better separation of policy making and its

² At the time of writing the report, the SCPEC was developing guidelines on calculating fines to address these concerns, particularly to take into account the nature of the infringement and its gravity and duration.
implementation; the independence of regulators from interference from regulated entities, industry consultation, and complaint-handling mechanisms; capacity building to help the Armenian regulator better monitor and enforce contracts, including the airport management concession; and greater transparency with regard to contracts and agreements to level the playing field for actual and potential market participants.

Figure 3. Lowest Available Fares from Yerevan, Tbilisi, Baku, and Almaty Direct and Non-Stop Routes (in US dollars/km)

Source: Author’s calculations, based on the third week of November 2012.
Note: Fares do not include airport charges, security fees, or taxes.

While exports of goods are facing an uphill struggle against Armenia’s high transport costs, exports of services, especially those offered through information and communications technology (ICT), have tremendous potential. Although Armenia’s ICT sector is comparatively small, its rapid development and prospects continue to attract foreign investments. Local companies are starting to become more active in engineering, systems development, and research and development (R&D). In 2010, the size of the domestic market totaled US$91 million and the turnover of the software and services sector reached US$150 million; what is more, the sector employed nearly 5,000 professionals with above-average salaries.

The ICT sector in Armenia has an opportunity for expansion. Innovative strategies could help it to break into the league of leading global destinations, proposals that should address policies, processes, institutions, access to finance, infrastructure, and skills development. These actions would go far to improve intellectual property protection and ensure business data confidentiality, intensify export and industry promotion efforts to raise foreign investor awareness of the opportunities in the Armenian ICT-based services market, and stimulate competition and reduce barriers to entry.

Conclusion: A Reform Agenda

A new growth model for Armenia should be built on a combination of the four factors outlined here. First, higher investment and better financial intermediation between savers and investors. Second, better utilization of the labor force, including the largely untapped resource of Armenians abroad. Third, stronger competitive pressures in the markets for goods and services, which will improve incentives for companies to innovate, adopt new technologies, and become more efficient. Fourth, enhanced connections between the landlocked Armenian economy and world markets, including through land, air, and ICT.

The Armenian government’s medium-term reform agenda—supported since November 7, 2013, by a new Development Policy Operation with the World Bank—reflects these priorities. It includes critical business climate and public administration reforms aimed at strengthening competitiveness and public sector efficiency. These are expected to contribute to job creation through reducing the costs of doing business for firms, expanding access to credit to MSMEs, and increasing opportunities for employment and job creation through increased trade and connectivity within and outside Armenian borders. Public administration reforms will also contribute to a more inclusive access to services as a result of a more efficient use of resources and a more sound policy formulation framework.

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