



ARMENIA 2011

WITHOUT ILLUSIONS

## ARMENIA 2011. WITHOUT ILLUSIONS

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## ARMENIA: WITHOUT ILLUSIONS

If each of these Civitas end-of-the-year summaries had been intended to serve as a window to the policies, events and trends of the last year, this year's report is almost a guide to opportunities lost and opportunities that still lie ahead. If there was a single unifying theme to 2011, it was confusion, frustration and anxiety, all around the globe. This was coupled with the loss of any lingering illusions, as the world marked the 20th anniversary of the collapse of the Soviet Union.

Further, in 2011, there was a new imperative to review and rethink the economic and political assumptions that form the foundation of some of the Western world's greatest powers.

While still in the midst of a deep economic crisis, US public and political circles began to angst over the tenets of the American economic and political institutions. The European Union, too, will continue for months and years to agonize about the essence and nature of that union, and the new fiscal and political creed that will be required to sustain it.

The deliberations extended beyond the West and even beyond deliberation. In the Arab world, anger and hope combined to bring an awakening and a search for a democratic future. In Asia, political and economic uncertainties were given voice. Even in Russia, the end of 2011 saw the beginnings of a public search for a shared vision of a 21st century Russia.

But in the 20-year-old Republic of Armenia, the historic anniversary came and went with no search for new political answers to society's economic ills, no urge to move forward with additional reforms, no talk of austerity and debt, no compulsion to compete with the neighbors.

Instead there was silence. Not only was there no mood for revolution, there was not even a concerted push for political evolution. Those who voiced dissatisfaction with the status quo and the need for change did not have, or did not believe they had, the means to make change possible.

In a Civitas poll, conducted in the fall, two-thirds of those queried across the country said they would

vote again to leave the Soviet Union. For them, and even for the one-third whose disappointments clearly approach regret, some things are assumed to be irreversible. Those are personal freedoms: the right to free movement, the hope for gender equality, the right to speech and to worship, the right to a minimal standard of living and to basic health and education.

These are the ideals taken for granted by the independence generation. They still do not know how to strategize, organize, make change or make policy, but they do know they have rights and have no fears about exercising those rights.

Possibly best of all, they have no illusions. They have seen difficult years. In that same Civilitas poll, it was the 20 to 40 year olds, and the 60+ year olds who were most optimistic. Perhaps the promises, the realities, the uncertainties of the last several years will give way to a new year, without illusions, but with hope.

## A REGION IN FLUX

For most of 2011, the revolutions in Tunisia and Egypt in January-February and the protracted crises in Libya and Syria preoccupied the international community, deflected attention from the Caucasus and created a window of opportunity that Azerbaijan, Georgia and Turkey each sought to exploit.

Armenia and its neighbors remained adrift and outside international focus, due also in part to the continuing global economic crisis. For Europe the crisis was also political and consequently, Europe's availability for broader engagement in its eastern neighborhood diminished. Major international policy initiatives in the region, such as the push for Georgia's NATO integration and Armenia-Turkey normalization, effectively stalled.

In 2011, **Russia** continued to play a pre-eminent power role in the Caucasus and its leaders made several key pronouncements to accentuate this reality.

In October, Prime Minister Vladimir Putin proposed a post-Soviet free trade zone and the establishment of a Eurasian Union, both initiatives publicly welcomed by Armenian officials.

Speaking at the United Nations in September, Russia's Foreign Minister Sergei Lavrov said that Russia was ready to be the "guarantor" of "non-use of force" in the Caucasus.

And in an August interview with Georgian journalists timed to coincide with the third anniversary of the 2008 war over South Ossetia, President Dmitry Medvedev said that the leaders of Armenia and Azerbaijan had acknowledged that for them, the war was a "lesson" in what to avoid.

The Russian-backed candidate in South Ossetia lost in both rounds of the November presidential election. The winning candidate's supporters hit the streets to defend their votes. Nevertheless, the Supreme Court of South Ossetia annulled the ballot and called for new elections in March, when the current winner will be able to run again.

The March date coincides with the Russian presidential election in which Prime Minister

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Putin is the expected winner. However, during the December 2011 parliamentary election in Russia, Putin's party received less votes than expected. The results were contested on the streets by activists and voters who insisted that even that vote was exaggerated and rigged.

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In Turkey, the move to write a new constitution was the culmination of the ruling Justice and Development Party's systemic (and successful) campaign to exclude the army from influencing domestic politics, and prevent it from instigating coups d'état. The army, which had been considered the guarantor of the Turkish Republic's secular identity, remained under judicial attack as its generals were arrested and brought before the courts for inciting violence, or being party to conspiracies. These cases, bundled under the name Ergenekon, also continue to affect the judicial process to identify and convict those responsible for the assassination of Hrant Dink, in January 2007. Thus, the unraveling of Turkey's internal political power bonds will directly impact the role of individual Armenians and Armenian community institutions in Turkey.

On another taboo topic, the Turkish prime minister, Recep Tayyip Erdogan, made an extraordinary announcement. He publicly apologized for the massacres that had taken place in 1937-38 in Dersim, in Central Turkey, where on orders of Kemal Ataturk, the founder and then-president of the modern Turkish Republic, more than 10,000 Kurds were killed by Turkish soldiers. The Erdogan

apology followed the arrests, in large numbers, of Kurdish activists and sympathizers, possibly in a show of force in the face of new military clashes between Turkish soldiers and Kurdish factions in southeastern Turkey. The mass detentions were denounced by many inside Turkey as well, coming as they did at the end of an election season where the party of Erdogan adopted a harsher and more nationalistic tone which, critics said, alienated many Kurds. The combination of the Dersim apology which left Ataturk in a negative context, the continuing nationalist rhetoric, and the easing of restrictions on minorities may be part of an AKP strategy to set itself up as a legitimate ideological force entitled to initiate major constitutional changes.

2011 witnessed a concerted push by **Azerbaijan** to parlay its hydrocarbon resources and wealth into status and recognition as a regional power. Azerbaijan's election in October as a non-permanent member of the UN Security Council was the manifestation of that strategy.

That strategy has been the impetus for a more assertive stance by Baku in its dealings with Moscow, Tehran and Ankara. Azerbaijan also plans to increase investments in Turkey and Georgia and to start investing in Russia's North Caucasus republics.

This thrust by Azerbaijan has pushed Georgia to embrace the opportunities inherent in deepening its "strategic partnership" with Azerbaijan and thus overlook what used to be irritants in bilateral relations (such as the disputed status of the medieval David Gareja monastery situated on the border between the two countries.)

A measure of the extent of bilateral economic cooperation is the fact that Azerbaijan's state oil





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company SOCAR was in 2010, and probably is for 2011 as well, Georgia's largest taxpayer. In June, Baku extended a \$575 million credit to Georgia to finance construction of the Georgian section of the Kars-Tbilisi-Baku railway, which was conceived to circumvent an existing Kars-Gyumri-Tbilisi link, but which continues to lag behind schedule.

Pragmatic partnership remains the hallmark of Azerbaijan's relations with the Russian government, even as it acts with greater assertiveness vis-à-vis the weak and ineffective leadership of Daghestan, to the north.

Azerbaijan signed a new agreement in January with Russia's Gazprom on the sale in 2011 of two billion cubic meters (bcm) of natural gas – more than double the amount Azerbaijan supplied to Russia the previous year, but modest compared with the 10 bcm expected to come on line in 2017. Russia expressed readiness to buy the entire supply, attempting to undercut the ambitious Nabucco supply circumventing Russia.

In August, the Russian Defense Minister visited Baku for the start of talks on extending the lease and modernizing the Gabala radar station in central Azerbaijan. The 10-year lease is due to expire in December 2012.

Azerbaijan proved less accommodating in its handling of the problem of resettling to Daghestan of some 450 Russian families living in two villages in northern Azerbaijan that were de facto Russian exclaves until the signing in September 2010 of the Russian-Azerbaijani agreement demarcating the border between the two countries. A solution was reached only after the Russian government agreed to fund the resettlement of the effected families, who had to forfeit without compensation their homes on what is now Azerbaijani territory.

In early October, the Russian presidential envoy to the North Caucasus Federal District, together with the heads of the North Caucasus republics, travelled to Baku to try to interest Azerbaijani investors in a multitude of long-term projects in the agro-industrial and energy sectors and in the planned development of a string of resorts on Daghestan's Caspian coast.

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In January, Azerbaijani President Ilham Aliyev signed a declaration with visiting European Commission President Jose Manuel Barroso affirming Azerbaijan's commitment to export "substantial volumes" of its natural gas to the European Union via Turkey. While that declaration served to enhance Azerbaijan's standing vis-à-vis the EU, the decision on the choice of export pipeline(s) for the so-called Southern Corridor remained contingent on Azerbaijan reaching agreement with Turkey on the legal and commercial terms for that transit, specifically the volume of gas Turkey will receive and the price it will pay. That agreement was finalized only in late October after talks lasting several years.

The entire process pointed to bilateral Azerbaijani-Turkish problems despite the publicly professed brotherhood between the two countries. There are other problems as well. Azerbaijan has still not reciprocated the abolition by Turkey of its visa requirement for Azerbaijani citizens, apparently because Baku is reluctant to abolish visas just for Turkey without doing so with Iran, with which its relations remain tense.

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The two countries exchanged diplomatic notes, in protest, following the shooting of an Azerbaijani serviceman on the frontier in July, and the characterization, in August, by the Iranian Armed Forces Chief of Staff of President Aliyev's policies as "anti-Islamic" and pro-Israel.

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The antagonism between Russia and Georgia worsened too, with Georgia continuing to allege Russian espionage and other subversive activities on its territory. In early July, the Georgian authorities arrested four photo journalists, three of whom were charged with spying for Russia. They were found guilty but after plea bargaining were given suspended sentences and released. This followed the strict sentencing, in July, of nine (including two Armenian) people arrested in Batumi in October 2010 and similarly charged with spying for Russia.

Following six rounds of talks during which Georgia continued to block Russia's application for World Trade Organization membership, in late October, under increasing pressure from both the US and the EU, Tbilisi endorsed a compromise solution proposed by Switzerland, and which Russia too accepted. This will entail the deployment of international observers to monitor the transit of

goods between the Russian Federation and Georgia via Abkhazia and South Ossetia.

Georgia pushed ahead with its efforts to win hearts and minds in the North Caucasus. The Georgian parliament voted overwhelmingly in May to designate as genocide the wholesale killing or expulsion from their Black seacoast homeland of the Circassians by Tsarist Russian troops in the 1860s. Armenians took note that the Armenian Genocide of 1915 has not yet been acknowledged by the Georgian government.

In July, the Georgian authorities organized a conference in Tbilisi, to which academics and journalists from the North Caucasus republics were invited, to showcase Georgia's successful implementation of economic reform, democratization and eradicating corruption.

In its relations with Turkey, Georgia's extreme sensitivity to any perceived disrespect for its national patrimony continues to take second place to the benefits of political and economic pragmatism. Armenia understands this well, given its own similar sensitivity in Armenian-Georgian relations.

In late May, Georgian President Mikheil Saakashvili and the Turkish Prime Minister jointly inaugurated the updated Sarp border crossing between the two countries. They also signed an agreement that takes one step further the 2007 agreement on visa-free travel between them, making it possible to cross the border at Sarp on production of a national identity card. Turkish businessmen continue to seek investment opportunities in Adjara, and elsewhere in southern Georgia.

As senior partner in the relationship, Turkey risked incurring Georgian displeasure by approving a private visit in April by Sergei Bagapsh, then-de



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facto leader of the breakaway Republic of Abkhazia, during which Bagapsh met with representatives of Turkey's Abkhaz diaspora, which outnumbers Abkhazia's own population. The Georgian Foreign Ministry did not lodge a formal protest.

Bilateral talks continue on Georgia's request for permission to restore several medieval Georgian churches on what is now Turkish territory. Georgia has sought to use to best advantage what limited leverage it has over Ankara, delaying the release of a Turkish merchant vessel, the *Afro Star*, intercepted in the summer of 2009 in Georgian territorial waters en route for Turkey from Abkhazia.

Iran's ATA airlines has begun twice-weekly flights between Tehran and Tbilisi following Georgia's overtures in 2010 to Tehran, including the abolition of visa requirements for travel between the two countries and the opening of an Iranian consulate in Batumi.

In the North Caucasus, Russia continues to balance the use of force against the Islamic insurgency with plans to invest more, and more effectively, in projects intended to galvanize local economies and create thousands of new jobs, including as service personnel in a string of high-end ski resorts in which French and South Korean companies have shown interest.

In February, President Medvedev proposed Ramzan Kadyrov to serve a second term as Chechen Republic head, thus effectively reinforcing Kadyrov's status as the most powerful political figure in the region. But disagreements within the Russian cabinet over funding have delayed the adoption of a planned grandiose development program.

Despite the loss of at least a dozen senior commanders, the North Caucasus insurgency

remains a force to be reckoned with. A suicide bomber from Ingushetia dispatched to Moscow by self-styled Caucasus Emirate head Doku Umarov killed three dozen people at Moscow's Domodedovo airport in January. Two senior Chechen commanders who split with Umarov last year again pledged allegiance to him during the summer and launched a three-man attack in Grozny in late August, killing nearly 40.

## ARMENIA – IRAN

2011 demonstrated the paradox of Armenian-Iranian relations. A year devoid of any notable interaction or bilateral accomplishment nevertheless served to reinforce that the Republic of Armenia and the Islamic Republic of Iran have exemplary bilateral relations. This is predicated on each side's willingness to satisfy the minimum requirements of the other.

Over the last 20 years, none of the events in and around the region, including wars, change of governments or economic and political crises were able to shake the foundation of this reciprocal understanding.

That Iran is essential for Armenia was proven at least twice in the last 20 years – first in the early years, 1991 to 1994, during the military conflict over Nagorno Karabakh, and the second in 2008, during the Russian-Georgian war. Both events confirmed that Armenia's only reliable access to the world was through Iran.

Although Iran's reliance on Armenia is far less, nevertheless Iran appreciates Armenia's consistent adherence to a policy of non-instrumentalizing its bilateral relations. In its turn, Iran maintains a position of positive neutrality vis-a-vis the

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Karabakh conflict, and also adheres to an even-handed approach in its bilateral relations with both Armenia and Azerbaijan. This neutral, balanced approach is driven entirely by Iran's own national interests.

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Iran is often impelled by Islamic solidarity to support Azerbaijan on various international votes. At the same time, given that Iran and Karabakh de facto share a border, Iran cooperates with Karabakh on agricultural programs.

Various Armenia-Iran economic programs have been put in place these 20 years. Certain new programs which were to have reinforced bilateral economic and therefore political relations have not moved forward, however. The Iran-Armenia gas pipeline and the two 220-kw high voltage electricity transmission stations were the last two significant programs. The other programs which would have regional significance – two hydro electric power plants on the Arax River, the Armenia-Iran railway, an oil refinery on the Armenian-Iranian border in Armenia's southern city of Meghri, a pipeline bringing refined oil from Iran to Armenia, and the construction of an oil storage facility all remain on the drawing boards, although some of them were to have begun this year.

Western governments do not encourage Armenian-Iranian economic ventures that might have regional

implications and go counter to the policy of trying to isolate Iran. On the other hand, given Armenia's geographic reality and the continuing blockade of Armenia by Azerbaijan and Turkey, Armenia is not at the receiving end of serious American and European pressure, aware as they are of Armenia's limited options. Nor have the international sanctions on Iran had any real effect on Armenian-Iranian business ventures, trade or other bilateral programs.

Armenia's trade with Iran does not exceed \$300 million, most of which consists of Armenian imports of Iranian goods. Armenia exports electricity, wood, foodstuffs and mining products at an annual volume of around \$50 million.

Armenia's President Serzh Sargsyan visited Tehran during the Iranian government's second annual international Novruz celebrations. Of nearly two dozen invited heads of state, Sargsyan was there together with four others -- the leaders of Turkmenistan, Tajikistan, Iraq and Afghanistan. Iranian President Mahmoud Ahmadinejad's June visit was postponed at the last moment because the Iranian side claimed the Armenian side had not prepared the necessary bilateral documents to be signed. That visit was expected to take place before the end of the year.

There were reciprocal visits by the foreign ministers as well as a visit to Armenia by Iran's deputy defense minister. President Ahmadinejad's Special Envoy twice visited Yerevan. In May, the Armenian-Iranian Intergovernmental Commission held its 10th session in Tehran. In the fall, in Meghri, at the Armenian border with Iran, the two countries held Days of Friendship, on the occasion of the 20th anniversary of the establishment of Armenian-Iranian diplomatic relations.

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But the visits most worthy of note were those made by tens of thousands of Iranian tourists, who now choose to vacation in Armenia throughout the year.

### ARMENIA-GEORGIA

Georgia and Armenia have survived a range of political and international upheavals over these two decades, despite the fact that two fundamental obstacles stand in the way of deeper political and economic cooperation and integration.

The first of those are the acrimonious Georgian-Russian relations; the second are the unresolved conflicts in the South Caucasus.

In the South Caucasus, the Armenian alliance with Russia is reason enough for Georgia to consider Armenia a potential danger, despite the fact that in its darkest hours, including during the August 2008 war, Armenia demonstrated positive neutrality. The Georgians harbored similar reservations regarding the Armenian-populated Georgian Javakheti region, although that area, of all of Georgia's regions, has seen the least turmoil since Georgia's independence.

The second factor is the problem of unresolved conflicts in the Caucasus. Georgia is, in principle, opposed to the idea of the right of the people of Nagorno Karabakh to self-determination, and at each opportunity stands at Azerbaijan's side in that matter. Although Armenia recognizes Georgia's territorial integrity, Tbilisi is still suspicious when Armenia's Ministry of Education sends Armenian language textbooks to Armenian schools in Abkhazia. Armenian citizens who entered Abkhazia at the Abkhaz-Russian checkpoint were arrested when they later entered Georgia and were accused of illegally crossing the border. Although these are simply expressions of state policy, each such incident

compounds reciprocal distrust and the perception of enmity between the populations.

Although these are the two main areas of divergence and dispute, there are other problems too which do not help to reinforce bilateral relations.

- The continuing Armenian-Azerbaijani conflict, in the face of ever-deepening Georgian-Azerbaijani strategic cooperation
- The absence of Armenian-Turkish relations, in the face of high-level Georgian-Turkish dialogue
- Turkish and Azerbaijani efforts to distance Armenia from regional energy and communication projects, and Georgia's indirect complicity in Armenia's de-facto isolation
- Georgia's discriminatory policies towards Javakheti and other Armenian-populated areas, manifested in the lack of care and attention given to the Armenian language and Armenian historic monuments
- For 15 years, efforts to demarcate the Armenian-Georgian border have remained incomplete

All Armenian and Georgian presidents have made reciprocal visits, as have the spiritual heads of the respective churches. Indeed, 2011 began with President Saakashvili's visit, in the first days of January, to the historically Armenian district of Havlabar in Tbilisi and the Holy Etchmiadzin Church where he delivered Christmas wishes to Armenians on Armenian Christmas. This gesture was especially well-received since it was accompanied by a message about "thousands of years of friendship and brotherhood" and

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an “exceptional historic example” of how two neighboring peoples can help each other in complex historic and geographic circumstances.

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This visit was highly symbolic in the context of continuing tensions surrounding the status of the Armenian Apostolic Church in Georgia and the issue of six Armenian churches in Tbilisi and one in Akhaltsikhe. It appeared that the issue had been resolved during the summer when appropriate changes were made to the Civil Code thus enabling the five religious organizations in Georgia, including the Armenian Apostolic Church, to gain the status of a legal entity. The legislation was accompanied by a huge wave of anti-Armenian sentiment from all segments of the Georgian public, including clerics.

Thousands took to the streets in protest after the Parliament approved the legislative changes. The Patriarch of the Georgian Orthodox Church, Ilia II, chastised those who had thus ‘belittled’ the Georgian Church. Another cleric cursed those parliamentarians who voted in favor of the measure.

The decision, made under pressure by European structures, was welcomed by the Mother See of

Holy Etchmiadzin which continued to be the target of all Georgian church criticism.

Following the passage of the legislation, the Georgian Orthodox Church made occasional statements about possibly establishing a diocese in Armenia, which Armenian law allows. It does appear however that the attempt is a desire to establish a quid pro quo – in order to barter ownership of Armenian churches in Georgia against Georgia’s claims of ownership of five orthodox churches in Armenia’s north.

Although church-related issues were apparent throughout 2011, the other controversy – over differing, sometimes conflicting votes in international organizations – continued to be a problem. Armenia not only voted against Georgia in the UN General Assembly resolution on deportees and refugees from Abkhazia and South Ossetia, but the vote was held in NY on the same day when Armenia’s foreign minister was in Tbilisi. The Armenian vote came despite a written request from the Georgian government that Armenia change its traditional stance this time. Although Armenia has no obligation to vote with Georgia, especially given Georgia’s consistent votes against Armenia and in favor of Azerbaijan, nevertheless if Armenia were to abstain, this would give it the right to ask and expect a similar position from Georgia in Karabakh-related resolutions. Finally, by abstaining, Armenia would find itself with the majority of the world’s countries and not with North Korea and Sudan.

In mid-April, one day after a visit to Armenia by Georgia’s Defense Minister, the Georgian Parliament voted to rescind the 2006 treaty with Russia which also regulated personnel and armaments transport thru Georgia to Russia’s 102nd military base, in Armenia. This treaty had



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de facto ceased to be relevant following the August 2008 war.

This can be viewed in the context of Yerevan and Tbilisi's membership in differing security systems. Armenia is a member of the Collective Security Treaty Organization, formed and led by Russia. Georgia aspires to NATO. Despite this and other differing political, there is some Yerevan-Tbilisi military cooperation. For example, Armenia and Georgia cooperate in peacekeeping (in Afghanistan and Kosovo) and in military exercises within NATO.

A series of official meetings took place throughout 2011. President Saakashvili visited Armenia in late January. Despite public statements about bilateral discussions aimed at facilitating border crossing and easing customs procedures, such steps were not visible by year's end.

In mid-February, the Georgian Prime Minister visited Armenia and sounded assurances that the north-south gas pipeline management portfolio would not be sold. Azerbaijan has expressed an interest in purchasing this pipeline which transports Russian gas to Armenia.

Just a week later, Georgia's foreign minister came to Armenia which he had Armenian-Georgian relations as 'de-facto strategic cooperation.' This statement does not receive commensurate effort by the leadership of the two sides, although such cooperation is possible in the Caucasus, and in the context of the existing power balance.

In November, Georgia's foreign minister again visited Armenia, and Armenia's prime minister traveled to Georgia.

Georgia remains Armenia's major transit route. Georgia railways and ports carry 70 percent of

Armenia's imports and exports. Armenian-Turkish trade, too, one-sided though it is, travels through Georgia.

In a rare cross-border cooperation effort, a trans-boundary national park in the South Caucasus is being planned for 2015, with support by the Caucasus Nature Fund, to include Javakheti National Park in Georgia and Lake Arpi National Park across the border in northwestern Armenia.

Finally, Tbilisi and Yerevan may be the only two neighboring capitals in the world without reliable, consistent flights.

## ARMENIA - TURKEY

In 2011, not only did Armenia-Turkey relations return to the early days of 2008, prior to the beginning of football diplomacy, but even mid-level contacts that used to take place among foreign ministry officials, ceased. Worse, a series of blunt statements during the year served to further muddy the Armenia-Turkey waters. This was a far cry from 2009 and 2010 when Yerevan, Ankara and the international community were hopeful that two protocols would be signed to establish diplomatic relations and address a host of bilateral disagreements. Following Turkey's insistence on positive movement on the Karabakh issue prior to ratifying the protocols, relations did not just freeze, but worsened.

The year started off ominously when Turkish Prime Minister Erdogan visited Kars. During a January visit he called the Statue of Humanity, in Kars, a 'monstrosity.' In 2004, Nayif Alebeyoglu, a former mayor of Kars and a strong advocate of improved relations between Armenia and Turkey, had collected some 50,000 signatures (in a

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population of 90,000) supporting the opening of the Armenia-Turkey border. The statue was his idea and it represented ‘friendship and peace’ between Armenians and Turks.

Four months after Erdogan’s criticism, the statue was taken down. Despite Turkish Foreign Minister Ahmet Davutoglu’s assurance that the statue’s removal was in no way related to Armenia-Turkey relations, still, the entire episode was seen as the symbolic end to football diplomacy. Even the sculptor of the piece joined the debate. If the statue goes down, he said, Erdogan will be like the Taliban. And when the actual destruction began, he accused Turkish authorities of “destroying the hope for peace.”

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*Following Turkey’s insistence on positive movement on the Karabakh issue prior to ratifying the protocols, relations did not just freeze, but worsened*

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In May, during the Parliamentary election campaign period, Erdogan visited another Turkish city near the Armenian border. In Igdir, he declared that Ankara would not improve relations with Armenia so long as the Karabakh conflict remains unresolved.

The Turkish linkage between Turkey-Armenia relations and the resolution of the Karabakh conflict was repeated throughout the year by various high-level officials. At the Council of Europe in April, Davutoglu went so far as to condemn the reconstruction of an airport in Karabakh’s capital, Stepanakert, stressing that “such provocative actions do not benefit the settlement process.”

The statements coming from Yerevan and especially Ankara left the impression that no one regretted the demise of the Armenia-Turkey process. Diplomacy appeared to have been replaced by propaganda and sometimes insolence. The most vivid expression of such insolence was the Turkish response to a Sargsyan statement. When asked by a visiting Diasporan youth what kind of future awaits Armenia, “one that is reminiscent of the Treaty of Batumi, or a future that returns Western Armenia, with Mt. Ararat as well,” the Armenian President responded “That depends on you and your generation. Our generation was victorious in Karabakh.”

The reaction from Ankara was harsh. In Baku, a visiting Erdogan lectured President Sargsyan, qualifying his remarks as provocative and not appropriate for the leader of a country. He said the president was “planting seeds of hatred and enmity” in future generations and should therefore “apologize.” Other high-level Turkish officials joined the criticism, with the Deputy Prime Minister going so far as to sound a threat: “No one can look askance at our mountains, fields and waters. We are the owners of these lands. Armenia has serious economic problems. When they were starved, we sent them wheat. They should think straight and not pull the Diasora into the game.”

Armenia’s President ignored the incident. But during an official visit to Cyprus and Greece, the President lashed back, condemning the policies of Erdogan’s Turkey, calling them neo-Ottoman. In a subsequent interview, he said that Turkey, despite its size, does not have the right to lecture others.

He went further and said Armenia can retract its signatures on the 2009 Armenia-Turkey protocols. Nevertheless, he did not do so, probably not to elicit adverse international reaction. Instead, high-level



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Armenian officials tried to stay on one message – that Turkey was responsible for the unsuccessful rapprochement process.

Given that there is no change in the Karabakh process, it is unlikely that Turkey will validate the protocols which it re-introduced to the agenda after the convening of the newly elected Parliament. Turkey has publicly claimed a position from which it cannot move. Nor does it appear to have any desire to do so. Whatever degree of pressure Americans and Europeans used to apply until 2008 and the introduction of the protocols, in order to convince Turkey to remove the blockade of Armenia, that pressure is no longer there. Turkey succeeded in creating a linkage – a situation in which international public opinion accepts that the major obstacle to overcoming the adversarial Ankara-Yerevan relationship is the unresolved Karabakh conflict.

There are several reasons for the absence of domestic and international pressure on Turkey to normalize relations.

- Joining the European Union is no longer an urgent priority for Turkey. Therefore, requiring Turkey to recognize the Armenian Genocide or lift the blockade on Armenia are no longer useful levers.
- The Genocide recognition process has in fact halted, thus Turkey is not compelled to create the impression of dialogue with Armenia.
- Turkey's fundamental purpose in closing the border was to economically bring Armenia to its knees. So long as that objective remains on Turkey's agenda, Armenia should not have serious expectations of an open border.

- The closed Armenian border is no longer perceived to adversely affect Eastern Turkey's economy. During the last eight years, Turkey has registered unprecedented economic growth, has become the world's 17th largest economy and is capable of investing in its eastern regions, at the Armenian border.

For Turkey, Azerbaijan remains an important country and partner. Given ethnic and political alliances between Azerbaijan and Turkey on the one hand, and tortured historical memories with Armenia on the other, Ankara will not shake the Turkey-Azerbaijan relationship.

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Even as Turkey's Armenia policies have become more inflexible and harsh, Turkey appears to be trying to compensate for that by adopting more tolerant approaches to the problems of the Armenians of Turkey.

Armenians who had temporarily relocated to Turkey from Armenia were allowed to send their children to Armenian schools in Istanbul – something that was not allowed in the past, but was suddenly possible for the 2011-12 school year,

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without any official paperwork. This somewhat ameliorated the situation of the migrant Armenians living in Istanbul, who have no official immigrant status and therefore no legal access to educational institutions. The community's response had been to establish secret schools, operating out of cellars.

Turkey is also allowing the renovation and re-opening of Armenian architectural and historical structures on its territory as a way of demonstrating goodwill, despite official relations being frozen.

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*The statements coming from Yerevan, and especially from Ankara, left the impression that no one regretted the demise of the Armenia-Turkey protocols*

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Thus, in August, the Turkish government signed a decree regarding the return of the community properties seized by the state in 1936 from minority communities. In September, the Holy Cross Church on the island of Akhtamar in Lake Van held religious services for the second time. In October, Diarbakir's St. Karapet Church was re-opened. It is the largest Armenian Church in the Near and Middle East. Its renovation was sponsored by individual Armenian donors together with the Diyarbakir Municipality.

In response to the strong earthquake which caused great damage in the City of Van, in Eastern Turkey, in October, the Armenian government offered to send a disaster relief team, but Turkey announced that they would handle the consequences of the disaster on their own. Nevertheless, Armenia's Emergency Situations Ministry sent tents, sleeping bags, blankets and other essentials to Van. President

Sargsyan, on a visit to Moscow, joined the Russian President to speak to the Turkish president to express concern.

Ironically, Turkish journalists in Armenia during the weeks of the earthquake and immediately after, realized for the first time the proximity of the two countries and the impact of closed borders. The city of Van is 200 km (or 130 miles) from Yerevan, and was the center of major media and emergency operations. Yet, travel from Armenia was prohibitive and immediate participation was not possible.

This year, too, no new countries were added to the list of those who have already recognized the Armenian Genocide. The process had come to a halt with the introduction of the protocols, whereby Turkey gained the right to say that they themselves are dealing with this bilateral issue as well and international intervention is unnecessary. Although Turkey has not followed through with the protocols' commitment to bilaterally addressing the genocide issue, the international community has not re-engaged on genocide recognition. Turkey continues to strike back at any international efforts towards recognition. In September, French President Nicolas Sarkozy visited Armenia and announced that in the face of continuing denialism by Turkey, France may consider making state denial a crime in France. The Turkish Prime Minister's quick response was that Sarkozy should worry about the generations to come, not the elections to come.

## NAGORNO KARABAKH CONFLICT

For the Karabakh conflict resolution process, the year ended pretty much as it began. The mediators – the three Minsk Group co-Chairs, representing the US, France and Russia, visited at the beginning of the year, with hope, and at the end, with frustration over what had already become a political stalemate.



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At the same time, the situation escalated on the front line. Without hope in negotiations, snipers (mostly from the Azerbaijani side) had become active and successful. The number of deaths and casualties on the line of contact escalated.

Throughout the year, the sides not only blamed each other for the failed negotiations, but also continued to disagree over which is the legitimate negotiating document – the Madrid document or its modified version.

The most important event of the year was the meeting of the Armenian and Azerbaijani presidents, in Kazan, Russia, under the auspices of the Russian president. Oddly, in the run-up to the Kazan meeting, when the Haykakan Zhamanak daily newspaper published the six points in the Madrid document presented to the OSCE depository in December 2007, there was almost no public debate on the contents.

There were meetings of the presidents prior to Kazan, as well. They had met in March, in Sochi, Russia, again under the auspices of the Russian president.

In May, during the G8 summit in Deauville, France, the presidents of the co-chair countries issued a joint statement calling on the presidents of Armenia and Azerbaijan to use the Kazan meeting to conclude the basic principles of the resolution of the Karabakh conflict. They also called on Sargsyan and Aliyev to prepare their publics not for a new war, but for peace. This was the fourth joint statement by the leaders of co-chair countries, made over a decade and a half.

The June 24 meeting of the presidents in Kazan evoked a great deal of optimism, especially in international circles. The President of the US

personally called both Sargsyan and Aliyev on the eve of the talks. President Sarkozy sent a message.

Following the failure at Kazan, the US and France publicly expressed disappointment. President Medvedev did the same, but he also dispatched his foreign minister to Baku and Yerevan to make one last ditch effort. Everyone kept silent about the new proposals presented by Minister Lavrov; neither their contents nor the response of the sides to the Kremlin were made public.

In 2011, there were three fundamental factors which brought the process to a deadend.

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*Azerbaijan ignored the international community's, specifically the OSCE's, calls to remove snipers from the front lines*

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First, Azerbaijan consistently attempted to underscore the principle of territorial integrity, exclusively. From the president on down, high-level officials undermined the referendum concept which was codified in the document and served as the fundamental and binding element that makes possible the conciliation of the two seemingly contradictory principles of territorial integrity and self-determination. Without a referendum as a mutually-acceptable instrument, the entire document can and perhaps has collapsed.

Second, the Kazan meeting failed despite the international community's unprecedented high expectations and the cautious expectations of the conflicting sides. The problem was not the failure of the meeting itself, but that the Armenian side accepted the document as a basis for negotiations while the Azerbaijani side still had 10 additional

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demands. This pointed to a deep dis-balance in the negotiations.

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*Throughout the year, the sides not only blamed each other for the failed negotiations, but also continued to disagree over which is the legitimate negotiating document – the Madrid document or its modified version*

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Third, 2011 was notable for the exceptionally high tone of military rhetoric, an equally unprecedented number of ceasefire violations and the number of deaths on the line of contact. As the negotiations appeared more and more hopeless, shooting incidents increased. There were dozens of casualties. When in October and November, Azerbaijani snipers killed Armenian recruits, Armenia's defense ministry announced that sniper activity would receive a "full response" using "disproportionate force" and the other side would be punished "several times over with greater losses."

Azerbaijan ignored the international community's, specifically the OSCE's, calls to remove snipers from the front lines. Nevertheless, Yerevan and Stepanakert responded favorably saying they would withdraw their front line shooters if Azerbaijan did the same.

In September, Karabakh's anti-air defense forces shot down an unmanned Azerbaijani missile.

Armenia's president invited the attention of the international community to Azerbaijan's militaristic rhetoric stressing that Azerbaijan is looking for an opportune moment to recommence military activities.

First Azerbaijan, then Karabakh and Armenia each organized military parades, with the purpose of demonstrating military might before the adversary. In October, there was a short meeting in Brussels of the defense ministers of Armenia and Azerbaijan.

In the context of increased warmongering, the possible re-opening of the Stepanakert airport in Karabakh did elicit significant threats from the Azerbaijani side, promising to down any Armenian planes. Although Armenia's president vowed to be the first passenger, there have been no flights yet, for reasons which range from technical explanations to possible political or diplomatic obstacles.

Anti-Armenian propaganda could even be seen in athletic meets. In the fall, the World Boxing Championships in Baku became the scene of an attack on Armenian boxers in the ring, something the authorities quietly tolerated.

The Turkish foreign minister, too, joined in and used his UN General Assembly podium in September opportunity to aggressively and openly link Armenia-Turkey normalization to Armenian concessions on the Karabakh conflict.

The CIS Inter-religious Council held its meeting in Yerevan in November, in the context of these frontline incidents. Sheikh ul Islam Allahshukur Pashazade, head of the Committee of Caucasus Moslems, attended and was received by the Armenian president as well. The Patriarch of All Russians, Kiril I, joined the Armenian and Azerbaijani religious leaders in a joint statement again calling for the removal of snipers from the line of contact.

In December, the annual OSCE Ministerial Council took place in Vilnius. During the meeting, the high-level diplomats of the Minsk Group co-

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chair countries and the Armenian and Azerbaijani foreign ministers adopted a joint declaration confirming that the Karabakh conflict cannot have a military solution.

In October, Azerbaijan became a UN Security Council non-permanent member for 2012 and 2013, from the East European group, competing against Hungary and Slovenia. The victory was interpreted differently in Yerevan and Baku. The Azerbaijani authorities hailed this as a major diplomatic victory, while in Yerevan, the authorities undermined and dismissed its significance.

Years earlier, Armenia, too, had placed its own candidacy for Security Council membership for 2012-2013. In July 2011 however, Armenia withdrew, assuming perhaps that those countries that would have voted for Armenia, might vote for Slovenia. In fact, however, Armenia's withdrawal helped Azerbaijan's candidacy because those countries which might have abstained from supporting either Armenia or Azerbaijan because of the conflict between the two, now were free to support Azerbaijan.

On the other hand, the history of UN votes even on nonbinding resolutions which have over the years been introduced to the UN agenda by Azerbaijan garnered not more than three dozen votes, fundamentally because Armenia resisted and countered the effort.

## BEYOND THE REGION

While **Russia** remained most active as mediator in the Karabakh resolution process, it also expanded weapons transfers, not just to its ally Armenia, but to Azerbaijan as well. Military parades in Baku in June and in Yerevan in September served as

opportunities for the two sides to show off their latest acquisitions.

Azerbaijan displayed Russian-made S-300 theater air defense systems. There were credible reports that Azerbaijan is awaiting delivery on two dozen Mi-35 attack helicopters from Russia. These in addition to earlier Azerbaijani acquisitions which had come from Ukraine, Israel, Belarus and Turkey

For its part, Armenia for the first time confirmed that its arsenal held surface-to-surface ballistic missile systems, including short-range Tochka and medium-range Scud-B, which S-300s are aimed to combat. There were also reports that Armenia would soon receive more advanced S-400 air-defense systems from Russia.

The arms build-up is continuing to raise the stakes in a potential military confrontation between Armenia and Azerbaijan, with the two sides facing a sort of MAD doctrine, where 'D' – for now at least – stands for 'devastation' rather than 'destruction.'

But for this strategy to continue to have a deterrent effect, Armenia is forced to rely on the benevolence of foreign powers – most significantly Russia – to be able to counter Azerbaijan's energy-fueled acquisitions. As a member of the Collective Security Treaty Organization, Armenia is able to buy arms at concessionary prices.

Reflecting this dependence, there was no official Armenian criticism of Russian arms supplies to Azerbaijan or Russia's support for Azerbaijan's ultimately successful bid for a UN Security Council seat also sought by NATO members Slovenia and Hungary.

Towards the end of February, after President Sargsyan's visit to Moscow, it was announced that

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gas prices would remain the same for Armenian consumers during 2011. It was not clear whether Armenia had negotiated a lower price for the Russian gas, given the fact that Armenian consumers pay twice the purchase price from Russia.

In October, the Armenian president was in Moscow for a state visit. In 2011, as in the previous year, bilateral trade was expected to reach \$1 billion.

But an all-important goal of building a new nuclear power plant appeared stalled with Russia – already selected as main contractor – offering only one-fifth of the required \$5 billion financing. By year's end, given the deferred new construction, Armenia's president acknowledged there may be a need to extend the life of the current plant.

For over a decade, shut down of the existing nuclear reactor has been a **European Union** priority with regard to Armenia, which refuses to close the reactor in the absence of equally reliable replacement capacity.

Shortly after assuming the EU presidency in the second half of 2011, the Polish president toured the region in July and Poland hosted the Eastern Partnership summit in September where familiar promises were heard about further economic integration, visa facilitation and the expected association agreement. During the year, the High Representative of the European Union for Foreign Affairs and Security Policy Catherine Ashton also visited the region as did the President of the European Parliament.

Bilaterally, 2011 saw a number of high-profile exchanges between Armenia and France, probably reflecting the role of the French Armenian voting bloc rather than Armenia's place in French foreign policy.

Sargsyan was in Paris in September, and shortly after, Nicolas Sarkozy arrived in Yerevan for a two-day state visit that contrasted with brief stops in Baku and Tbilisi that followed. As part of the domestic political contest, the Mayor of Paris, a leading member of the party opposing Sarkozy's re-election, appeared in Yerevan, not long after Sarkozy.

In March, the Nagorno Karabakh President visited the French National Assembly and in August, a French parliamentary delegation consisting of senior ruling party members made pro-Armenian pronouncements while on a visit to Karabakh.

Also in 2011, Armenia stepped up military cooperation with Poland and Germany. In the first instance, plans were announced for joint military production facilities and in the second the emphasis was on international peacekeeping training as well as German assistance for introducing rule-of-law measures within the Armenian military.

Armenia's expanded 126-person troop continued to serve as part of a larger German unit with NATO forces in Afghanistan. (Prior to 2008, the Armenian contingent in Iraq deployed with a Polish-led multinational division). An Armenian unit also remained in Kosovo as part of a Greek battalion.

Unlike Russia and probably following the US lead, Germany and other European Union countries have so far refused to permit major military sales to either Azerbaijan or Armenia. This helped delay the sale to Azerbaijan of Turkish self-propelled howitzers that use German-American engines.

**The United States** also continued its de-facto restrictions on military cooperation with Armenia and Azerbaijan, with engagement largely limited to education and peacekeeping operations training.



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Although the US expressed interest in boosting Azerbaijan's maritime defenses to counter Iran, it has refused Baku's repeated requests for arms sales since 2006. At the same time, the American ExImBank agreed to guarantee financing for Azerbaijan's purchase of US satellite technology that could have dual-use implications.

In July, US and Armenia resumed the Bilateral Security Dialogue that was suspended years earlier and the annual US-Armenia Task Force that focuses on US assistance and economic ties met in September.

The five-year Millennium Challenge assistance program concluded mid-year with no immediate prospects for extension. The program was curtailed from the original \$235 to \$175 million because Armenia did not meet the rule of law and good governance criteria.

In August, using across-the-board budget cuts as explanation, congressional appropriators did not include a specific allocation for US aid to Karabakh, leaving the 12-year-old program to the State Department's discretion. A specific aid allocation was also dropped for Azerbaijan and several other countries. Armenia assistance programs were expected to remain at the level of about \$40 million a year.

US-Armenia trade stood at about \$190 million in 2010 and about \$125 million for the first eight months of 2011.

There were only limited high-level contacts between the US and Armenia in 2011. In September, President Sargsyan's visits to New York and Los Angeles focused on Armenian community events marking the 20th anniversary of independence and no meetings with senior administration officials were reported.

The American Secretary of State met with the Armenian president during the Munich Security Conference early in the year, and with the Armenian foreign minister in May. Deputy Secretary James Steinberg and his successor Bill Burns were the highest-ranking US officials to visit Armenia (and its Caucasus neighbors), respectively in February and October. Those visits largely focused on regional security, Armenia's domestic politics and ways to expand economic ties.

## OUTLOOK

2012 will see presidential elections in Russia, France and the US, the results of which can change the internal priorities in each country and their relations with each other. These three countries, besides being global power centers, are also the Karabakh conflict Minsk Group mediators and thus the nature and direction of their continuing engagement may see changes. Of the three, Russia will regardless remain more directly engaged, given its geographic proximity and influence.

Little can be expected in terms of improved Russia-Georgia relations. Swiss-mediated dialogue led to Georgia's removing its veto of Russian membership in the World Trade Organization. But further deepening is unlikely given Prime Minister Putin's probable return to the presidency and the continuing Putin-Saakashvili mutual acrimony.

Georgia's NATO membership is not expected to pick up speed, due both to the European hesitance to further antagonize Russia, and Georgia's own unreadiness.

There are no grounds for optimism in either Turkey-Armenia relations or the Karabakh settlement process. Ankara continues to insist on progress on the Karabakh matter before moving forward with

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Armenia relations. And the Karabakh process is stalled because the sides are in disagreement over what document is on the table.

Tensions will remain high on the line of contact between Karabakh and Azerbaijan, with active sniper activity. Azerbaijan will continue to ignore the OSCE's calls to pull back the frontline shooters. Nevertheless, planned full out war is unlikely. Azerbaijan's UN Security Council membership will also serve to restrain Azerbaijan militarily, even as it achieves greater diplomatic influence.

The Arab Spring moved from Northern Africa to the Middle East. Syria and Iran fell under international scrutiny and the pressure on them will increase in 2012. Iran's parliamentary elections will also invite additional attention on Iran.

### POLICY OPTIONS

Armenia's regional policy lacks an ideological anchor. The government offers no interpretation about its actions vis-à-vis neighbors or allies. As a result, it is left up to others to interpret Armenia's policies. That interpretation is rarely in Armenia's favor. The poor state of US-Armenia and Russia-Armenia relations is a consequence of such inaction. Armenia must retake the initiative to articulate its own national policy.

Armenia must augment its efforts in the international arena to balance the opportunities Azerbaijan has gained by its UN Security Council membership. Indeed, Armenia should use Azerbaijan's presence on that Council to pressure it to tame the military rhetoric, the line of contact aggression, and instead positively engage in the talks.

The Karabakh negotiating document is in an uncertain state. Even as Azerbaijan continues to try to dilute the document's targeted approach, Armenia must clarify which document is actually on the table and once and for all highlight and formalize the use of a referendum as a non-threatening instrument to codify the self-determination principle.

The stagnant Armenia-Turkey situation works to Turkey's benefit. Turkey's representatives use frequent high-level meetings to reinforce their position. In the first months of 2012, Armenia must initiate some action in order to force Turkey back to the process, perhaps by taking action regarding the protocols, even if that means recalling them from Armenia's National Assembly.

The EU Association Agreement discussions present a fine opportunity to publicly redefine and reaffirm Armenia's policy regarding Europe. The call for deeper European integration ought to be heard regularly. If packaged correctly, this does not need to alienate Russia, or contradict Armenian-Russian relations. Armenia's European aspirations should be heard in calibrated and articulated statements, demonstrating passion and commitment to European processes, beyond facilitated visas. For that commitment to be credible, beyond talking Europe, Armenia's leaders must take political steps that are in line with European standards, beginning with good elections.

Armenia lags behind Georgia in European integration. Even that undesirable situation should be used to advantage to deepen relations with Georgia, by developing common programs that aim not just for good neighborly relations, but integration.



## ANTICIPATING SPRING

The political situation in Armenia remained tense but calm in 2011 as President Serzh Sargsyan further consolidated his power in the run-up to the parliamentary elections of 2012 which will have a determining effect on the presidential poll in 2013. Sargsyan handily warded off continuing challenges to his rule from the Armenian National Congress, led by Armenia's first president, Levon Ter-Petrossian. The other major opposition parties, the Armenian Revolutionary Federation - Dashnaktsutyun and the Heritage Party, posed even less of a threat to the ruling regime. They both acknowledged that both the president and the national assembly will complete their constitutional terms of office.

Despite repeated threats to stage the kind of popular revolt that brought down ruling regimes in Egypt and Tunisia, the Armenian National Congress (ANC) and its leader avoided a renewed confrontation with the government, confining themselves to regular demonstrations in Yerevan's Freedom Square. Ter-Petrossian proved to be ready

to compromise with the government. And the president, too, made concessions and promises.

This give-and-take took the form of a dialogue between representatives of the ruling Republican Party and the ANC. The President appears to have been the main beneficiary of this brief and incomplete gesture. He clearly scored points in the West, while avoiding further concessions that, at home, could have been seen as a sign of weakness.

As much as it was hailed as a landmark development by Western governments and the Council of Europe, the dialogue was never expected to address the root cause of political tensions in the country: a lack of elections widely recognized as free and fair, and consequently a continuing distrust of the most recent nation-wide elections, held in 2008. Government promises, made in the course of the year, to hold more democratic elections, met with skepticism from the opposition and many civil society representatives. Hence, there are lingering fears in society that the next national elections due in 2012 and 2013 might see a repeat of the 2008 political crisis.

These fears are legitimized in the context of various studies on social cohesion, reciprocal trust (or distrust) between the governed and their rulers, and the population's hopes and fears.

The year began with signs of growing friction within Armenia's governing coalition. The coalition, which had been formed immediately following the 2008 election, continued to be led rather unilaterally by the president's Republican Party. The second most important coalition party, Prosperous Armenia, increasingly strived to stake a greater role as an independent political force. What had begun in 2010, as an attempt by Prosperous Armenia to work more independently continued in 2011.

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Representatives repeatedly stated that the party led by National Assembly member and one of the country's biggest businessmen, Gagik Tsarukian, while remaining in the coalition, would seek to come out on top in the 2012 National Assembly election. Thus, Prosperous Armenia was for months reluctant to endorse Sargsyan's reelection bid despite mounting pressure from the Republican Party and from President Sargsyan himself. In February, Tsarukian caved in and together with the leaderships of the Republican Party and the third coalition party, Rule of Law (Orinats Yerkir) said they will jointly strive to help Sargsyan win a second five-year term in 2013. Moreover, they also pledged to refrain from competing against each other or "changing the proportion of seats held by the forces within the coalition" in the May 2012 National Assembly elections.

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*The year began with signs of growing friction within Armenia's governing coalition*

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This, of course, came to directly contradict Prosperous Armenia's earlier stated ambition to gain the largest number of seats, even at the Republican Party's expense. But by year's end, the party and its leader insisted again that they were determined to go it alone and to challenge the Republican Party in the elections. The resulting demonstrations of pressure on Tsarukian and his supporters extended from administrative coercion, including from the Tax Service, to efforts by law enforcement agencies to detain those close to the politically ambitious businessman. As a result, the public began to see the potential of Tsarukian's party not as opposition, but at least as alternative to the status quo.

In February, the ANC launched a new campaign of anti-government demonstrations. The bloc was clearly buoyed by the success of popular uprisings in Tunisia and Egypt, as were many of its supporters who attended its spring rallies in 2011 by the thousands. Ter-Petrosian initially threatened the government to call early presidential and parliamentary elections or face the kind of unrest that rocked the Arab states. Speaking at the next rally held on the March 1 anniversary of the 2008 post-election violence in Yerevan, he issued a list of 15 political and socioeconomic demands which he said Sargsyan must fulfill before the ANC would be prepared to enter a dialogue.

But Ter-Petrosian subsequently softened his rhetoric, saying that his political force is ready to start negotiations with the authorities if they free all political prisoners, promised an objective inquiry into the March 2008 events and guaranteed the opposition access to Yerevan's Freedom Square.

Sargsyan essentially accepted all three preconditions. Later in March, the ANC met with virtually no resistance from riot police as it led, for the first time in three years, thousands of supporters into the square, albeit, as in the past, without permission from the municipality.

In late April, the president ordered a renewed and objective inquiry into the 2008 unrest in Yerevan and ensured the lifting of a de facto government ban on opposition demonstrations in Freedom Square.

Sargsyan went on to initiate a general amnesty that led to the release of some 1000 persons convicted of various crimes. Four ANC loyalists, including Nikol Pashinian, editor of the opposition daily newspaper Haykakan Zhamanak, and Sasun Mikaelian, a former deputy of the National Assembly, who were still in prison on charges that were disputed, were



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also set free in late May, the day after the National Assembly passed an amnesty bill. The amnesty was in effect through Independence Day September 21.

Addressing another Freedom Square rally at the end of May, Ter-Petrosian hailed the government concessions as his “biggest victory” since 2008 and spoke of the emergence of a “new political situation” that allows the government and the opposition to achieve “reciprocal understanding” through dialogue.

From the beginning, the expectations were that such a dialogue could, at most, improve the internal political environment in Armenia, improve Armenia’s international standing and shed more light on the factors behind post-election instability in Armenia. The dialogue could not eliminate the causes, but could perhaps ameliorate the political consequences of the Great Divide that had ensued since 2008.

Rival opposition groups as well as some commentators asserted, however, that Ter-Petrosian has simply struck a deal with Sargsyan that would enable the president to at least complete his five-year term in office in 2013. They said the ANC leader is also seeking government assurances that the ANC will have a solid presence in Armenia’s next National Assembly. Ter-Petrosian dismissed this speculation, insisting that the ANC will press for fresh elections during upcoming negotiations with the ruling coalition.

Negotiating teams formed by the three-party coalition and the ANC held five rounds of negotiations essentially focusing on ANC demands for special elections. Discussion was cut short when the ANC suspended the dialogue in protest against the August arrest and prosecution of a young ANC activist, who was detained along with

six other members of the ANC’s youth wing after an altercation with riot police in Yerevan under circumstances that remain disputed. Unlike the other activists, even at year’s end, he remained under arrest charged with assault.

Ter-Petrosian again made clear in September that he is against the idea of a “revolution or uprising” and appeared to retreat from the pre-term election demand as part of a “reasonable compromise” with the Sargsyan administration.

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*The ANC met with virtually no resistance from riot police as it led, for the first time in three years, thousands of supporters into the square*

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Thus, after a year of consistently moving the bar and elevating demands, Ter-Petrosian dropped the key ‘special election’ condition and with it, the dialogue. In a later rally, he also extended a tentative invitation to cooperate with the Prosperous Armenia Party, extolling their decision to challenge the ruling Republican Party as a positive contribution to a fair electoral process.

Sargsyan, for his part, earned plaudits in Europe. The European Union and the Council of Europe welcomed the already-stalled dialogue. In a resolution adopted in early October, the Parliamentary Assembly of the Council of Europe (PACE) commended the president’s overtures, stating, “The chapter on the March 2008 events can finally be considered closed.” The ANC and the Heritage Party criticized this conclusion, accusing PACE of pro-government bias.

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But the PACE resolution also stressed that “genuinely democratic parliamentary elections” are essential for avoiding a repeat of the March 2008 events. Sargsyan pledged to do his best to ensure the proper conduct of the 2012 elections. He pointed to the passage in May of fresh amendments to Armenia’s Electoral Code that were largely endorsed by Council of Europe experts.

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*The opposition insists that the authorities still lack the political will to hold free and fair elections so long as they run the risk of losing power*

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All three leading opposition forces – the ANC, the ARF and Heritage – downplayed the promises and the significance of the Electoral Code changes. A key opposition argument is that Armenia’s new Central Election Commission and precinct-level commissions are heavily dominated by government loyalists. But most curious is the coalition deal, they say, signed in February, that signals an a priori agreement among coalition members on the number of seats to be gained and shared among them. They control at least 100 seats in the current 131-member National Assembly and thus the opposition claims that Sargsyan and his political allies have effectively predetermined the outcome of the 2012 elections, thus raising serious questions about the government’s democratic credentials. The opposition insists that the authorities still lack the political will to hold free and fair elections so long as they run the risk of losing power.

The other two opposition parties both are represented in the National Assembly. The ARF with 16 seats, launched in February a nationwide campaign called “A Vote is Power” and aimed at

raising public awareness of electoral rights. The party claimed to have signed thousands of symbolic “contracts” with voters across the country, obliging them, to participate in the next elections and not to sell their votes. The ARF also rallied several hundred supporters in Gyumri in early September in what its leaders described as the start of nationwide demonstrations aimed at drumming up popular support for “regime change.” But this was done without attacking the president or demanding his resignation.

Thus, the ARF’s place in political circles remained somewhat confusing, given their careful pronouncements, and their continuing chairmanship of National Assembly commissions, even after the Party left the coalition in 2009.

The third opposition party, packing the most punch for their size, with a mere seven seats in the National Assembly, the Heritage Party is the one whose members most often raise popular issues within the National Assembly, including environmental alarms, speaking against domestic violence and violence in the army.

Raffi Hovannisian, the party’s founder, in March, carried out a two-week long hunger strike. He did so “for justice,” he said, as he sat in Freedom Square, prior to and following the government decision to re-allow rallies to be held there. Thousands of individuals came out of curiosity or to express solidarity, including representatives of political parties, but not Levon Ter-Petrossian.

Later in the year, Hovannisian addressed a very specific and lengthy open letter to the president, identifying the steps necessary to hold representative and fair elections. This time, he was snubbed by the president, who dismissed the



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proposals, explaining that the process to free and fair elections is under control and assured.

Thus, whether borne of political or personal reasons, various opportunities for the three non-coalition parties to join forces were missed during an otherwise unremarkable political year. Given each party's strong ideological underpinnings, none of them seriously threaten each other's base. Nevertheless, there were no demonstrable efforts to seeking a path to cooperation and cease undercutting each other.

They even ignored the opportunity presented by local elections. Over the course of the year, elections took place every week in various towns and villages, electing either mayors or members of city councils. In a most important election in the border city of Ijevan, in Tavush marz, the Prosperous Armenia candidate beat out the candidate of the ruling Republican Party, thus making plain the real opportunity for competition that 2012 may present. No other parties or coalitions have registered victories.

It was probably this election that drove Ter-Petrossian and other political actors and observers to begin to view the possible re-drawing of forces, with Prosperous Armenia as a separate actor, as a real possibility. The Prosperous Armenia Party began to slowly perceive itself, and the public perceived it as, if not opposition, at least alternative to the status quo. If it succeeds, it will be more about the phenomenon of Tsarukian as alternative, not the person.

The final piece in this newly-forming domestic political puzzle is the possible role that former president Robert Kocharian may play.

Earlier in the year, Kocharian denounced the coalition's unfolding dialogue with the ANC, saying that the dialogue could result in a dangerous "collusion behind the voters' backs" over the "parameters of an imitation at a political struggle" by the two rival camps.

Those statements by Kocharian were the clearest indication yet of his disagreements with Sargsyan. The ex-president exposed his discontent with the current Armenian leadership in February when he backed Tsarukian in his initial dispute with the ruling Republican Party. Kocharian himself was a factor in that dispute, when the Prosperous Armenia Party leader claimed that Kocharian could easily have taken over Sargsyan's Republican Party during his 1998-2008 presidency but did not do so because he never regarded political parties as "anybody's property," hinting at a possible Kocharian return to politics. Kocharian made no statements confirming or denying that possibility. The continuing questions about Kocharian's possible return will influence the ways in which the Prosperous Armenia and Republican Party conflict develops. It will certainly impact the possibility of Prosperous Armenia's cooperation with other political forces.

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*The final piece in this newly-forming domestic political puzzle is the possible role that former president Robert Kocharian may play*

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Indeed, these changing configurations and the inherent political dangers were both the cause and the consequence of several major end-of-year resignations within the government, including

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that of President Sargsyan's Chief of Staff, and the President of the National Assembly.

In the midst of these political developments, Armenia's **National Assembly** passed a series of important legislative packages this year.

None of this legislation came as the result of direct civic pressure, although the year did see further growth in civic activism, increasingly carried out through Facebook and other online social media.

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*The public groups and movements were composed of activists concerned with a variety of sectors and united in their opposition to various government positions*

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**Non-governmental organization (NGO)** leaders insist that although there have been no significant obstacles to NGO operations and activities, nevertheless, the lack of significant growth in public engagement in legislative and social environments is tantamount to a fallback.

2011 saw improvement in NGO registration efforts by making them simple on-line procedures. The Justice Ministry's 2010 effort to create some government oversight of NGO operations ended when the Ministry shut down its own agency charged with that responsibility. State harassment was limited or non-existent in most cases, but that was coupled with little state interest, cooperation and facilitation of NGO activism, visibility or access.

Within civil society, narrowly defined groups emerged and became visibly and vocally active to

address specific issues. They generally presented their concerns to government through public actions, being skeptical about the receptivity or willingness of executive or legislative branch officials to listen or act without public scrutiny. Civil society activists were either afraid to engage in dialogue with the government, felt inadequate to offer their views or simply did not believe the government would listen to their recommendations. In other words, as policy issues became more complex and challenges by policy makers more sophisticated, activists and their supporters came up short in capacity to respond to and effectively engage with decision makers on a substantive level. The result was that civil society activists managed to influence specific events or decisions but did not play a role in public policy.

Universities and think tanks did not step in to offer alternative policy analysis. In addition, aside from isolated and targeted polling, or donor-supported research, little or no quantitative data are available for the formulation of public policy. On the other hand, selective and targeted efforts by some NGOs, organized with the purpose of offering policy recommendations to legislators, through the National Assembly's permanent commissions, were successfully received. The reason for the success can be found in the nature of the type of legislation proposed – not targeting specific economic or political interests, but focusing on general policy decisions.

The public groups and movements were composed of activists concerned with a variety of sectors and united in their opposition to various government positions. Yet, there was no visible formation of coalitions or permanent structures.

In addition, as new, young activists move into the **civic activism** sector, it is clear that there is

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a need for new skills necessary if expressions of public discontent are to be transformed into policy recommendations.

The media did not offer civil society organizations and actors broad coverage because they are not seen to have a following of a scale that would create the necessary audience. Additionally, media outlets remained driven less by public interest and more by their corporate agendas. At the same time, civil society activity continues to be considered weak and ineffective, or irrelevant. Local donors did support NGO activity but quietly or anonymously, in order to avoid unpredictable government reaction.

But the mostly apolitical and youth-oriented groups, many of them lacking official registration, capitalized on the rapid spread of the Internet in Armenia to gain public support for their causes ranging from environmental issues to chronic abuses within the armed forces. They were thus emerging as a more vocal and, in many cases, effective alternative to established non-governmental organizations. The Internet enabled ad-hoc groups to attract the attention of the mainstream media and quickly mobilize sympathizers despite a lack of financial resources.

The online activism has gone as far as to question the moral authority of the Armenian Apostolic Church and its supreme head, Catholicos Karekin II. Scores of people joined in June and July a Facebook group demanding the partriarch's resignation over his perceived failure to look after medieval Armenian monasteries and other alleged missteps. The church's Mother See in Echmiadzin had to resort to a public relations campaign, usually absent in Armenia, in response to respond to the unprecedented campaign.

Non-combat deaths in the Armenian **army** are another case in point. The problem, endemic since the early 1990s, has had a much greater public resonance since the summer of 2010, and the social media is a major reason for that. Faced with mounting public uproar, the Armenian military has repeatedly promised a tougher crackdown on hazing and other abuses within the army ranks. Dozens of officers and soldiers have been arrested, fired or demoted over the past year.

Still, some three dozen non-combat deaths were reported in 2011. The decreased numbers may be due to greater transparency. At the same time, once made public, the same transparency does not result in information on the actual causes and perpetrators of the crimes.

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*Mostly apolitical and youth-oriented groups capitalized on the rapid spread of the Internet in Armenia to gain public support for their causes*

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Civic activists joined parents of some of the dead soldiers in staging weekly demonstrations outside the prime minister's office in Yerevan in September. They demanded urgent government action against army criminality and accused military prosecutors of continuing to cover up many such cases. Defense Minister Seyran Ohanian met and reassured the protesters.

Hrayr Karapetian, the chairman of the National Assembly's Commission on Defense and Security, added his voice to the criticism, saying that the military authorities are still not doing enough to address the problem. Karapetian, who is a senior member of the opposition ARF, said more radical

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defense reforms are needed to eliminate its root causes.

Armenia has already been reforming its armed forces under the Individual Partnership Action Plan (IPAP) with NATO. Launched in 2005, the cooperation framework commits Yerevan to bringing them into greater conformity with NATO standards and practices. The IPAP's most recent version calls for "maximum transparency" in defense planning and budgeting and an "adequate mix" of civilian and military personnel within the Armenian Defense Ministry.

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*Faced with a mounting public uproar, the Armenian military has repeatedly promised a tougher crackdown on hazing and other abuses within the army ranks*

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Speaking at an annual meeting of NATO's North Atlantic Council in Brussels in July, Ohanian announced that the Armenian government has drawn up a new five-year plan for defense reforms. He said the plan is the result of a strategic review of Armenia's military capabilities and security challenges, conducted by the government earlier in 2010. Ohanian's first deputy, Davit Tonoyan, discussed the results of that assessment with senior U.S. Department of Defense officials during a visit to Washington earlier. The Armenian Defense Ministry said the two sides mapped out "new areas of further cooperation" between the American and Armenian militaries.

Although those in the defense establishment insist that the reform-minded form a very small minority,

still, Armenia's armed forces cooperate with the Organization for Security and Cooperation in Europe (OSCE) Yerevan office to introduce and reinforce reforms leading to democratic and civilian control over the security services. This includes strengthening the National Assembly's oversight of defense administration, improving the army's understanding of human rights, trying to comprehend the causes of ill behavior and assist in implementing reforms, focusing on education for the leadership especially. The accountability issue still needs to be addressed, so that punitive actions are taken more adequately and with transparency.

Democratizing **police** services and improving relations between police and the public will be essential during the next two pre and post election seasons. The public's interaction with the police was the least analyzed and most explosive aspect of the 2008 post-election violence, and will be of paramount importance again.

The OSCE is involved in helping the administration of Armenia's police and bringing Armenia's public order management strategies, tactics and techniques in line with international best practices and focusing on the introduction of democratic policing practices.

In 2011, there was an upsurge in libel cases brought against Armenian newspapers and other **media** outlets mostly critical of the government. That was the widely anticipated result of amendments to Armenian media-related legislation passed by the National Assembly in March 2010. Those amendments decriminalized libel offenses but toughened financial sanctions for defamation of character. Media watchdogs expressed concern at the time that this could make it easier for authorities to curb press freedom. In fact, 12 such cases were reported in the first quarter of 2011 alone.





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In one case, three of Armenia's wealthiest businessmen, all members of the National Assembly, filed in January a lawsuit against the opposition daily Haykakan Zhamanak over an October 2010 article that implicated them (along with President Sargsyan) in criminal activity in Russia. The plaintiffs found it libelous, demanding a total of 7.5 million dram in damages. A Yerevan court ordered Haykakan Zhamanak in February to pay them six million dram. Other newspapers and NGOs in the journalism community helped raise the funds.

Two other newspapers highly critical of the government, Zhamanak and Hraparak, were taken to court by family members of former President Kocharian and both fined. Zhamanak was fined three million dram and Hraparak six million Dram.

Hraparak was also sued by the head of Armenia's Judicial Department for a report on a collective letter by the agency's employees accusing their boss of corruption. In September, a Yerevan court controversially froze three million Dram of the newspaper's assets and banned it from writing about the litigation pending a verdict in the case.

Another district court slapped a more modest fine of 288,000 Dram on the Yerkir daily in June for a disparaging article about a wealthy businessman and National Assembly deputy notorious for rarely attending parliament sessions.

The lawsuits prompted serious concern from the Armenian Chamber of Advocates. Reporters Without Borders also expressed serious concern about the defamation cases. In a May statement, the Paris-based watchdog said the heavy fines imposed on media "threaten their survival and create a climate that encourages self-censorship."

There were few other major changes in the Armenian media landscape in the course of the year, with the government maintaining its decisive influence on political news coverage by virtually all local broadcasters. The New York-based Committee to Protect Journalists (CPJ) deplored that situation in its annual Attacks on the Press report released in February. The CPJ also criticized amendments to an Armenian law on broadcasting which were passed in 2010 despite strong domestic and Western criticism. It echoed a widely held belief that the amendments (which regulate the broadcast digitization process) were primarily aimed at keeping the independent TV station A1+ off the air and pulling the plug on an independent broadcaster, GALA TV, in 2015. Indeed, both applied and both were rejected.

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*In 2011, there was an upsurge in libel cases brought against Armenian newspapers and other media outlets mostly critical of the government*

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In June, the Council of Europe's top decision-making body, the Committee of Ministers, found that the Armenian government had fully complied with the letter of a European Court of Human Rights verdict on the closure of A1+. Armenia's leading media associations slammed the decision for ignoring the spirit of the European Court's decision. That decision required the Armenian government to pay a 20,000 Euro (\$28,500) fine for having shut down the broadcaster in 2002 and for subsequent rejections of A1+ applications for new broadcasting licenses. However, it did not explicitly order the Armenian authorities to allow A1+ to resume broadcasts. Thus, the 2011 Council of Ministers upheld that the Armenian government followed the letter of the verdict.

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The closure of A1+ is the main reason why the US human rights group Freedom House has described the Armenian media as “not free” since 2003.

In late October, the Gyumri-based GALA had to remove its transmitter from the city’s old TV tower after finally losing a lengthy court battle with the Gyumri municipality. The latter accused the small TV channel of using the facility illegally in 2008. Nevertheless, GALA was allowed to place its transmitter on Gyumri’s new TV tower which is used by other local broadcasters. GALA should be able to do so until its broadcasting license expires, ostensibly because of the digitization process, in 2015.

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*There were few other major changes in the Armenian media landscape in the course of the year, with the government maintaining its decisive influence on political news coverage by virtually all local broadcasters.*

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Also in October, the Gyumri-based Asparez Journalists’ Club launched Armenia’s sole daily newspaper based outside Yerevan after receiving an 18 million Dram grant from the Open Society Foundations. The paper called “Gyumri Asparez” started out with a print run of 500 copies a day.

The Parliamentary Assembly of the Council of Europe, in a draft resolution circulated in September, said that despite its repeated calls, Armenia’s leadership had failed to ensure more pluralism in the Armenian broadcast media.

With parliamentary and presidential elections on the horizon, there seems little prospect for the easing of the government grip on TV and radio stations. Instead, the government continues to tolerate the much greater diversity in the print and online media. However, the impact of Armenian newspapers on public opinion remains seriously limited by low circulation numbers. Print runs are not rising because readership is limited due to the overt political partisanship displayed by each publication, and newspapers continue to exhibit a lack of comprehensive reporting. Another important factor is the rapid expansion of online news services. Falling Internet prices and growing speed of connections have transformed a couple of dozen Internet sites into key sources of information for the public. Still, they lack the editorial infrastructure that will be necessary for serious coverage of elections, for example.

According to a survey by the Caucasus Research Resource Centers released in October, 28 percent of Armenian households now have an Internet connection, up from 21 percent in 2010 and 8 percent in 2009. The survey also suggested that 21 percent of Armenians use computers on a daily basis. More than 80 percent of those accessing information from the Internet were found to trust, to varying degrees, Armenian online news services.

## OUTLOOK

The discontent expressed in Russia following the December Parliamentary election there will impact Armenia.

Although public dissatisfaction in Armenia has been visible only following presidential elections (1996, 2003 and 2008) and not after parliamentary

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elections, 2012 may be different. Expectations of both 2012 and the 2013 presidential elections are so high, and the likely impact of the first on the second is so obvious, that unfair and illegal actions in the 2012 elections, especially those taken with impunity, will present larger problems for the authorities.

The opposition insists that the authorities still lack the political will to hold free and fair elections so long as they run the risk of losing power.

The Republican Party will continue to push the Prosperous Armenia Party to enter the election together on a combined slate. If Prosperous Armenia does not manage to resist the pressure and succumbs, then a Republican-Prosperous-Rule of Law coalition will assure a majority and Armenia's National Assembly will still not serve as a check and balance.

Alliances among the opposition groupings are unlikely. Two of the three opposition groups – the Armenian National Congress and the Armenian Revolutionary Federation - Dashnaktsutyun, will probably each run its own late. The Heritage Party may join forces with the liberal Free Democrats who splintered off the Armenian National Congress.

The NGO community and civic activists will be faced with expectations of greater engagement before and during the elections.

News sources, especially television broadcasters, will be under greater pressure and will therefore resort to self-imposed limits or self-censorship to follow the expected line in support of the authorities. Those in opposition will be at a disadvantage in terms of media access.

## POLICY OPTIONS

The Parliamentary election of May 2012 will be the first national election to be held since the 2008 presidential race which was followed by civil unrest and political violence. The distrust that deepened as a consequence of those elections and the subsequent events remains entrenched between government and people, and within society itself. Expectations of the results of the May elections will be that they are perceived to be a true expression of the voice of the people.

Given the public's high expectations regarding parliamentary elections, especially in the context of developments in Russia, in the European institutions, and given the promises regularly being made by Armenia's top leaders at European podiums, the unfair conduct of parliamentary elections will critically undermine Armenia-EU relations. The government must resist using administrative and other resources and demonstrate the seriousness of Armenia's European commitment.

The government should not fear releasing controls on electronic media and provide access even earlier than the legally-mandated campaign period, thus broadening debate

To allow non-governmental organizations to grow stronger and become more independent in their programs and activities, the government should begin to reward charitable contributors with tax advantages.

The police must not just be forced to work on public order management reform but also be willing to publicly demonstrate work on public order management reform to inspire confidence.

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The military prosecutor's apparatus needs to be overhauled. Deaths in the army, although decreased significantly, will remain at the forefront of public attention, and therefore should remain the Defense Ministry's focus to demonstrate improved transparency and accountability.

Civil society activists should begin to focus on policy development as well, and not only on events or interventions.

## CRIPPLING GROWTH

The dominant challenge in 2011 for the global economy was the debt problem, both in the euro zone and in the US.

This prompted most euro zone countries to adopt austerity measures. Those in the periphery did so to avoid catastrophe; those in the core rushed to take preventive measures, and in the process raised the specter of economic slowdown and even recession. In its end-of-the-year economic outlook, the OECD slashed its 2012 forecast for economic growth for its 34 member states from 2.3 percent mid-year to 1.6 percent and for Europe alone from 2 percent to 0.2 percent.

Indeed, towards the end of the year, the challenge for advanced economies remained on the one hand, adopting a credible strategy to reduce their fiscal deficit over the medium and long term, and at the same time dealing urgently with slow growth and high unemployment. For emerging market economies, the expectation continued to be that they play a role in helping to achieve the re-balance of the global economy by relying more on domestic demand.

In 2011, the Armenian economy, too, struggled to recover from the deep recession of 2009, and to overcome the continuing repercussions of that year's 14.5 percent GDP loss. Towards the end of the year, Moody's Investors Service lowered its outlook on Armenia's sovereign ratings from stable to negative, pointing to risks to the country's growth.

Armenia in 2011 faced the same economic challenges, albeit on a different scale, as the rest of the world. The Armenian government, too, was compelled to find ways to navigate "the twin threats of undermining credibility and undercutting recovery" in the face of high national debt accumulated in the first years of the global crisis and its subsequent struggle to recover.

In 2011, as in 2010, government policies targeted economic growth and poverty reduction, fiscal and debt sustainability, lowering the trade deficit, managing inflation and deepening structural reforms.

The simultaneous tackling of these challenges however have created several dilemmas for the government. For example, addressing the national debt and the budget deficit requires actions which go counter to the steps required to foster growth and to reduce poverty. The second dilemma – addressing external imbalances – among other

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things, assumes a devaluation of the Armenian dram. This would go counter to efforts to restrain inflation. The third dilemma is that the nature and scope of structural reforms that are necessary today, on the face of it, contradict the interests of the few politically-connected large businessmen who control a large portion of Armenia's economy.

In the absence of a truly free market economy – an even playing field, open and fair competition and protection of private property – those dilemmas cannot be overcome.

In 2011, the government adopted a restrictive fiscal and monetary policy. First, it focused on inflation containment and fulfilling budgetary requirements, rather than securing economic growth. The Central Bank's policy rate was raised several times, as were reserve requirements on foreign liabilities. Second, additional revenues were secured not at the expense of the shadow economy but at the expense of small and medium size enterprises.

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*2011 figures show that in 2010, the incidence, the gap and the severity of poverty increased as compared to 2008*

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During the year, despite rearrangement of excise taxes and broadening the tax base, the revenue to GDP ratio went up a mere 0.4 percent and Armenia continues to have the lowest ratio in the region. Third, despite the promise and effort devoted to diversification, the economy remained heavily dependent on the mining and agriculture sectors. Finally, structural reforms to induce greater productivity and competitiveness by reducing patronage and corruption were ineffective.

As we close the year, Armenia's growth is uneven and anemic. For most of the year, inflation was still higher than the Central Bank target, there was high poverty, high national debt and high trade deficit.

## THE ECONOMIC PICTURE

On the threshold of the second wave of the global economic crisis, little was resolved regarding the fundamental causes which brought on Armenia's 2009 economic decline. Armenia still faces the same old bottlenecks – the lack of economic diversification, growing dependence on resource-oriented exports, and a growing external debt. In 2011, Armenia, with another unlearned lesson from 2009, is still very vulnerable to external economic shocks.

After a sharp downturn in 2009 followed by a moderate recovery in 2010, represented by 2.1 percent GDP growth, 2011 is expected to see 4.6 percent economic growth by year's end. In absolute numbers, the 2011 Gross Domestic Product is 3,763 billion dram (or USD \$10 billion.) However, the first half of 2011 registered only 2.8 percent GDP growth compared to the same period in 2010. In contrast, the GDP growth rate in the first half of 2010 reached 6.1 percent.

According to the Central Bank, 2011 was marked by rising consumer confidence but a worsening business climate and stagnating economic activity. Indeed, the economic activity index has barely changed since last year, registering, in the third quarter of 2011, a slight decrease of 0.1 percent compared to the second quarter of 2011. Overall, economic activity demonstrated a rather unstable pattern this year, reflecting the low level of economic diversification and thus the seasonality of the economic buoyancy. In month to month

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comparisons, between 2011 and 2010, May saw a 9.9 growth in economic activity, and June saw a mere 2.3 percent. In July, it was seven percent, in August 9.6, in September, nine, and in October 2.4 percent. The rise in economic activity was largely caused by growth in services and a rebound in the agricultural and industrial sectors. Conversely, trade and construction did not show significant improvement this year.

Inflation concerns – although temporally eased by seasonal price reductions on agricultural products – still remained high. The month-to-month average inflation rate from January to October stood at 8.3 percent, considerably exceeding the Central Bank inflation target set at 4 with plus or minus 1.5 percent. Moreover, food and beverages were hit the hardest, fueled by soaring prices on eggs, dairy products, sugar and fruits, inflating by 12.3 percent over the period. This, in turn, further worsened conditions for the poor, whose consumption basket is comprised largely (up to 69 percent) of food products.

Gains in economic growth during the so-called recovery year of 2010 were not distributed evenly, leading to further polarization of Armenia's population. Thus, the Gini coefficient for consumption inequality and the coefficient for income inequality rose significantly during the last two years. In 2010, those numbers reached 0.265 and 0.362 respectively. Further, at the national level, the richest 10 percent of the population did not suffer from recession, whereas the poorest 10 percent suffered more than the others, thus increasing the gap between the richest and the poorest even further. Just released figures show that in 2010 the richest made 14.2 times more and spent 8.1 times more than the poorest. In two years, the Gini coefficient for consumption increased by 10

percent, while the income inequality coefficient rose by 7 percent.

2011 figures show that in 2010, the incidence, the gap and the severity of poverty increased as compared to 2008. More than one-third of the Armenian population – 35.8 percent – today lives in poverty, and 21.3 percent of the total population is considered 'very poor.' The third level, the 'extremely poor,' is three percent of the population (versus 1.6 percent in 2008) and lives on less than \$2 a day.

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*The recovery in 2010 and the expected economic growth in 2011 did not bring with it any recovery to the labor market*

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In just the last two years, around 270,000 people became poor, raising the number of those living on less than 33,500 dram (or \$90) per month to 1.2 million. The number of the 'very poor' soared to 694,000 people. The severity of poverty was estimated to comprise around 98,000 people in 2010. Given that the cost of the basic consumer basket is around 42,000 dram, those who are considered above the poverty line because they earn around 33,500 dram remain at risk. Moreover, over 54 percent of the poor live in households where more than two family members are in fact employed, yet the family is still below the poverty line.

The recovery in 2010 and the expected economic growth in 2011 did not bring with it any recovery to the labor market. The unemployment

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rate, as calculated by International Labor Organization methodology, has increased and reaches 19 percent. In other words, according to the ILO, of those Armenians able to work, and of working age, one of five does not have a job. This brings the total number of unemployed to roughly 278,000. Around 38 percent of the unemployed have never worked and 19 percent of the unemployed have now been out of work for more than four years. Over these two years, the value of the minimal consumer basket has soared by 18 percent to reach 42,000 dram while unemployment benefits have remained unchanged at 18,000 dram (less than \$50.)

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*Armenia has improved its position both in the World Bank Doing Business ranking and on the World Economic Forum Global Competitiveness scale this year*

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On the other hand, Armenia has improved its position both in the World Bank Doing Business ranking and on the World Economic Forum Global Competitiveness scale this year. In terms of ease of doing business, Armenia was rated six points higher than the previous year. Improvements were observed in the process of attaining construction permits, paying taxes and getting credit. As regards the Global Competitiveness Index, Armenia advanced its ranking by six positions from 98 to 92. According to the World Economic Forum, Armenia improved in 10 out of 12 categories, performing increasingly well in labor market efficiency.

At the same time, Moody's Investors Service lowered its outlook on Armenia from stable to negative. Moody's explained its decision based on the country's ongoing economic vulnerability to weaker growth prospects in Europe and Russia, which together account for 58 percent of Armenia's export market. Moody's also noted that the country is now faced with a large current account deficit (estimated to be 11 percent of GDP in 2011) and a government external debt ratio that has doubled to 35 percent in 2011 from 14 percent of GDP in 2008.

No changes were registered in Transparency International's corruption perception score. In 2011, the score retained its earlier level, 2.6 points, putting Armenia in 129th place out of 183 countries.

After the severe downturn in the **construction** sector, the hardest hit of all sectors by the global financial crisis, in 2011 the sector still remains depressed. Worse, construction figures are not only far behind those of the pre-crisis level, but they are decreasing further. In the period January to October, construction output dropped around 25 percent compared to the same period in the previous year. Moreover, 40 percent of the sector was financed by the state and international organizations, or supported by humanitarian aid. This was insufficient to uplift the sector. Additionally, individuals and commercial organizations were reluctant to invest in construction, contributing less than 60 percent to the development of the sector. In pre-crisis Armenia, commercial and residential construction constituted 89 percent of the sector, reflecting increasing returns from investment. Agreements with the Asian Development Bank and the World Bank to implement major infrastructure projects promise to reinvigorate the field next year.



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Armenia's **industrial** sector achieved impressive growth this year, shooting up by around 20 percent in the first 10 months. A large portion of the registered growth was boosted by higher metal prices on the international market, and thus does not reflect the real growth of the sector. If calculated based on constant prices, industrial output grew only 13 percent. The mining sector and related industries again became the primary driver of the growth. The share of mining and base metal production in the industrial sector increased further and now constitutes 34 percent. The export-oriented nature of both of these industries and, consequently, the rising dependence on resource-heavy exports, further increases the vulnerability of the local economy to external fluctuations.

Agriculture was the savior of Armenia's economy this year. If the 13.4 decline in agriculture in 2010 put the brakes on GDP growth, this year, that same agricultural sector performed better and contributed to economic activity. Good weather helped make a rebound of around 15 percent in the first nine months of 2011. Data on agricultural lands also demonstrates that agricultural growth was mainly conditioned by the climate.

Agriculture, although one of Armenia's most important economic sectors, remains underfinanced. Supported by the government's March decision to allocate 200 million dram to subsidize four percentage points on loans to farmers, agricultural loan portfolios went up 18 billion dram or 34 percent in the first ten months of 2011. Approximately 7.3 billion dram in loans were made available under this program. Yet, agricultural loans comprise a mere 6.2 percent of total bank loans. Given that agriculture comprises over 18 percent of GDP and employs approximately 45 percent of the labor force, this share of agricultural loans in

commercial banks' portfolios is disproportionately low. Consumer loans, on the other hand, have increased by 38 billion dram and constitute 18 percent of total bank loans. Although interest rates on both categories of loans are the same – approximately 24 percent – commercial banks clearly prefer to loan to consumers, considering the agricultural sector to be high risk.

The weather is not the only risk factor for Armenian agriculture. The reluctance of commercial banks to invest in agriculture is, to a great extent, conditioned by unpredictability and the short-term nature of the policies applied to the sector. Moreover, dominated by small-scale subsistence-driven agriculture, the sector is producing far below its capacity. In fact, the value added per worker in agriculture is on average five times less than in developed countries. An average farmer household in Armenia produces around \$4,000 a year, which is barely enough for subsistence. However, rather than creating long-term programs and mechanisms to increase the productivity of the sector and to reduce the risk both for farmers and investors, the government has chosen to take the quick path by subsidizing high interest rates and obliging banks to enter the agricultural loan sector.

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*Construction figures are not only far behind those of the pre-crisis level, but they are decreasing further*

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Retail turnover continued to grow this year, showing albeit a steady, but slow increase. Overall, retail sales growth averaged 2.8 percent by the end of the third quarter of 2011 compared with the same period the previous year. This was mainly

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attributed to a substantial 65 percent increase of the total official turnover in shops and supermarkets, in the January to October period. Share of large supermarkets as percentage of total retail sales constituted over 52 percent, whereas turnover in mid-size outlets decreased to 22.4 percent.

Driven by aggressive marketing strategies and a lottery based on cash register receipts (launched by the State Revenue Committee with the intention of bringing grocery stores out of the shadows) the total turnover of shops and supermarkets comprised around 624 billion dram in the first 10 months of 2011. The lottery initiative may have considerably decreased the share of the shadow economy in retail, yet the market is still highly monopolized and run by large, politically-connected businessmen.

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*Agriculture, although one of Armenia's most important economic sectors, remains underfinanced*

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The combined **services** sector saw a slight acceleration in the growth rate this year, reaching 5.8 percent in the January to September period. Despite consistent growth over the last decade, services still account for less than 30 percent of average monthly household expenditures (compared to 70 percent in the developed world.)

Over two-thirds of transactions in the services sector are in the financial sphere, transport, information technologies and communications. Yet, even these areas have not fully exploited their capacities and in terms of productivity still lag considerably behind developed countries. An

IT specialist in Armenia, for example, produces, on average, 3.2 times less than a Singaporean programmer and 2.8 times less than an Israeli IT professional.

Overall, the Information and Communication Technologies sector was one of the most rapidly growing segments of Armenia's economy. From 2008 to 2010, the industry revenues grew by 34 percent and by the end of 2010 comprised around USD \$149 million. Moreover, the widespread introduction of relatively inexpensive broadband and wireless internet providers, caused partially by the introduction of a third mobile company, substantially increased the number of internet users. In 2010, the number of broadband subscribers reached 200,000, while the overall number of wireless internet users is around 100,000. Mobile GSM networks cover about 85 percent of the country's territory and 95 percent of the population. 3G is used by only 3 percent of Armenia's residents.

Fueled by the launch of mandatory automobile liability insurance and the resultant expansion of the insurance market, the **financial** sector enjoyed one of the fastest growth rates within the service sector.

One of the most promising sectors of the Armenian economy – the **tourism** sector – continued to enjoy double digit growth this year. The number of tourists visiting Armenia in the first three quarters of 2011 was already 13.1 percent more than in the same period last year, reaching 552,000 travelers, and expected to hit 800,000 by year's end. Moreover, the number of those staying in hotels nearly doubled in the January to September period, consequently yielding a noticeable growth in sales in the hotel sector. The number of available hotel

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rooms has also jumped, recording near 20 percent growth over the same period.

Europeans represented the fastest growing inbound markets for Armenia's tourism industry. In the period January to September the number of visitors from European countries soared 2.4 times, reaching 39.3 percent of the total number of tourists staying in hotels.

The main source countries of arrivals to Armenia are Russia (17 percent), the US (15 percent), Iran (11 percent) and France (10 percent) with the share of the Diaspora in the total number of arrivals estimated at over 60 percent.

However, the increase in numbers of tourists has not meant a commensurate improvement in tourism infrastructure throughout the country. Only Yerevan, and more and more Tsaghkadzor, too, have emerged as a reliable hub for inbound tourism, while the regions lack strategic tourism development and therefore do not have access to the necessary resources. Sevan and Dilijan still lack a service-oriented tourism plan. Jermuk has one but it is far from having the necessary infrastructure. Only in Armenia's south, in Syunik, near the newly constructed Tatev skyline, is there a systematic effort to develop an integrated approach to tourism.

In 2011, in the Tourism Competitiveness Index, commissioned by the World Economic Forum, Armenia was ranked 90 among 139 countries, one position higher than the previous assessment. At the same time, the neighbors fared better. Georgia was ranked 73, Azerbaijan 83 and Turkey 50. Only Iran was given an overall ranking of 114. While Armenia scored relatively high in the areas of qualified labor availability and the quality of health

and hygiene, Armenia's tourism industry was ranked far less competitive when it came to environmental sustainability, natural resources, information and communication technologies, air and ground transport infrastructure.

The direct contribution of the tourism sector to GDP is expected to reach 66.4 billion dram (1.8 percent of total GDP) in 2011. Yet, despite the industry being called a government priority, official budget allocation for tourism promotion in 2011 constituted 50 million dram, or 0.005 percent of total budget expenses. Whether this budget is measured in absolute numbers, in relation to country size or in relation to population, Armenia ranks near the bottom among all the countries in the world.

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*An average farmer household in Armenia produces around \$4,000 a year, which is barely enough for subsistence*

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**External trade** saw a 16.6 percent increase in the first three quarters of 2011 compared to the previous year. Imports were three times the amount of exports. The trade deficit value over the same period reached around \$2 billion. Despite a slight decrease in its share of trade in the January to September period, Russia remained Armenia's top trading partner, accounting for roughly one fifth of all foreign trade. Over the same period, trade turnover with the European Union surged further, this time by 22.8 percent to reach, by the end of the third quarter, 33.6 percent of total external trade. There was a general improvement in trade turnover within the region in 2011,

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with trade with Iran reaching 6.1 percent and 4.3 percent with Turkey. Oddly, trade with Georgia next door, constitutes only 2.2 percent of overall trade, while trade with China is 7.3 percent -- more than that with any of Armenia's immediate neighbors. Trade with US was 4.6 percent of the total. The remaining trading partners are the countries of the CIS, as well as, among others, Israel, Brazil and Switzerland.

This year, as in 2010, exports grew three times faster than imports. Fueled by price increases on metals and mining products which constitute Armenia's major exports, the export growth rate reached 33.5 percent in the first nine months of 2011. Despite the huge change in export volumes, the structure of external trade saw almost no change. Exports still are highly concentrated in polished diamonds, base metals, mining and mineral products. Indeed, this group of resource-intensive products represented over 75 percent of exports in the first three quarters of 2011.

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*The number of tourists visiting Armenia in the first three quarters of 2011 was already 13.1 percent more than in the same period last year*

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Conversely, the main imports to Armenia are energy products, machinery and transport equipment. In total, they comprise over 42 percent of the total imports. Trade is now vulnerable to weak global demand and Armenia is particularly affected as it relies heavily on exports to Russia, where economic demand is itself a hostage of oil prices. Demand

from Armenia's other major trading partner, the European Union, is also subject to changes brought on by the crisis.

Overall, despite the impressive growth of Armenia's foreign trade, the rising trade deficit will eventually pose a serious burden and threaten the Armenian economy. Moreover, the dependence on non-diversified low value-added resource-intensive exports renders the country highly vulnerable to external price shocks.

Private transfers to Armenia increased by 15 percent. Three-fourths of remittances flow from Russia and the increase can be explained by increases in oil prices which are the major drivers of economic development there. According to Armenia's Central Bank, there is a direct correlation between oil prices and the amount of remittances to Armenia. As in the pre-crisis period, the biggest share of private transfers was channeled into consumer spending rather than into value-added sectors. Private transfers to Armenia had only indirect impact on the development of local industries, by raising demand.

Increased exports coupled with private transfers led to volatility in the dram exchange rate. The Central Bank stated a commitment to a floating exchange rate and still intervened in the currency market to prevent sharp fluctuations. Between January and September 2011, the dram depreciated by two percent. The average exchange rate in September was 372.3 dram to 1 USD.

In 2011, the Central Bank's monetary policy targeted inflation, which in the beginning of the year comprised 10.3 percent. Throughout the first trimester, the Central Bank implemented a

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policy of expensive money and increased the policy rate by 1.25 points up to 8.5 percent. However, inflation still remained high at nine percent in May. The inflation rate declined significantly only in July and August, mainly due to reduced prices on agricultural products. The attempts to restrain the supply-driven inflation using monetary tools proved to be ineffective.

Moreover, the strict monetary policy of the Central Bank along with the devaluation of the national currency increased risks to the banking system. Throughout the first nine months of this year, the share of foreign currencies in the total loan portfolio of the banking system increased by 2.5 percent, reaching 60 percent. So, while the monetary policy of the Central Bank created incentives for entrepreneurs to obtain loans in foreign currency, the devaluation of the dram placed the burden of risks squarely on the shoulders of businesses. The high policy rate had little impact on deposits. The share of foreign currencies in total deposits decreased by one percent, but still comprising a rather high 68 percent.

In 2011, tax revenues (including obligatory social payments) are expected to grow by 20 percent and the budget deficit is not to surpass 3.9 percent. In comparison, in 2010, the budget deficit of Armenia comprised five percent of GDP, whereas the corresponding indicator in 2009 reached 7.6 percent. Half the budget deficit in 2011 – some 150 billion dram – are to be financed from internal sources, while the rest will be covered by external sources, which in its turn will magnify the foreign debt. In 2011, the foreign debt is expected to reach USD \$3.73 billion, comprising 35.5 percent of the GDP. In contrast, the corresponding indicators in 2010 amounted to USD \$3.3 billion or 35.2 percent of GDP. As privileged terms expire on the

current loans, servicing the debt will eat up even more of the national budget. As of December 31, 2010, the average payback period for state debts comprised 11.4 years, whereas the corresponding indicator for the internal debt was 3.9 years and 12.6 for the external debt.

The government's limitation to borrow on concessionary terms from international financial institutions obliges it to borrow from local and foreign sources at commercial terms. Thus, the risks associated with high interest rates increase especially since in the government's debt structure, the weight of foreign loans at adjustable rates is already very high. In 2009, adjustable rate loans were 24.8 percent; in 2011, they formed 26.2 percent. By 2014, the weighted average can hit 32.6 percent. According to the Ministry of Finance, if international interest rates were to register even a one percent rise in adjustable rates, the interest payments alone on external debt would increase by USD \$10 million. And, if in relation to the US dollar, there is just a one percent deviation in the exchange rate of the IMF's SDR, the Euro, or the Japanese yen, that will affect the government's external debt by USD \$23 million.

## INSTITUTIONAL MATTERS

Armenia's social and political development continues to pay the price of unimplemented second-generation economic reforms. Fiscal and other structural reorganization requires a political will to adopt the required legislation and to implement the letter and the spirit of that legislation. Heading the list of necessary fiscal reforms is always tax compliance, tax collection and tax administration. The remaining structural reforms address a fair business and competitiveness environment.

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In Armenia, those with the competence to tackle such essential transformation are the very same persons most apt to be affected by the necessary shakeup. The officials responsible to bring such reforms are indeed those who would be the objects of the reforms – from members of the National Assembly to heads of ministries and agencies. Changes would threaten, or at the very least, limit the interests of the entangled business and political elite. Such entanglement, already formalized although clearly prohibited by law, constitutes the eternal impediment to change.

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*Oddly, trade with Georgia next door, constitutes only 2.2 percent of overall trade, while trade with China is 7.3 percent*

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In the run-up to elections in 2012 and 2013, it would seem essential for those in office to address this structural barrier to growth, release the controls on the economy, allow small and medium size enterprises to flourish and thus improve the economic and electoral climate. On the other hand, releasing controls means reducing the power of monopolies and thus access to revenues for the politically connected business elite whose financial and political weight is consequential to the funding and winning of elections. It is the combined institutional power of these groups – enjoying tax and customs advantages on the one hand, and being allowed to control certain economic sectors on the other – that is at the core of the economy's structural weakness.

The most important standard by which to judge the success of **tax reform** and an equitable tax

administration is if the tax revenue ratio to GDP reaches the expected levels – 23 to 25 percent. This year, the ratio is expected to increase a mere 0.4 percent rise, thus approaching 17.27 percent.

Throughout the first nine months, the sum of tax payments collected from the 1000 largest taxpayers amounted to 485 billion dram, 75 percent of which (352.8 billion dram) came from two huge corporations, ArmRosGazProm and the Zangezur Copper and Molybdenum Combine. This is a larger figure than their tax payments last year by 11 percent or 34.3 billion dram and can be explained by soaring prices of gas and metals in 2011. A full 40 percent of the increase in tax revenues comes from the Zangezur Combinat which paid an additional 13.7 billion dram in 2011.

Another achievement of the year was the enforcement of the law on Tax Benefits for Corporations and Private Entrepreneurs on Tax and Other Obligatory Payments. According to the law, taxpayers can determine their own schedule for paying taxes. Entrepreneurs would be freed from tax penalties and fees if they sign and make full payment before the due date. The government resorted to such 'tax amnesty' in order to tackle the large amount of the unpaid taxes, which in January 2010 amounted to over 200 billion dram. Half this amount was actual unpaid taxes, the remainder was fees and penalties.

Despite the institutional reforms in the tax sector, rules for customs duty calculation remain arbitrary. Export procedures, certificates of origin for imports, construction permits, business registration, and other procedural improvements have been simplified.

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Some steps were also noted on the way to improvement of the **business environment**. According to government estimates, the number of steps needed to receive a construction permit will decrease from 20 to seven. Consequently, this will decrease the total number of days for starting a business from 137 to 27.

Considerable changes were also made to the law on Protection of Economic **Competition** in 2011. These included increasing penalties and enforcing the rights of the state commission for the protection of economic competition. However, the commission is still handicapped. While price increases on a variety of consumer goods were found to be unjustified, the commission did not publish the results of its investigation against those abusing their market share. Most cases of unfair competition are resolved at a level higher than the commission.

The voluntary accumulative **pension** system, was not introduced in 2011, as planned. Despite the fact that the government and the Central Bank approved most necessary legal acts, they did not seem to be in a hurry to produce all the documentation for the chosen operators to enter the market. The launch delay creates risks for the entire pension reform timeline, which according to plan was to have all the problems and risks addressed before January 2014, when the mandatory pension system was anticipated.

This year, compulsory motor vehicle **insurance** went into effect. Despite initial widespread skepticism, the system appears to be working effectively with 85 percent of the 430,000 registered vehicles covered by insurance. It will take a few years to assess the

success of the system's intent to introduce rules, predictability and civility in the institutional realm, thus influencing similar movement in the health insurance sector. However, the other intent – to strengthen the financial sector – has met with limited or no success.

Thus, the **financial market** remains underdeveloped. Contrary to hopes that obligatory car insurance purchases (and voluntary pension deposits) would contribute to market development for dram instruments, it did not do so, at least in this first year. Insurance companies deposited the revenues, while the banks went after safer and high-yield investments, purchasing government bonds (with a coupon rate fluctuating from 11 to 13.6 percent) rather than providing higher risk loans. Furthermore, the Armenian corporations because of high government bond yields would not issue corporate bonds, which could have been safe alternatives as bank investments, while at the same time contributing to economic growth.

## OUTLOOK

Outlook for the global economy is at best anemic growth, and at worst, another decline and a recession. The IMF and the OECD, among other international organizations, revisited their predictions at year's end, and made downward adjustments.

Armenia's own economic projection for next year is 4.2 percent growth, but the international organizations expect lower, taking into consideration global developments. Thus, it will be very difficult for Armenia's government to turn its projection into reality.

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If the international projections are correct and there is a global slowdown, Armenia will be on shaky ground since its macroeconomic foundations are much weaker than they were in 2008 when the crisis struck. State debt is higher, purchasing power is lower, as is FDI.

The EU and Russia are Armenia's biggest trading partners. And if the next slowdown starts with the EU, which will inevitably affect Russia, then through trade, the impact on Armenia will be immediate.

There is unprecedented attention on the 2012 elections and especially high anticipation of the results. On the one hand, this will lead to greater government economic activity; on the other hand, investors will approach the economy with uncertainty and caution.

Given election considerations, the government will not undertake serious structural reforms, although those decisive actions against political-economic entanglement are already crucially late.

## POLICY OPTIONS

Institutional and structural reforms ought to be priority policy objectives. The absence of notable successes this year is evidence that economic problems cannot be overcome without essential change. Indeed, the IMF year-end statement included a rare public disagreement with the government, insisting that Armenia can no longer afford to tolerate those problems.

Economic growth must be the government's primary and overriding goal; only then should the government focus on containing inflation. It is not inflation containment that should become policy.

Armenia's revenue generation remains the poorest in the region and must see an improvement. The government's targeted annual 0.4 percent increase in the tax to GDP ratio is insufficient and tantamount to an admission that reducing shadow activities is not the priority.

Following the dram's controlled depreciation in 2011, in 2012 it must be allowed to find its normal equilibrium, which according to international financial organizations means another 10 to 15 percent loss in value. A true exchange rate equilibrium will benefit exports and increase the purchasing power of remittances, as well as encouraging FDI.

Lack of diversification continues to make Armenia's economy most vulnerable. Despite government promises, there was no serious diversification of economy; yet that must be a key 2012 target. Areas such as tourism which have great growth potential require more support, greater promotion and will benefit the expansion of small and medium enterprises.

The government should take advantage of the EU Association Agreement's opportunity to establish the norms and standards necessary to support economic competitiveness and efficiency in areas that are Armenia's comparative advantage areas, such as agriculture and information technologies.





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The government must reconfirm its commitment to revise the Sustainable Development Program, the need for which became apparent following the onset of the crisis. A new report is essential and must reflect current realities and the government's vision. This must be done quickly to serve as the main guiding document for sustainable economic development.

## THE REGION IN FIGURES 2011

### ARMENIA

*GDP Growth:*  
4.6 percent

*Inflation:*  
8.8 percent

*GDP:*  
\$10.2 bn

*GDP per capita:*  
\$3048  
(PPP \$5395)

*Population:*  
3.3 m

Regarding Karabakh, the authorities will not be able to take further steps beyond those taken in Kazan. As a consequence, no progress can be expected.

Armenia will struggle economically to rebuild its 2009 economic losses. Success depends on political will and the introduction of serious political and economic reforms. But, given the upcoming parliamentary and presidential elections, political interests will probably have priority and this decision will be the fundamental indicator of economic development.

Parliamentary elections will be especially competitive, regardless of what cooperative formats or coalitions are formed. If the second major coalition party, Prosperous Armenia, participates independently and successfully in the parliamentary elections, a new political environment can be expected in parliament, without a monopoly by the ruling party and with new checks and balances in the political system.

### AZERBAIJAN

*GDP Growth:*  
0.2 percent

*Inflation:*  
9.3 percent

*GDP:*  
\$68.5 bn

*GDP per capita:*  
\$7510  
(PPP \$10217)

*Population:*  
9.1 m

No elections are expected; the same imposed quiet and stability will continue, despite the inevitable impact of calls for reform in Russia and the Middle East. Azerbaijan will attempt to use its UN Security Council seat to disseminate the Azerbaijani position on the Karabakh issue, and will be increasingly aggressive in international organizations, stressing the principle of territorial integrity, exclusively.

Despite international pressure, Azerbaijan will continue with both military rhetoric and sniper activity on the Line of Contact. Economically, Azerbaijan continues to rely on oil resources and will have low or medium economic growth depending on oil prices. On the one hand, the beginning of the realization of the Nabucco pipeline, on the other hand, the Azerbaijan-Russia gas deals will embolden Azerbaijan.

### GEORGIA

*GDP Growth:*  
5.5 percent

*Inflation:*  
9.6 percent

*GDP:*  
\$13.8 bn

*GDP per capita:*  
\$3098  
(PPP \$5430)

*Population:*  
4.5 m

A tense domestic political situation is to be expected in 2012. If the new political figure, Boris Ivanishvili succeeds in rallying opposition around him, they can pose a serious challenge to President Saakashvili's rule at the 2012 parliamentary elections. Georgia-Russia relations will remain tense. Georgia will continue to focus on NATO and EU integration, aiming to have new achievements to show in time for the October elections.

Despite the continuation of amicable talk between Armenia and Georgia, beneath the surface differences will remain and deepen, in security alliances, and regarding the socioeconomic situation in Javakheti. Although both sides speak of deeper integration between the two countries, each, for different reasons will not pursue the tangible expressions of such integration.

## THE REGION IN FIGURES 2011

## RUSSIA

**GDP Growth:** 4.3 percent

**Inflation:** 8.9 percent

**GDP:** \$1884 bn

**GDP per capita:** \$13236 (PPP \$16687)

**Population:** 142.4 m

The ruling United Russia Party's inability to win a majority in Russia's year-end parliamentary elections was a wake-up call. Although this does not represent a direct threat to Putin's election in March 2012, the tendency to challenge the reproduction of the ruling elite will continue and there will be real pressure on Putin to become a reformed Putin. The dilemma is to adopt some democratic reforms without losing political power. The degree of maneuvering space available to the rulers and to the emerging vocal middle class will, in large part, depend on the international economic situation, and chiefly, the price of oil.

In 2012, given these heightened and public expectations for democratization, given the quickly-evolving political complications in Syria and Iran, and given heightened rhetoric in the run-up to American elections, a certain amount of tension between the US and Russia is inevitable, and this will naturally affect this region.

## TURKEY

**GDP Growth:** 6.6 percent

**Inflation:** 6.0 percent

**GDP:** \$763.1 bn

**GDP per capita:** \$10576 (PPP \$14616)

**Population:** 72.2 m

With expectations of a euro zone slowdown in 2012, Turkey's high economic growth, too, will be affected. Politically, the two most important political challenges for Turkey in 2012 will be resolving the re-surfaced Kurdish tensions and pulling off constitutional change. Entering their third successive term in office, the AK Party has the upper hand in its long running battle with the army and the opposition, but, its reduced majority means that further progress on reforming the 1982 constitution will have to be negotiated. Or, given the prime minister's popularity, he can appeal to a popular vote on the constitutional changes and be assured a victory.

The frustrations of the Kurdish minority are also resurfacing, sometimes violently. Both military and legal procedures are being used to crush the Kurds and their ideological and logistical supporters. Turkey will continue its active engagement in the region. EU relations will continue to stall, perhaps stagnating further when Cyprus takes the EU presidency in the second half of 2012.

No movement should be expected in relations with Armenia, either, since no progress is expected on the Karabakh conflict settlement, given the deep deadlock on negotiations on the one hand, and Armenia's upcoming parliamentary and presidential elections, too.

## IRAN

**GDP Growth:** 2.5 percent

**Inflation:** 22.5 percent

**GDP:** \$475.1 bn

**GDP per capita:** \$ 6260 (PPP \$12258)

**Population:** 75.9 m

Iran's socioeconomic problems and resulting tensions will persist as will deep divisions between the presidential team and the religious leadership. During the 2012 parliamentary election process different factions will begin to reclaim power and potential successors to President Ahmadinejad will begin to emerge. Pressure by the international community regarding nuclear issues will grow. Even in the absence of a UN Security Council decision, the EU, the US and other individual countries may impose their own sanctions on Iran, which will inevitably impact Armenia, Georgia and Azerbaijan.

Regardless, Armenia-Iran political relations will remain friendly, but it cannot be expected that any of the Armenia-Iran projects with regional significance will be set in motion. Changes in Syria will affect Iran's regional influence.

\*All indicators represent estimates for 2011. Source: International Monetary Fund

