

5.2.2. Strategy and Policy

The future development strategy must be impounded into each of the plans above. They must include a daring structural reform and related critical planning of the industry that is not influenced by the interests of any particular existing power groups. Such restructuring should be based on an analysis and evaluation of Armenia's potential in terms of selection of the future direction for Armenia, priority areas for fostering enhancement and areas to cut loose and to allow to collapse.

Another important issue for this plan is the reduction in the fiscal deficit. In order to restrain the future growth in the expenditure it is necessary to realize a small and efficient government, to which end fundamental administrative reforms are necessary.

"VISION ARMENIA-2005" aims to realize a structural reform in order that not only the economy but also the whole country operates functionally.

5.2.3. Planning Methodology and Implementation

As it is generally known in the planning methodology there are two approaches: macro approach and micro approach. "VISION ARMENIA-2005" and the "Private Sector Development Plan" employs both of these two approaches to develop the target numbers.

Planning process depicted in Fig. 5-2 appears to be common sense.

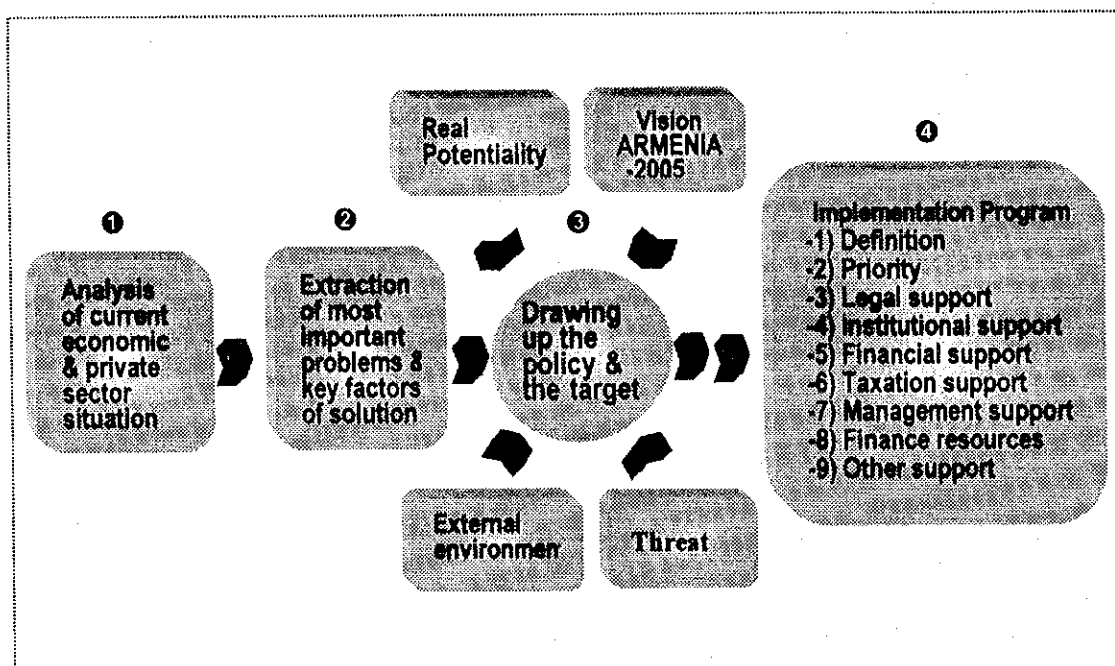


Fig. 5-2 Process of Drawing of Development Policy

Macro policy target indicators in the “VISION ARMENIA-2005” described in Table 5-2 is first given macro policy target numbers.

In a micro approach it should be prepared development plans for such main economic sectors as a plan for industry development, regional development plan, financial and budget plan, foreign trade plan, etc. In this report you may find 2 examples of idea plans for trade policy and regional development policy for reference of planing approach.

5.2.4. Foreign Trade Plan (Policy)

If current deficits in the trade accounts are allowed to continue and without financial assistance from international agencies and bilateral sources, Armenia will no longer have the capacity to settle its obligations and be bankrupt as a state even before the 7 years are up.

This plan must have as its paramount priority issue, the fostering of export industries that include import substitution industries, and have as its objective the mobilization of every possible practical policy tools to achieve the objective. The effects must begin to gradually surface by 2001 and by the year 2005 drastic improvements must be realized. In terms of the trade balance, the deficits in 1998 of approximately US\$670 million must be sharply reduced by the year 2005 and further in the future need to achieve a balance.

For example, the ultimate policy objective is **to achieve a Trade Deficit of US\$300 million or less in 2005.**

The strategy is to examine the realistic feasibility of the objective, “**what will it depend on**” and “**how the target can be achieved**”. In order to examine the basics of this strategy, an accurate understanding based on broad base of information regarding current production, exports, imports, resource endowments, and demand trends in neighboring markets whither exports are possible is necessary.

Particularly a matrix analysis of the current trade structure, in which almost all merchandise and materials are imported and only paltry number of products are exported, and markets is essential.

Without having to look at the export and import figures for 1996 and 1998, it would take nothing less than a miracle to achieve a drastic increase in the exports and restrain the growth in the imports. There in Armenia exists unutilized potential, including human resources. As under economic structure increase of exports involves that of imports, the above mentioned examination must be done, reducing imports by improving prices of domestic products and non-price competition force. Table 5-3 is the target figures to reduce the trade deficit from US\$670 million of 1998 to US\$300 million in 2005. Table 5-4 shows the trade target commodity to be increased / decreased.

The target figures below is achieved by increasing exports by approximately US\$560 million and holding down the growth of import to approximately US\$190 million in year 2005 with the resultant deficit reduction by year 2005 of US\$370 million.

Table 5-3 Target Trade Figure in 2002 & 2005 (Unit: Million US Dollars)

| | 1996 | 1998 | 2002 | 2005 |
|---------------|--------|--------|-------|-------|
| Export | 290.3 | 223.4 | 490 | 785 |
| Import | 861.5 | 895.7 | 1,015 | 1,085 |
| Trade Balance | -571.2 | -672.3 | -525 | -300 |

Table 5-4 Trade Commodity to be increased/decreased

| | Export | | | | Import | | | |
|---|--------|-------|------|------|--------|-------|-------|-------|
| | 1996 | 1998 | 2002 | 2005 | 1996 | 199 | 2002 | 2005 |
| Total Amount | 290.3 | 223.4 | 490 | 785 | 861.5 | 895.7 | 1,015 | 1,085 |
| Live animals & animal products | 0.1 | 0.1 | → | → | 67.4 | 47.5 | ↘ | ↘ |
| Vegetable products | 0.9 | 1.3 | → | → | 114.9 | 117.8 | ↘ | ↘ |
| Prepared products | 11.8 | 16.8 | ↗ | ↗ | 83.0 | 109.9 | ↘ | ↘ |
| Mineral products | 19.1 | 31.7 | ↗ | → | 192.2 | 197.6 | ↗ | ↗ |
| Chemicals | 5.4 | 2.2 | ↗ | ↗ | 56.1 | 74.7 | ↗ | ↗ |
| Textile & textile article | 9.7 | 13.6 | ↗ | ↗ | 21.0 | 31.7 | ↗ | → |
| Precious stone & metal. Article thereof | 140.3 | 53.1 | ↗ | ↗ | 129.8 | 45.5 | ↗ | ↗ |
| Base metal & article thereof | 47.3 | 40.4 | → | ↗ | 10.2 | 20.4 | → | → |
| Machinery & mechanical appliances | 34.3 | 40.1 | → | ↗ | 80.5 | 78.8 | ↗ | ↗ |
| Vehicle. Aircraft. Transport equipment | 2.7 | 3.3 | → | → | 12.0 | 47.3 | ↗ | ↗ |
| Others | | 20.8 | ↗ | ↗ | | 124.5 | ↗ | ↗ |
| New item A (software) | | 0 | ↗ | ↗ | | 0 | ↗ | ↗ |
| New item B (Gold & others) | | 0 | ↗ | ↗ | | 0 | → | → |

The target figures for 2002 and 2005 assume implementation of some policies.

- Promote domestic agriculture and substantially reduce the imports of meats and vegetables from Georgia and other countries, which combine to comprise a large share of the imports.
- Promote light industry which center on sewing industry rapidly recovering in recent years by the joint venture with foreign capital, and traditionally strong shoe manufacturing industry.
- Promote industries by means of foreign capital or technical tie up utilizing Armenia's knowledge resources such as software industry and computer related industries. Promote also other new business such as production of gold.
- Introduction of new technologies (this would result in increase in machinery imports).

Table 5-3 and 5-4 are just an example of one way of thinking, the actual target by each article must be prepared together with formulation of concrete promotion policy by the planning committee after careful analysis.

Amount and the financing sources of the capital that would be required to be mobilized in order to achieve the target need to be analyzed. Foreign direct investment is the most desirable type of financing and it is critical that conditions to attract such capital are orchestrated.

5.2.5. Regional Development Plan (Policy)

Each region deriving strength from its particular areas of strengths and specialties to be stimulated ultimately leads to the rebuilding of Armenia. From this "Regeneration of Armenia through Rebuilding of the Regions" makes sense. Authority and budget need to be allocated in such a way that the state, the issues and the potential of each region are examined on an individual region basis and that each region is able to resolve its own regional problems.

A review of the administrative division is also seen to be necessary from the point of view of achieving simplicity and efficiency of regional governments.

A regional development policy effectively does not exist in Armenia. A Minister for Regional Affairs is appointed but is practically given no budget and there have been very little organizational efforts toward issues regarding regional promotion. Even looking at official statistics, an emergence of major regional disparities in many issue areas can be seen.

Employment issue is a major problem in many areas.

There has been a recent decline in the newborn. The rate of reduction in the childbirth in most regions (MARZ) is more than twice that of Yerevan.

In the earthquake disaster areas such as Gumri, many of the buildings, factories and water and sewage facilities remain in disrepair. The state and issues of each district must be inspected and examined on a region by region basis.

There are MARZ that have too small a population for an administrative unit such as Vayats-Dzor, Tavush, Siunik, Aragatsotn. A minimum size of population and economic size are necessary for a regional administration unit and leads to question the necessity of having 10 MARZ in addition to Yerevan and the appropriateness of the budgetary distribution between the central and regional governments. Authority and budget need to be allocated in such a way that the state, the issues and the potential of each region are examined on an individual region basis and that each region is able to resolve its own regional problems.

A review of the administrative division is also seen to be necessary from the point of view of achieving simplicity and efficiency of regional governments.

Japan is a country in which the administrative units are fragmented (48 prefectures).

Table 5-5 shows the administrative units of the 3 islands, excluding Honshu that relatively approximate to Armenia in size.

Table 5-5 Number of Prefectures (Marz)

| Island | Population (1,000) | Area (km ²) | No. of Prefecture | Special status city |
|----------|--------------------|-------------------------|-------------------|---------------------|
| Hokkaido | 5,731 | 83,452 | 1 pref. | 1 city |
| Shikoku | 4,219 | 18,798 | 4 pref. | |
| Kyushu | 13,521 | 42,157 | 7 pref. | 2 cities |
| Armenia | 3,791 | 29,800 | 10 pref. | 1 city |

From among the 3 islands in Japan above, Armenia is close to Shikoku in area but within Shikoku there are only 4 administrative regions.

The largest prefecture in Shikoku island has a population of 1,528 thousand, while the smallest (Kochi Prefecture) has a population of 814 thousand. The scale of the economy of Japan and Armenia are so disparate that it is difficult to draw any comparisons but, as a point of reference, the annual fiscal expenditure of the Kochi Prefecture is about US\$ 5.1 billion.

Table 5-6 and Fig.5-3 are one example of possible reorganization of the administrative divisions into 5 MARZ + Yerevan giving due consideration to regional characteristics and existing MARZ. In Armenia GDP figures have not been collated on a MARZ level thus here industrial and agricultural output are used in its stead.

Table 5-6 An example of reorganization of Marz (Unit: Billion AMD)

| | New Marz | Population (1,000) | Output of Industry | Output of Agriculture |
|---|----------------------|--------------------|--------------------|-----------------------|
| 1 | Shirak + Aragatsotn | 526.2 | 3.4 | 63.8 |
| 2 | Lori + Tavush | 549.9 | 5.5 | 61.0 |
| 3 | Armavir + Ararat | 628.6 | 29.9 | 103.7 |
| 4 | Kotayk + Gegharkunik | 604.8 | 52.7 | 81.8 |
| 5 | Vayots-Dzor + Siunik | 232.0 | 10.4 | 41.1 |
| 6 | Yerevan | 1,249.7 | 78.3 | 4.4 |

Remark: Some items are excluded from Output of the industry.
(Source: Ministry of Statistics, State Register and Analysis)

Below summarizes the ideas and the intentions behind the MARZ reorganization described above.

① In Gumri, a place of importance in transport (the border blockage problem with Azerbaijan and Turkey will eventually be resolved sometime), reconstruction of the city and promotion of new

industries are important. Once the railroad is reopened, exports of substantial amounts of Tufa, cement and other industrial goods would become possible.

② A unique region with scenic areas of forests and canyons, hydroelectricity generation using its water resources (sale of electricity to Turkey), repair and building of irrigation to promote agriculture, resort development using existing facilities.

③ High value added agriculture, food processing industries, light industries promotion area and refining gold etc.

④ Diamond processing, jewelry production, resort development around Lake Sevan and promotion of related industries, mineral development of gold (ZOD) on east shore of Lake Sevan and other mineral resources.

⑤ Redevelopment with foreign direct investment of copper, molybdenum, fruit cultivation, promotion of processing. Also this region may be developed as the processing center of labor concentrated industries for the purpose of re-export of products to and / or through Iran.

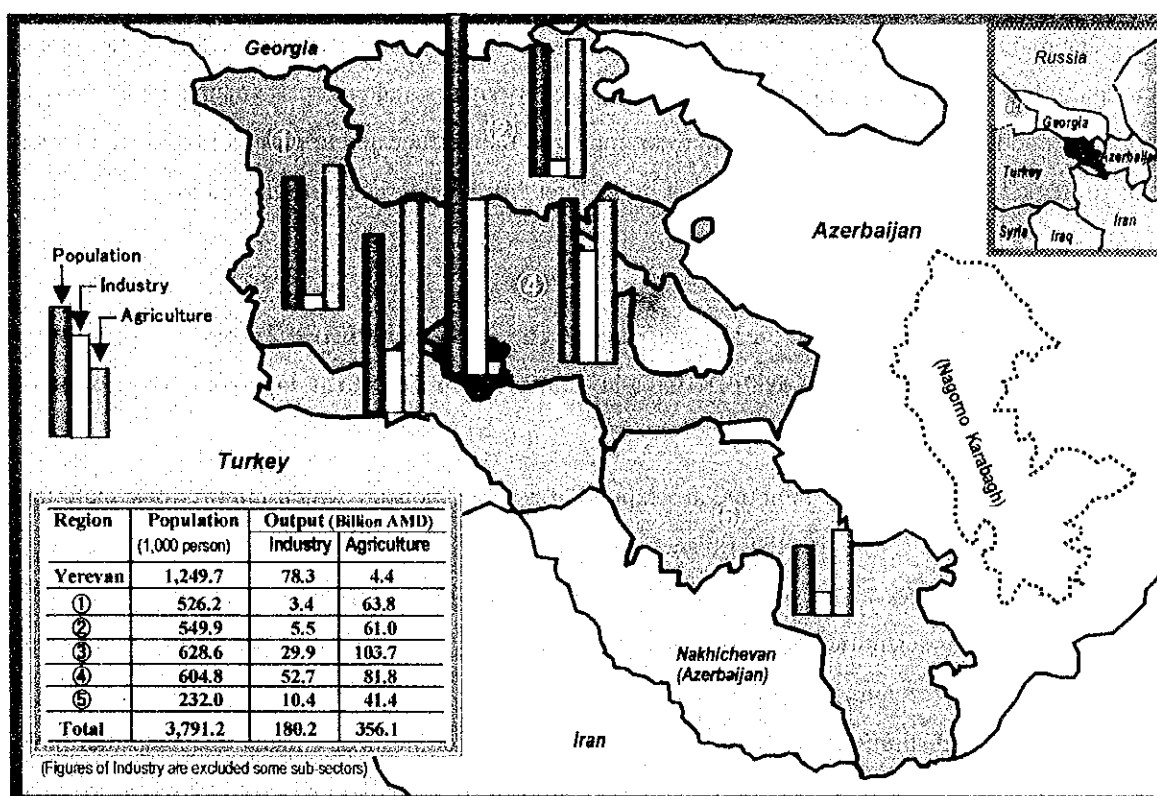


Fig. 5-3 An Example of Reorganization of Marz

5.3. Private Sector Development Plan

5.3.1. Development Strategy and Policy

The Private Sector Development Plan will form a major component of the vision for the Medium Term Development Plan.

The strategy and the methodology of the planning are basically the same as those outlined in section 5.2 but with the following emphasis.

1) The development of the Armenian economy is dependent upon the entrepreneurs taking active roles. The various systems and structures and the economic environment must facilitate the realization of the entrepreneur's ideas and efficaciously rewarding the entrepreneur's ardent efforts with reasonable results.

2) There are many energetic and resourceful entrepreneurs in Armenia (The entrepreneurial drive of those in the shadow economy goes without saying). However, the Armenian economic situation presents too many obstacles for the entrepreneurs and presents difficult challenges.

The major role of the government, under this plan, is to eliminate or minimize the obstacles and prepare the economic conditions under which all entrepreneurs and enterprise managers are able to operate and by so doing bring the shadow economy to the surface and to promote the development of strategic target sectors that are essential in the long term development of the country.

(1) Development Priorities

The priorities will be placed on 1) **export goods and services industry**, 2) **import substitution industry**, and 3) **promotion of sectors that play important roles in the long-term development of the country.**

Included in the category 1) above are export processing industry which imports raw materials for processing and re-exports the finished product, sectors that provide high quality resources, materials and services to the above 3 areas, research and development sector, contract research activities in the scientific field, software development, tourism and recreation sector that contributes to the foreign exchange revenues.

The import substitution sector in 2) includes producing domestically many products that have the potential of successfully competing with the imports in terms of both price and quality. In some cases, it will include industries that must be fostered to become successfully competitive whatever the means and efforts that are required to achieve such competitiveness.

3) includes a broad array of areas that is closely connected with the promotion of 1) and 2) above. These would include improvements in the social infrastructures including airports (emphasis

on the software side including management and provision of user conveniences), roads, communication, hotels. Also included are the development and achieving profitable production of metallic ore resources such as molybdenum, copper and gold. Enhancement of education from primary level through university education including graduate level studies and improvement in human resources development such as through adult reeducation programs are also included in the 3) category.

(2) Industrial Development Policy

The industrial development policy must be consistent with the direction of the medium term national development plan, "VISION ARMENIA-2005" proposed in section 5.2. and it must also be created as a policy for an industrial development plan that is realistic. The state of the Armenian industry must be accurately assessed. In the phase of analysis of the existing conditions through the identification of major policy issues, it would be necessary to reflect a broad spectrum of opinions of the private sector. Management of successful enterprises is well aware of the policies

It would be better for the Armenian development policies to have a wider menu of successful examples to emulate. The study group recommends that the Armenian government studies the industrial policy planning and implementation process adopted by the East Asian economies. Examples that may be subject of such a study would include Singapore, Malaysia and the People's Republic of China.

The above three countries all differ in the timing and the direction of their development strategies. Singapore has focused on becoming the operation center for the trade and finance and had invested in the infrastructure such as the port facilities, communications, roads and offices as well as into the soft areas to put into place a favorable investment climate, all of which have led to the success that they have achieved to date.

Malaysia succeeded through attracting electrical-electronic industries, mostly from Japan. In China, since the Deng Xiaoping's southern peace initiative, each province competed to implement foreign investment inducement policies, particularly for the manufacturing sector, and succeeded in dramatically increasing exports that had been leveraged to produce high rate of economic growth. By the end of 1997, they were able to forge an economic foundation that had US\$140 billion in foreign currency reserves that was just US\$3.4 billion in 1988. The common threads that runs through the three countries are aggressive introduction of foreign capital and high rates of economic growth. Singapore has achieved a per capita GDP of US\$ 30,000 in 1996.

As a reference, the trend of foreign capital introduced and the foreign currency reserves of the three countries in the period between 1991 and 1996 are shown below.

Table 5-7 Dynamics of FDI acceptance in 3 countries (Unit: US\$ Billion)

| | (Base) | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | Foreign Currency Reseve | | |
|-----------|-----------|------|------|------|------|------|------|-------------------------|---------|---------|
| | | | | | | | | 1988 | 1996 | 1997 |
| Singapore | Approval | 1.4 | 1.7 | 2.0 | 2.8 | 3.4 | 4.0 | 16.9 | ↗ 76.9 | ↘ 71.3 |
| Malaysia | Approval | 6.2 | 7.0 | 2.4 | 4.3 | 3.7 | 6.8 | 6.5 | ↗ 27.0 | ↘ 20.8 |
| China | Execution | 4.4 | 11.0 | 27.5 | 33.8 | 37.5 | 42.3 | 3.4 | ↗ 105.0 | ↗ 139.9 |

(Source: Economic Planing Agency, Japan)

5.3.2. Improvement and Utilization of Institutional Infrastructure

(1) Legal, Regulatory and Judicial Environment

The first impression of potential foreign investors is that it is difficult to gather basic information. They want to clearly know their personal rights and obligations, as well as their right to protect their investment and property. In case of conflict or infringement they want to know their problems can be solved or redressed.

The following comments of the Study Team regarding problems are summarized based on information obtained and listed in order of investors' concern.

- 1) Protection against monopolies and guarantee of free competition
- 2) Intellectual Property
- 3) Bankruptcy and recovery of debts
- 4) Settlement of disputes
- 5) Starting a Business
- 6) Land use

(2) Tax Incentives

1) Overview

Tax incentives are an important measure to foster industrial development. In order for Armenia that limit transportation measures to achieve its policy objectives such as attracting foreign investments, it should introduce daring tax incentives. As shown in Table 2-8, profit tax is less than 10 % of total revenue. Therefore, if making daring tax incentives in profit tax, it would not cause sharp decrease in tax revenue. Rather, profit tax as a whole, is expected to increase through increase in investments and effect on decrease in underground economy and other wide influence on economy. VAT and individual income tax would increase in proportion to increase in investments.

Clear priorities has to be determined according to its industrial policy, and then, introduction of

daring incentives should be considered in those limited areas, which have high effects according to the industrial policy.

The following are possible tax incentives that should be considered according to priorities of the Armenian industrial policy.

- Tax incentives to promote foreign investments
- Tax incentives to promote investments
- Tax incentives to promote exports
- Tax incentives to enhance technology

Fostering import substitute industries is important as well as export industries. It is technically difficult to put preference in import substitute industries in general. It should be considered that preference is put in import substitute products defined by the Government in tax incentives promoting foreign investments and investments.

Governmental policy should focus on practical usefulness in sustainable development of Armenian economy, and not on ensuring superficial equality. Considering current situation of Armenian economy and importance in investments, especially foreign investments, tax incentives should be considered from a view that several criteria combine into one system.

One of criteria is amount of investments. Criteria of AMD 5 million for foreign investment results exclusion of small foreign investments. On the other hand, no consideration is given to introduction of large-scale investments. For example, categorizing into 1) US\$200,000 to 1 million, 2) US\$1 to 10 million and 3) more than US\$10 million would effect in introducing various type of foreign investors.

Other important criterion is categorization based on priority considering direction of development of Armenian economy and importance in industrial policy. Various factors should be considered to make this priority. In case of Armenia, 1) Size of value added, 2) leading edge of technology and 3) contribution to export (inflow or saving outflow of hard currency) should be most important factors. In order to avoid unnecessary complications, three level such as A, B, C in each factor above, may be sufficient.

Investors or enterprises select criteria.

Geographical area and number of employment may be worth being considered additionally. Basically, the unified criteria needs to be decided by due consideration in combination of above two criteria.

2) Tax Incentives to be Introduced

Based on the above idea, outline of our proposal about four types of tax incentives is describes as follows.

a) Tax Incentives to Promote Foreign Investments

The policy intention can be achieved more effectively by introducing incentives limited to certain field of business. For example, more favorable incentives might be given to target industries such as biotechnology, computer software, export-oriented manufacturing and import substitute industries.

In the case of manufacturing, a two year tax holiday (and 50% reduction at most for 8 years, 2 years after 2002) may not be as attractive to investors, since manufactures often record losses in the first few years of investment (incorporation). In order to promote investments in manufacturing, tax holiday should start from the year of making taxable profit after applying tax loss carryover. We propose to change to the following system.

Table 5-8 Example of Tax Holiday-Incentive for FDI

| Priority \ Investment Amount | US\$0.2~1.0 mln. | | US\$1.0~10.0 mln. | | Over US\$10.0 mln. | |
|------------------------------|------------------|---------|-------------------|---------|--------------------|---------|
| | 0% | 50% | 0% | 50% | 0% | 50% |
| A | 3 years | 4 years | 5 years | 5 years | 5 years | 7 years |
| B | 3 years | 3 years | 4 years | 4 years | 5 years | 6 years |
| C | 3 years | 2 years | 4 years | 3 years | 5 years | 5 years |

Start of tax holiday: the year of making taxable profit after applying tax loss carryover.

In addition, in order to promote continuous reinvestment of foreign enterprises, tax incentives that if foreign investors reinvest profit from invested enterprises, a certain percentage (e.g. 40 %) of profit tax on reinvested amount would be reimbursed should be considered. China and Vietnam have such tax incentives system.

If importance is placed on introduction of cutting-edge technology and its sustainable development, there is an approach to reduce profit tax rate of those target enterprises from 25% to 15 %.

Same approach as Table 5-8 can be introduced in b) and c) described above.

b) Tax Incentives to Promote Investments

Favorable treatment to newly established enterprises in the past was abused in tax evasion by establishing new enterprises one to another and transfer business to those newly established enterprises. There is a need of tax incentives to promote investments in facilities by enterprises rather than investments in enterprises. Tax credit of a certain percentage (e.g. 20%) of investments is worth being considered. Favorable treatment not given in general, but given to target industries also can be considered.

c) Tax Incentives to Promote Exports

There are no tax incentives to promote exports in Armenia, currently. Favorable treatment to promote exports is essential because increase in exports is very important for Armenia.

One example is a reduction of profit tax (e.g. 50% multiplied by export ratio) to enterprises with high export ratios (e.g. over 60%) --- Method A.

Other approaches include giving favorable treatments to enterprises with a large amount of net export (export minus import), not with high export ratio, because enterprises, which Armenia should really give favorable treatments, are those with a large amount of net export, rather than those with high export ratios. However, such treatments are at high exposure to tax evasions since forgeries to decrease imports using dummy companies are easier than forgeries to increase exports using dummy companies. There is a need of some device to avoid such abused application.

For example, giving tax credit of a certain percentage (e.g. 5%) increase in net export can be considered --- Method B.

If combining Methods A and B, in other words, if such method that smaller amount is applied in the two methods is adopted, it would give an effective tax incentive to enterprises with a large amount of net export, and would be able to exclude high exposure of tax evasion simultaneously.

d) Tax Incentives to Enhance Technology

Examples are tax incentives to enhance technology are allowing double deductions of expenses (deducting twice of actual cost in calculation of taxable profit) related to enhancement of technology such as Research and Development costs or training costs, and giving tax credits based on the amount of increase for those expenses. However, such treatments have exposures to tax evasion, particularly as their accounting system has not been well developed. Risk of tax evasion is lower when focusing on the amount of increase rather than focusing on a definite amount. Such tax incentive system is popular among other countries to encourage Research and Development.

3) Securing Tax Revenue for Local Governments

Armenia does not have any local taxes. But a part of tax revenue from some taxes such as property tax is allocated to the local governments. In order to pursue regional development policy described in section 5.2.5., enlargement of tax revenue of local government would be important. However, establishing local taxes does not seem practical due to the related issue of collecting taxes. Enlargement of the current system, which allocates a part of the national tax revenue to local governments, can be more practical. Under the structure of the current tax revenue, one possible method might be the allocation to local funds of a part of the revenue from value-added taxes based on the population.

(3) Financial Sector Reform

1) Direction of Development of Financial Institutions

Development of financial institutions is essential to the development of the Armenian economy. There should be a major design as to how Armenian financial institutions shall be in the year 2005.

Some banks need to be recognized with certain confidence among world financial market by 2005 at latest. Confidence in an Armenian bank should be enhanced to that level; for example, any **beneficiary** can accept a **Letter of Credit** for the amount of US\$10 million issued by a bank without confirmation by a more creditable foreign bank.

There are 35 small financial institutions existing under the name of "bank", most of which do not make any effort to raise fund with deposits, and in fact have very few deposits, and which rely on a high yield of treasury bills and commissions on money transfer.

The above criterion is a rough example. But we believe that there is need for some radical reform in order to enhance the capital of banks → to obtain confidence from abroad and reliance from users of the banks → to increase deposits, as a result → to form a source of investment and finance.

2) Establishment of Deposit Insurance System

In order to change the situation where people are not willing to deposit at banks and rather keeping cash in their hands, establishing a deposit insurance system should be considered. The system will protect deposits limited to a couple of thousand US dollars per capita, and raise fund through insurance premiums from banks. Variable insurance rates based on capital ratio, or definite.

3) Development of Non-Bank Financial Institutions

Non-bank financial institutions sector in Armenia that includes financial institutions other than banks, namely, non-bank institutions dealing in financial products including securities companies, casualty insurance companies, life insurance companies, leasing companies, investment/money trusts, is underdeveloped. There are some 20 companies engaged in casualty, life and medical insurance but the scale is small and the scale of the funds raised is long way from being able to be effectively mobilized in economic activities. The single major factor is the lack of confidence in the institutions. Most people believe that even if insurance is contracted, the contract will not be fulfilled at the time of need.

The lack of development of the non-bank sector is one of the contributing factors behind the high level of interest rates being charged by the banks. The government needs to take measures to promote the development of non-bank financial institutions.

(4) Accounting and Auditing

- 1) Introduction of new accounting system
- 2) Support of conversion of accounting standards through on site assistance
- 3) Importance of management accounting
- 4) Fostering accountants
- 5) Fostering auditors
- 6) Enhancement of Accountants' organization

(5) Technology Development and Quality Improvement

1) Technology Development

It is needed for enterprises that the Government should implement the following 2 aspects of support simultaneously in technology development:

- a) Improvement of Technology
- b) Innovation of Technology

2) Quality Improvement

- Promoting Dissemination of ISO

The Government is implementing the gradual shift of the national industrial standards HST (Hayastan standard) from GOST based ones to ISO based ones. Also the Government is preparing to adopt ISO 9000 and 14000 in Armenia. However, so far no official institution of ISO certification was established, nor were the activities for dissemination for the adoption by enterprises of ISO standards. As for the certification, the Government is studying the possibility of having services agreement(s) either with SGS, Switzerland or ITS, U.K.

a) Dissemination of ISO 9000 to Enterprises

For the acquisition of ISO certification, it would take a considerable time. Most of the applicant enterprises have been expanding about one year from its commencement of preparation to the acquisition of certificate. Accordingly, the Government is asked to hold the dissemination workshops for the implementing staff of enterprises as well as seminars for the people in the management.

b) Scheme of Special Subsidy for ISO 9000

For SME it is relatively expensive to acquire ISO 9000 certificate. (If all costs were added up of the preparation, expenses for certification, it would amount to US\$ 5,000 to 10,000.) Now that ISO is the standard of the world, it is necessary for the Government to recognize the significance of

national level support to the acquisition of ISO standards by Armenian enterprises, just the same as being the member of WTO.

For the implementation of the above, it should be studied that either the financing having high priority and a special low interest rate under the scheme of SME Supporting Fund as the proposition of the Study Team is explained under section 5.4. (3) of this Summary be extended to the applicant to them as the case may be deemed appropriate.

(6) Human Resources Development

One of the Armenia's greatest resources is its manpower. The following 6 items are suggested for the development of human resources - the key factor in social and economic growth.

- 1) Effectively implementing the education budget - A drastic review of the number of teaching staff
- 2) Preventing the hollowing out of education in rural areas
- 3) Establishing initial education standards
- 4) Development of an open university to offer vocational retraining opportunities for working people.
- 5) Retraining teachers
- 6) Reform and reorganization of vocational technical schools

Human resource development should have as its ultimate goal the education and production of manpower adapted to meet the qualitative needs of Armenian society, and that will resultantly benefit both the individual and society as a whole. Armenia must gravitate towards creating a healthy flow of:

High quality manpower → revival of the economy → new demand for manpower

Opportunities for people who hope they can utilize their specialized knowledge in new occupations will no doubt increase with the development of the Armenian economy.

(7) Reorganization of SRI and their Effective Utilization

In order to develop scientific technology and Research and Development in Armenia, the following three policies are necessary.

- Integration and/or curtailment of research institutes are necessary according to domestic needs.
- It can be considered that promoting cooperation with foreign enterprises and/or SRIs such as contracted research work and joint research work in order to resolve lack of funds. It is necessary a system to promote such cooperation.

- There are many SRIs that perform at high levels of study. It is necessary to promote starting-up of business utilizing such studies.

UNDP has designed an aid program, "Marketing of Hi-tech Intellectual Resources". This program is worth being considered.

The program is summarized as follows:

- 1) Evaluation and selections of hi-tech R&D organizations (HTRDO)
- 2) Identification of the world markets for intellectual resources
- 3) Institutionalization of the hi-tech R&D exporting mechanism
- 4) Commercialization of selected HTRDO and their potentiality as well as organization of business partnership
- 5) Commercialization of education and training process

(In June 1999, a Japanese world-famous company placed orders on joint research works to 2 SRI in Armenia in field of microbiology and biochemistry under the Study Team's persistent recommendation.)

5.3.3. Improvement of Infrastructure through Development of Tourism

With respect to infrastructure of particular importance is the perspective on tourism development. Tourism with use of infrastructure would bring about such positive economic spillover effects, as external income to the country, development of many related industries and employment to regions with tourism resources, development of agriculture, improvement of quality in service industry, etc.

There are some common factors between a good business environment, especially for foreign businesspersons and a good environment to attract tourist. We recommend that improving infrastructure such as hotels and international and domestic transportation by implementing policies to foster tourism.

A clustering of several programs around a single strategic direction could produce without increasing costs larger and more lasting results than done separately.

Armenia has many assets that can make it an appealing tourist destination. Tourism is generally one of the popular ways to gain hard currency in developing countries. Many tourists seek:

- 1) Something new, old historical things, beautiful scenery
- 2) Art, culture, interesting things, encounters with people
- 3) Clean and pleasant lodgings and transportation

- 4) Delicious food and beverages with strong regional character
- 5) Ease in using international communications such as telephones, faxes, and email (directly from their hotel rooms)
- 6) Full installation of satellite TV (CNN, BBC, etc.), Cable TV receivers, etc.
- 7) Shopping fun (items peculiar to Armenia, folk art, ethnic design clothing with good fashion sense, accessories, gifts and souvenirs, duty-free shops selling world brands, etc.)
- 8) Safety
- 9) Quality and low prices that exceed expectations
- 10) The minimum time for procedures at airports and the like (tourists don't visit just to be kept waiting for hours)

If involved parties review and evaluate the current states of the foregoing items (actually broken down into smaller categories), establish goals on how and to what extent to make improvements by a target year, and organize a large-scale, sustained campaign, it would likely clear up many problems and inadequacies.

2001 is appropriate as the first target year because it is the 1700th anniversary of Christianity in Armenia, and many foreign travelers are expected to visit.

Armenia's tourism experience comes mainly from the former Soviet Union era in terms of both facilities and services. While facilities are of course important, it is first of all necessary to fundamentally change the perceptions of the people, including managers, working at tourism-related facilities. Some airport and hotel employees act as if they themselves are the people of central importance. Each workplace will have to thoroughly train its employees.

A shortcut would be to send Armenian tourism industry people to tourism facilities in developed and developing countries that depend heavily on tourism and have them work there and learn the ropes directly.

5.4. Building a Government Agency for Implementation of the Development Plans and Business Support Systems

In order for the government to attain an ability to reduce the fiscal deficits, substantial increases in fiscal revenues – tax revenues are essential. The only way that this is possible is by having the private sector enterprises develop into profitable and internationally competitive enterprises and increasing the income levels of the people. The responsibility of building and implementing a system to remedy the principal external environment that is impeding the development of the private sector lies with the government.

The Study Team believes that for the fostering of the Armenian private sector the following 6 structures or systems must be put in place with some urgency.

Building of these institutions forms an integral important part of the implementation of the plan “VISION ARMENIA-2005”.

(1) Creation of the Ministry for Economic Development and Planning

In June 1999, for various considerations, the Ministry of Economy and Finance was split into two ministries, Ministry of Economy and the Ministry of Finance. The original amalgamation of the Ministry of Economy and Ministry of Finance that inherited the former GOSPLAN, lacked the logical necessity in putting together the planning and the fiscal functions, thus it could be said that the breakup was inevitable.

This organization has gone through various transformations in the name, GOSPLAN → Ministry of Economy → Ministry of Economy and Finance → Ministry of Economy, function and make up since the days of the breakup of the FSU. During the transformations, a part of the organization had been shifted to the Ministry of Industry and Trade.

We have not been able to ascertain the actual functions of the newly created independent Ministry of Economy nor for which state operations it has responsibility but if it only involves the simple separation of the Economy section of the old Ministry of Economy and Finance, the roles and responsibilities of the newly independent Ministry in the economy have not been clarified. On the other hand, this Ministry is staffed with some capable economists.

As we have pointed out in the various sections of this chapter, for the rebuilding of the Armenian economy, like “VISION ARMENIA-2005” the preparation and the implementation of state medium term development plan is necessary and this requires capable economists. Centralization of the coordination function and a focal point for the acceptance and request for foreign assistance is necessary.

The Study Team, considering the above, propose that the existing Ministry of Economy be reorganized and form, de novo, a **Ministry for Economic Development and Planning** (“MEDP”) for the implementation of the functions described below.

MEDP in addition to its Think-Tank related functions would assume responsibilities for the following functions.

1) Establishment and Monitoring of Short and Medium term Economic Development Plan

- The Ministry will act as the administrative office for the “VISION ARMENIA-2005” Planning Committee created directly under the presidency, as recommended in section 5.2, and it will be engaged in the creation of “VISION ARMENIA-2005”. In addition, it will be engaged in the planning and monitoring of annual plans and will undertake the review of the plan in the fourth year.

2) Study of Diaspora and Formation of a Diaspora Network

- Examine the Diaspora who are dispersed across the world and systematically organize a network to link with the Diaspora. (The Prime Minister’s Office may become involved but because a great deal of the work would involve a long term and persistent investigations and network building a permanent organization with experts who have accumulated the information is required, an organization such as MEDP, close to the political center yet only slightly tainted by political influence would be the most suited.

3) Coordination and Acceptance of International Assistance

- MEDP will be a window of the government for requesting and receiving assistance and coordinate the various ministries’ interests. MEDP will also formulate a request for prioritized and effective assistance (draft) with a view toward the implementation of the “VISION ARMENIA-2005”.
- It will receive foreign specialists, dispatch trainees for overseas training, and undertake examinations of assistance agencies and the details of the assistance.

4) Coordination of Projects with Involvement by Multiple Government Agencies.

- The Ministry, in addition to the above, will coordinate development/investment projects that have the involvement of multiple government agencies for a timely and effective implementation.

5) Formulation and Promotion of the Implementation of Regional Development Policies

- The Ministry will formulate National Comprehensive Regional Development Plan and have it well coordinated with the development programs of the respective regions.

6) Interface for the Acceptance of 2-Step Loans from Donor Countries and International Agencies.

- It will act as the external interface for the 2-Step Loan extended as international assistance, and it will be responsible for undertaking the negotiations and determination of the basic framework for the acceptance and implementation of the 2-Step Loans.

7) Publish Economic White Paper

- The agency will prepare the White Paper on the Economy and upon receiving the approval of the cabinet, publish the White Paper.

(2) Establishment of Armenian Development Bank

1) Reasons

There are three essential reasons for the need for the establishment of the Armenian Development Bank (“**Development Bank**”).

- a) The requirement for the creation of the Development Bank has been pointed out in several sections of previous chapters. The Armenian financial sector is still in its infancy stage and still very fragile and has no capability to provide the private sector, particularly the manufacturing and export related industries, with the required funds quantitatively or in the amount of financing or qualitatively in the conditions of the financing. In addition, the private sector financial institutions are effectively guaranteed risk free income (effectively income transfers) through purchases of high yield Treasury Bills that bear average interest rates ranging from 45% to 60%. Excluding the short-term loans granted at high interest rates, they have no interest in providing short and medium term funds, that is the lifeline of industry, at reasonable conditions required by the users.
- b) The long term aid credits that have been granted by international financial institutions, other aid agencies and funds have not always been utilized as the credit had been intended.

For example, **Enterprise Development Project Credit** (US\$16.75 million, term 35 years interest free, maintenance fee 0.75%) has been extended by the World Bank with the government as the borrower. In spite of the favorable interest rate at the front end, the end user private sector enterprise pays interest rate of 15 - 21% as under the scheme, the government levies an interest rate of LIBOR + 2% when lent to the private sector bank who in turn adds 8 - 11% when the final loan is made to the user. The user is also required to provide a collateral equal to 200% of the amount of the loan and the users are required to assume the foreign currency risks associated with the loan.

The first point that needs to be made is that the World Bank financing is intended to provide financing for the promotion of private enterprises and not intended for the provision of opportunities for the government and the banks for profit taking. In other developing countries the prevailing fees extracted by the government for this type of credit is about 3%. The government's responsibility is to provide the environment where the chicken can lay eggs and the government and the financial institutions must not eat the feed intended for the hen.

The banks are provided with other people's money for which they have not incurred any cost in raising and exert no efforts in the formation and there is no rationale for the banks in charging exorbitant commissions. The Armenian political economy, as pointed out above, favors the banks one-sidedly.

LINCY (Kerkorian) Fund (\$ 10 million) is funding provided by Mr. Kerkorian at zero interest cost for fostering small and medium sized enterprises; however, the actual interest that is paid by the borrower is 15%. At the outset, the foreign exchange risks were borne by the borrower, but as a result of many criticisms from various sources, including the Study Team, the burden of the foreign exchange risks was transferred to the government. In this case the government's fee is 3% but the private sector banks levy an additional commission equaling 12%. In addition, the borrower is required to provide a 200% collateral coverage.

In order for the aid credits from international agencies to be able to function as a **2-Step Loan** according to the original intentions and be able to contribute to the development of the private sector enterprises, a receptacle - public implementation agency to eliminate the extortionist middle margins, such as those described above, is required.

c) To promote development of the private sector, provision of financial services such as production finance and trade finance that are not being provided by the financial institutions is required.

2) Outline of the Development Bank

a) Status: JSC - State Controlled Bank

b) Capitalization: US \$ 30 million

c) Investors: Central Bank - 40%, Government- 40%, public - 20%

(NB 1) For the government investment appropriate funds raised through the sale of state owned enterprises in the privatization program

d) Loan Funds: 1) Own funds

2) Long term credits in the form of **2-STEP LOAN** from aid agency.

e) Objectives: Promotion of the private sector with particular emphasis on promotion of exports and important substitution of goods and services, and promotion and development of industry and technology that have been positioned as being high target sector in the country's development

f) Functions: For project that meet with the above objectives, in addition to incorporating the function of an export-import bank, will have financing and guarantee function as listed below:

- ① Financing for purchases of production technology and equipment
- ② Financing purchases of raw materials and components
- ③ Financing the production from receipt of export order through the collection of the receivables
- ④ Financing and provision of credit guarantee relating to execution of deferred payment provision under an export-import contract
- ⑤ Financing for required capital for development of new technologies or products.
- ⑥ Other projects that effectively contributes to the development of the country or the private sector

g) Loan Limits: 20 - 80% of the required project funds

h) Loan Terms: ① Currency: foreign currency or AMD denominated in foreign currency
② Loan Amount: US\$ 100,000 – US\$3,000,000 per project
③ Interest Rate: 6 - 8% (Depending on the project details)
④ Collateral: Will accept varied forms of collateral. For example if the financing is for the purchase of machinery, the machinery purchased (100%), if to finance an export contract, an assignment of the export contract.

i) Syndication: Promote syndication with commercial banks. The combined amount of the loans will not exceed the above loan limits and the Development Bank will hold the first mortgage over the collateral. If the minimum interest rate that the commercial banks (funded out of own resources) are able to charge for their portion of the loans exceeding 8% per annum, then the Development Bank will, to the extent possible, make adjustment in their interest rates in order that the ultimate cost to the borrower is not excessively unfavorable.

For example, if the borrower wishes to finance a purchase of a machinery costing US\$1,000,000, the loan that would be available from the combination of the two sources would be US\$800,000 or 80% of the purchase price. If the commercial banks were to extend US\$200,000 of the amount at an interest rate of 10% per annum, the Development Bank's portion of US\$600,000 would be lent at an interest rate of 7.3%

By using such type of syndication approach, an attempt is made to mobilize the private sector banks. Exclusively the Development Bank will do the credit

evaluation and the monitoring of the loan after execution. The commercial banks, therefore, are able to obtain client who is relatively safe at a minimal cost expended for credit evaluation or credit control.

- j) Other: In addition to the items above, there are many issues that need to be considered in preparation for the establishment and the operations of the Development Bank. These would include method of establishment, organization, functional authorities and responsibilities, recruitment and compensation of staff, method of evaluation of loan projects, process of loan decision-making, loan agreements, collateral, and methods of monitoring of the borrowers. It is necessary to prepare a planning memorandum for the establishment of the Development Bank that takes into consideration all relevant issues. The planning memorandum should be neutral with no bias and should be prepared by an experienced specialist. If a request for technical assistance is made regarding this, it is likely that a cooperation from a donor would be forthcoming.

3) Examples of Developing Countries

Many developing countries have policy financing system as a tool to implement the development policies. Below are the institutional financial organizations in the Asian countries that play a role in the promotion of industry and export.

Table 5-9 Institutional Financial Organizations in Asian Countries

| Country | Name of Bank | Main function |
|-------------|---|--|
| Korea | Korea Development Bank | Finance in projects of economic reconstruction |
| | Export-Import Bank of Korea | Promotion of Heavy Industry Products export |
| | Korea Long-Term Credit Bank | More than 3 years credits to private banks |
| Singapore | Development Bank of Singapore | Mainly finance to SME |
| Thailand | Export-Import Bank of Thailand | Promotion of export & import |
| | Industrial Finance Corp. of Thailand (IFCT) | Medium/Long-term credit to manufacturers |
| Malaysia | Industrial Development Finance Berhad | Medium/Long-term credit for development of Industry |
| | Pembangunan dan Infrastruktur Malaysia Berhad | Long-term credit for infrastructure develop. |
| | Bank Industri Malaysia Berhad | Long-term credit to capital-intensive industry |
| | Export-Import Bank of Malaysia | Medium/Long-term credit for export & foreign investment |
| Indonesia | (Bank of Pembangunan Indonesia) | The bank was absorbed by the State Bank Mandiri in 1998 due to Financial crisis of the country |
| Philippines | The Development Bank of the Philippines | Industry support, Counterpart of 2-step loan |
| Vietnam | Bank for Investment & Development of Vietnam | Medium/Long-term credit to industry |
| | Vietnam Export-Import Bank | Promotion of export & import |
| India | Industrial Development Bank of India | Long/Medium-term credit to industry |

Note: China has the State Development Bank, Export-Import Bank, Agriculture Development Bank

(3) Establishment of SME Financial Supporting System

Most of the small and medium sized enterprises (hereinafter "SME") in Armenia face three types of problems in fund raising. Firstly, due to the poor state of their management and financial condition, they lack the ability to obtain credit. Secondly, consequently it is difficult for the SME to borrow from the private sector financial institutions. Thirdly, even if the credit were available the interest rate is so high that it is rendered effectively impossible to avail themselves to the credit.

Even if the enterprises were privatized with the huge factories that they have inherited, by their current state of management, most of these enterprises are equivalent to SMEs. For the regeneration of the Armenian economy, it would be necessary to bring about the regeneration of these SMEs and a development of new SMEs.

SME Supporting Fund formed in tandem with the scheme to augment the SME's credit outlined below has the objective of meeting the small ticket financing requirements of the SMEs on terms that the SMEs can realistically utilize. This involves establishment of three institutions as outlined below.

1) Create SME Supporting Fund ("Fund") (①)

- The initial size of the Fund will be US\$10 million and will be invested entirely by the government. The funding for this will be from the funds raised through the sale of state owned enterprises. (In the future, through the issuance of tax free debentures increase the private capital portion. It would be more desirable that the capital from Kerkorian Fund will be added to it.)
- The principal purpose of the loans will be short term working capital such as purchases of raw materials or production financing with a per loan limit set at US\$100,000.
- The interest rate will be set at 7 - 10% per annum (It varies with the content of the project, the implementation time and period of loans.).
- Enterprises wishing to borrow under the facility must become member of the Credit Guarantee Association outlined in ② below.
- At the time of obtaining the loan the beneficiary must pay the premium for the insurance provided to ② outlined in ③ below.

2) Create Credit Guarantee Association ("Guarantee Association") (②)

- The Guarantee Association will provide the Fund a guarantee of repayment under the loan agreement on behalf of the borrower.

- The initial capitalization will be shared 80% by the government and 20% by the private sector. The amount of capitalization shall be determined by the estimated gross guarantees to be issued. The government's investment will be funded out of the proceeds of the sale of the state owned enterprises.

3) Create State SME Insurance Institution (“Insurance Institution”) (③)

- Original establishment with initial fund of US\$ 1 million invested wholly by the government
- **Insurance Institution** provides a risk hedge for risk of subrogation under the guarantee provided by the **Guarantee Association** to the **Fund**. (The borrower borrowing from the **Fund** is required to pay the **Insurance Institution** the insurance premium)
- The operating expenses of the **Insurance Institution** shall be defrayed by the premia (for the insurance provided by the **Insurance Institution** for the **Guarantee Association**) paid by the beneficiary (the borrower).

This system provides in the place of credit or collateral that the SMEs are not able to provide against the loans with:

- **Guarantee Association** becomes a guarantor for the obligations on the behalf of the obligor to the **Fund**.
- **Insurance Institution** via insurance provides a risk hedge for the **Guarantee Association**.
- **Beneficiaries** (borrowers from the **Fund**) pays the insurance premium.

The mechanism provides support to facilitate SME's small ticket borrowings from the **Fund**.

The **Borrower** (the **Beneficiary**) submits a loan application addressed to the **Fund** to the **Guarantee Association**.

The **Guarantee Association** performs the evaluation of the credit, determines the terms of the loan, and reports the results to the **Fund**. The process from application to execution diagrammatically would be as shown in Fig. 5.4.

If the repayment of the borrowing is in arrears for longer than a specified period, the **Guarantee Association** will pay to the **Fund** under subrogation. The **Guarantee Association** will be compensated by the **Insurance Institution** for 90% of the amount of the obligations thus repaid. The **Guarantee Association** from the **Fund** assumes the obligation for the recovery of the loan and amounts recovered by the **Guarantee Association** are repaid to the **Insurance Institution**.

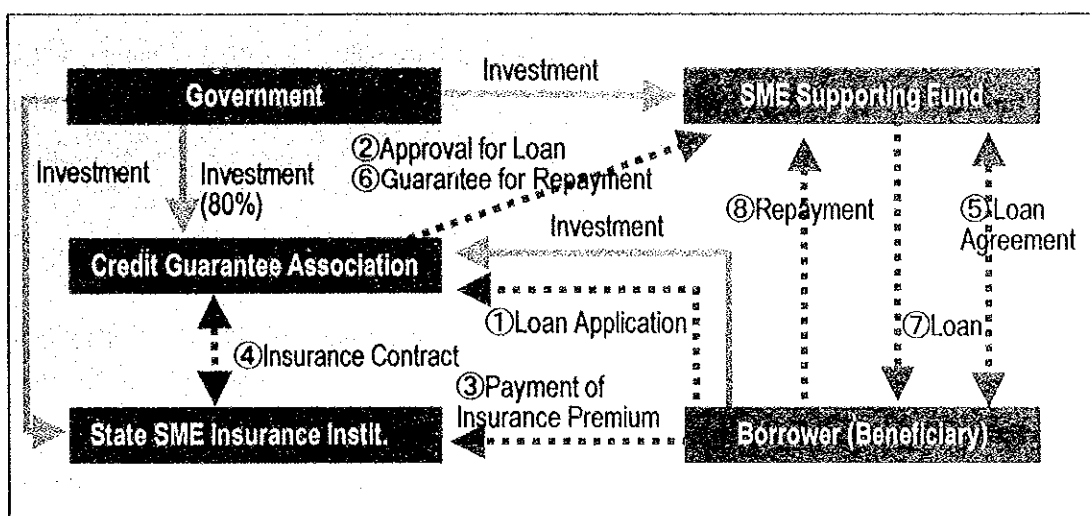


Fig. 5-4 Financing Scheme of SME Supporting Fund

(4) Creation of Foreign Trade Insurance System

Many of the companies have had their problems multiplied due to the inability to collect payments for exports to Russia.

Trade Insurance provides coverage for these types of risks that are not covered under normal insurance programs to enable the exporters to export and import activities free from these concerns.

There are two types of risks in trade activities.

- **Political Risk:** Risk of the counterpart country experiencing internal revolt, revolution or wars. The risk of counterpart government suspending remittance of proceeds by enacting prohibitions against imports or through currency restrictions.
- **Commercial Risk:** Risk of a trading partner experiencing situations such as bankruptcy.

The risks that Armenia should be most concerned are the “risk relating to recovering or export proceeds” and “risks relating to advanced payments for imports of raw materials and other goods”.

| Type of Insurance | Risks Recoverable Under the Insurance (Political Risk, Commercial Risk) |
|---------------------------------------|---|
| 1) Export Proceeds Recovery Insurance | - In case there is a valid export contract and goods have been produced but unable to export - Export proceeds become unrecoverable after the shipment |
| 2) Advanced Payment Insurance | - Funds advanced for the importation of goods become unrecoverable |

Foreign Trade insurance, by its very nature, is not amenable to the private sector and, in most countries, such insurance schemes are operated directly by the government or by an equivalent agency. In the case of Japan, it is managed by the Ministry of Trade and Industry, in the United

States it is managed by the US EXIM Bank, in the United Kingdom by the ECGD, in Germany by HERMES, and in France by SOFACE. The coverage ranges from 80 - 97% of the contract value.

The funding for the insurance will, as a matter of course, will be from the Armenian national budget.

(5) Enhancement of ADA

ADA has been created based on the recognition of the importance of the role of exports and foreign direct investments for the reconstruction of the Armenian economy; however, ADA has been given a meager budget and it cannot even afford repairs to copying machines, let alone pay staff expenses. As a result, it is given a respectable organization chart but only a small number of small groups are functioning and it is being supported through the patriotic sacrificial efforts of the few management and middle management staff.

In order for ADA to become an "ONE-STOP-SHOP" for the foreign investors and domestic exporters, this situation must be remedied immediately.

- 1) The status and the functions must be enhanced.
- 2) The operating budget must be increased.
- 3) The quality and the numbers of the staff must be enhanced.
- 4) Must be furnished with information and data.
- 5) Be equipped with a functional international communication facility.
- 6) Have the capability to formulate policies.

Below we discuss the requirements in some detail.

1) Enhancement of the Status and the Functions

ADA, in addition to being the implementing agency of the investment and export development policies under the SIPPD, that is chaired by the Prime Minister, is under the direct jurisdiction of the two ministries that equally invest in ADA. This severely constrains the independence of its actions. In the present situation, if ADA makes a policy proposal that the Deputy Minister of the Ministry of Industry and Trade supports, but if the Deputy Minister for Ministry of Economy opposes the policy proposal, under the existing arrangements there is little ADA can do. Jurisdiction over ADA should be limited to a single supervisory body and given the importance of ADA's future role for Armenia, it should be placed under the direct supervision of the Prime Minister. As for its role, ADA must be provided with the authority to and functions to enable it to provide its services relating to foreign direct investments and export promotions in an integrated fashion.

2) Increase of Operating Budget

Although under the current deficits of the Armenian government fiscal system securing a budgetary increase must be difficult, but at the least, sufficient budget to pay salaries to all staff and equip the agency to provide a normal business environment (office equipment, desks, chairs and stationary) must be secured. The copying equipment has not been maintained and just about ready to break down. Under such conditions normal business operations are not possible. Government's understanding and taking of appropriate measures would be anticipated.

3) Enhancement of Staff

Enhancing the quality of the staff is critical. It is necessary to supplement the staff with specialists from the fields below who have understanding of the real economy and business in both domestic and overseas markets.

- Foreign investment advisor2 (specialist with wide ranging knowledge of investment climate of Armenia, full time)
- Legal specialists.....2 (provide explanations to foreign investors, respond to queries, part-time)
- Tax consultant.....1 (provide explanation of tax system, tax amount calculation and consultation about tax problems to foreign investors, full time)
- Industry-Enterprise specialists...several (full time), several (part-time)... those who are working for private enterprises in various sectors
- Development specialists.....2 (policy planning of promotion of foreign investment and trade ... invite proper people, full time)
- Trade specialists.....2 (well versed in the practice of international trade transactions, provide counseling to exporters, full time)
- Marketing specialist1 (full time)

There are capable people with the several consulting companies and one possibility is to recruit them to work as advisors on a part time basis.

It is also important to upgrade the quality of the existing staff. Particularly the younger staff needs training in the basics of business. It is also necessary to have the staff obtain a first hand experience in the production and sales in the business environment. They must learn to appreciate through experience the importance of profit and risk management before they are able to provide useful advice to the foreign investors or domestic exporters.

4) Preparation of Information and Data

ADA lacks information and data regarding Armenia's economic conditions and investment climate. There have been attempts to create a database, but due to the lack of staffing a useful

database still does not exist. It may be worth to consider attracting a capable staff from the Ministry of Statistics, State Register and Analysis. This will facilitate access to the data prepared by the Ministry.

5) Normalization of International Telecommunication Facility

Sending a facsimile to ADA is a challenge. The fax and telephonic functions are shared and the switch over from telephone to fax mode is done manually so that when sending a one must first call up and talk to whoever answers the phone to switch over to the fax mode and then press "send" to initiate the transfer. (There are very few countries where such equipment is used in a business environment). If there is no one in the ADA office, the fax cannot be sent during working hours.

This type of reception will give an unfavorable impression and might be sufficient to deter potential foreign investors. ADA should be equipped with at least two dedicated facsimile machines.

ADA had introduced a LAN last year-end within the organization but the system has the following flaws:

- Due to the capacity of the server, the speed is slow and frequently cannot transmit complex data. The server must be replaced by a computer with sufficient capacity.
- The computers operating in Armenia are full of computer viruses. This is due to many people using the computer or the Internet without using virus checks or vaccines. ADA communicates worldwide and widely exposed to viruses and at the same time has many occasions to spread the virus worldwide. ADA should contract with a virus vaccine provider to have all computers download periodically the newest virus vaccines.

6) Policy Formulation Capacity

ADA must have the capacity to collect and analyze data and information, including from abroad. They should formulate and present to the government a policy (draft) to prepare the investment climate in Armenia for foreign investment and exports that are outlined in article 5.3.2..

For this purpose, it is necessary for ADA to have an Advisory Committee compose of experts including academics, businessmen in addition to having in-house expertise.

(6) SME Venture Activities Support Center

The feature of a phenomenon based on clusters and networks of independent but interdependent SMEs is to promote the effective utilization of technology as the whole sector through optimal division of labor by the respective enterprises, while each enterprise is to retain a competing

relation with other enterprises, rather than the specialized technology being dispersed by individual enterprises only for their own use. Through the creation of the SME Venture Activities Support Center on the government's initiative, this cooperative relationship among the enterprises will be developed and enhanced to provide counseling support (including financial assistance of small amount) for new venture activities or for common concerns relating to management or technology shared by SME managers and create the environment for the promotion of the industrial sector.

5.5. Recommendations on the Implementation Program

In relation to the Private Sector Development Plan Study, we recommend an implementation program outlined below.

(1) Creation of the Ministry for Economic Development and Planning

The study team, considering the importance of implementation of the Private Sector Development Plan, propose that the existing Ministry of Economy be reorganized and form, de novo, **the Ministry for Economic Development and Planning** for the implementation of the functions described in article 5.4..

(2) Establishment of the Armenian Development Bank

- Create the Armenian Development Bank as proposed in section 5.4. (2).

The creation of the Armenian Development Bank and the management of the created institution require specialized knowledge and expertise that is deficient in Armenia and assistance from abroad will be sought as an independent project. For a specific period after the creation, foreign specialists will be invited to provide technical transfer of knowledge and skills in all areas from the selection of loan projects through execution-recovery of loans.

(3) Establishment of SME Financial Supporting system

- As proposed in section 5.4. (3), prepare detailed planning document for the creation of the SME Supporting Fund, SME Loan Guarantee Association and SME Loan Insurance Institution including the mechanisms, preparations for the establishment and conditions of operations. If required, request for technical assistance will be sought overseas.

(4) Project Formation on Development of Export Industry

- In parallel with the implementation of (2) and (3) above, a request will be made for Two-Step Loans and specific project formation for the promotion of export industry, including the promotion of import substitution industries to the World Bank, EBRD, GTZ, OECF in Japan (as of October 1, 1999 it will be merged with the Exim Bank of Japan to form *the Japan Bank for International Cooperation*) in order to raise funds.

(5) Creation of the Industrial Zone

- Push forward with the creation of an industrial zone that is being planned in Yerevan at the initiative of the Ministry of Industry and Trade. The initial funding required for the project will be appropriated from the privatization funds but the management will be turned over to a third sector and shall be managed as a self supporting unit. (The person in charge will be responsible for researching similar facilities abroad, law, systems and operating formats)

(6) Implementation of Pre-Feasibility Study for Development and value-added utilization of Nonferrous ores including Copper and Molybdenum

- Request foreign assistance agencies for a comprehensive feasibility study on restarting production and developing project from smelting to secondary processing. The study will examine the possibilities of the use of Aragak Copper Mine that is currently shut down, a new development of the Shaumiana Copper Mine, the reopening of Kadjaran Copper Mine and ore transport facility and the Alaverdi Smelting Plant.

(7) Implementation of the Census

- A request will be made to the foreign assistance agencies for the implementation of the Census planned for in 2001. The assistance sought will include assistance in the implementation methodology, technical assistance relating to software development, implementation expenses and grant of necessary equipment such as computers.

(8) Creation of SME Venture Activities Support Center

- A center will be created to provide management and technical support for SMEs as proposed in section 5.4. (6). They will provide counseling to SMEs, especially to newly started venture businesses on management and technical issues and it will provide a forum for exchange of views and experiences relating to the common issues.

- It will be structured such that it will also be able to provide some financial assistance.

(9) Creation of the Tourism Development Center

- As it has been stated in 5.3.3., tourism, for Armenia, is an industry that is of relatively high value added content and an important industry that should be promoted. The Center should be established with the objectives of practical development and promotion of tourism industry. The funding should be requested as a grant from the Kerkorian Fund and investments by Armenian tourism related enterprises. Principle operations of the Center are:

- 1) Development of tourism resources and the related infrastructure (repair and maintenance starting with what is at hand).
- 2) Overseas public relations activities, creation of pamphlets in various languages, making and distribution of videos and films.
- 3) Education and training of tourism related enterprise management and staff.
- 4) Purchase of 5 medium sized and 5 large tour buses (to be leased to tourism enterprises).





JICA