

# Economic Reform and War

INTERVIEW WITH HRAND BAGRATYAN

**F**ormer Armenian Prime Minister Hrand Bagratyan discusses his tenure in office and his leadership in the transformation of Armenia's economy from the Soviet centrally planned command structure to a free market system, the difficulties encountered, and the models that were considered. He focuses on the mechanisms adopted compared to other Commonwealth of Independent States countries. He also discusses what he would have done differently in hindsight.

***Demokratizatsiya:*** You became prime minister of independent Armenia in 1993 when the world had still not recovered from the collapse of the USSR, when the Republic of Armenia was still a child, and you yourself were a very young man. Why were you selected? What had prepared you for such a huge responsibility? Did you know what you were doing?

**Bagratyan:** One of the peculiarities of post-Soviet Armenia was the presence of an explicit political leadership, the Armenian National Movement. I was one of that organization's active members, heading its economic team beginning in 1989. In 1990, when the movement won the National Assembly elections, I was appointed minister of economics and deputy prime minister.

My main responsibility was formulating economic reforms and ensuring their implementation. Within a month of the new government's formation, the parliament adopted basic laws on property and agrarian reform, and then after some months the process of land privatization was launched. I headed those projects. It was natural that during that period political thought had become polarized between the reforms' opponents and supporters. Yet in the autumn of 1991, following the resignation of the then prime minister, I was appointed acting prime minister. In February 1993, when Levon Ter-Petrossian, the president of Armenia, raised the question of reshuffling the government, my name appeared as a candidate for the

---

Hrand Bagratyan was prime minister of Armenia from 1993 to 1996 and held various positions in the preceding governments. In 2005, he was awarded doctorates in economics in Armenia and Russia. He is the author of six monographs and numerous articles on economic theory and transformation. Bagratyan's contributions have been recognized by numerous international organizations. The interview was conducted by Gerard Libaridian through a series of e-mails, in October 2005. Copyright © 2006 Heldref Publications

premiership. At the end in February 1993, I was appointed prime minister and had a second opportunity to head the government of the Republic of Armenia.

It should be noted that for the leading political forces and the president, this was not just an issue of appointing a prime minister. This was a question of the country's direction. To place this question in its proper setting, let us recall the political and economic situation of the post-Soviet space in 1993. The majority of the people were disappointed with the advocates of market economy due to the huge decline of the economy, the fall in the standard of living, and the idleness of big factories. Nostalgic Communist and nationalist political forces "had raised their heads" everywhere. Old Communist leaders had returned to power in neighboring Georgia and Azerbaijan. In Russia, Yeltsin barely succeeded in staying in power through the use of extreme methods, such as the assault on the White House in Moscow, the dismissal of reformists (Yegor) Gaidar and (Anatoly) Chubais from the government, and reliance on forces carried away with Soviet populism. Political nostalgia became dominant in Ukraine. Belarus had already been turned into a totalitarian regime. The same was true of Central Asia. The exceptions were Armenia, Moldova, and, to some extent, Kyrgyzstan. Under these conditions, the appointment in Armenia to prime minister of a liberal economic reforms advocate was, of course, not only a domestic, but also a regional challenge.

The issue was not only the appointment. My government immediately undertook significantly extending liberal economic policies and launching general changes. Following seventy years of the Soviet Communist totalitarian regime, the transition to the market economy was the same as crossing a stormy river without the benefit of a bridge. It was difficult to feel envy toward those people taking further steps, knowing that each successive step could be the last, leading to drowning. More unenviable was the status of those deciding to turn back after having already passed the halfway mark. Crossing the river was, nonetheless, compulsory. I realized this fully.

It should also be added that, at that time, Armenia was blockaded because of the Azerbaijan-Nagorno Karabakh conflict. There were war conditions as well as shortages of bread, electricity, etc. According to traditional theories of management, the only way to stay afloat amidst a deficit of resources is through centralization and fully controlled distribution of the existing resources. From this perspective, the experience of Armenia is unique. It was exactly under such conditions that the government decentralized economic resources and rapidly transferred economic activities from state bodies to private producers. In my view, we had to create a situation where not only some state bodies or large entrepreneurs take part in solving economic issues in a progressive spirit, but a significant majority of the producers as well. This strategy allowed Armenia to effectively confront the challenges of that time. It succeeded in overcoming the above-mentioned crises in the spheres vital to the republic, and took the path of development through these radical steps.

***Demokratizatsiya:*** Even before it had achieved independence, Armenia had enacted a radical agrarian reform program. Was it an economic measure, or did

it also have political significance? What was its impact on the economy and politics of the country?

**Bagratyan:** We started to work on radical agrarian reforms as early as February 1990, when the Gorbachev government adopted a law on land ownership. The immediate danger of incomplete land reforms became apparent. This law by Gorbachev turned society backward, especially within the economic sphere. You can see that, following its adoption, they launched a process of leasing lands from collective and state farms—*kolkhozi and sovkhozi*—and developing a farming economy. However, the law prohibited the development of a system of private land ownership. As a result, on the one hand they started to take the land back from the leasers and to redistribute property, but on the other, because of the absence of both a system of ownership and public and mass sale of lands, the right of leasing the land was fiction. The chiefs of the collective farms and the agrarian sector of the party apparatus realized land leasing for themselves only, being both the leaser and the tenant. This example vividly shows how Gorbachev's reforms were doomed to failure from the beginning. It was clear that Armenia did not need such reforms. In this country of insufficient land, there was a need for real land reform, such as the liquidation of collective and state farms, then from the balance of those farms the mass sale of land to the peasants, and the privatization of available infrastructure (tractor-machines, agroservice, financial services, agricultural foods, etc.).

In Armenia, the process of mass sale of land was launched in February 1991. In ten months, 713 collective and state farms were liquidated, as 51.9 percent of ploughlands, 65.5 percent of perennial plants, 31.1 percent of hay production, and 69.7 percent of cattlehead were sold. Within a year, farmers comprised 67.5 percent of the agricultural food production sphere. This process continued in 1992, when farmers' production of agricultural goods reached 92 percent of all production. In practically two years, agricultural goods production had been transferred from the state to private producers. This is a unique economic-political event, not only in the Commonwealth of Independent States (CIS), but also in the whole of post-Soviet space.

Land privatization made approximately one-half million peasants self-employed, prevented an essential decline of agricultural goods production (for comparison, it should be noted that the volume of industrial goods decreased 2.5 times during the period 1989–1993), and rescued the country from imminent starvation, taking into account martial law and the blockades. It should not be forgotten that Armenia is not rich with natural resources. And under the conditions of the collapse of the Soviet Union, the attempts to create a market-oriented economic system and the absence of a national currency, it became essentially difficult to import fuel, lubricating oil, agricultural machinery, fertilizers, and pesticides. At the same time it was difficult to export traditional agricultural foods (fruits, canned food, vegetables, etc.). In both Russia and the other CIS countries, the struggle to realize food supplies became inexpressibly sharp with the opening of economic borders, while traditional relations based on the centralized state were wholly broken off or became extremely complicated. Nevertheless, for

example, under these conditions in 1993, the agricultural products index was 108.1 percent of the 1990 index. This was the case when, at the same time, the use of fertilizers had decreased to one-twelfth, diesel oil by 90 percent, and petrol and lubricating oil by significant margins. Can you imagine what Armenia would have faced had we not privatized the land? Collective and state farms would not have been able to cultivate land with the mentioned resources. In that case, famine would have been unavoidable. Indeed, for example, the 1995 index of agricultural production in Armenia was 117 percent of the 1990 index. In other CIS countries, there was a sharp decline: Russia, 17 percent; Belarus, 73 percent; Azerbaijan, 57 percent; and Georgia, 32 percent.

The political side of land reform was overcoming agrarian populism. In the 1990s, its spread in other CIS countries hindered their further development. There were no such grounds in Armenia as the peasants were engaged in land cultivation. Finally, I should point out the great patriotism of the people of the republic. For example, carrying out the land reforms in Nagorno-Karabakh after having already done them in Armenia significantly helped the peasants win the war against Azerbaijan. You may think what you wish, but the peasant who owns land is more stable. I remember Pyrrhus, who explained his failures against the Romans by the fact that Roman soldiers were private land owners.

*Demokratizatsiya:* What were the main areas of economic transformation? How did you decide what to do first, given the interdependence of spheres of economic life?

**Bagratyan:** In 1991, we formulated a program of economic reforms raising the idea of an engine. From our point of view, the transition to the market economy should have been achieved quickly so that new economic relations would quickly develop. At the same time, we felt there was an objective alternation of reforms—land, services, and processing of agricultural foods, trade, industry, construction, infrastructures and so on. In our opinion, it was not expedient to privatize, for example, metallurgical industrial complexes before privatizing the land. The economic reforms were divided into three stages: structural reforms (including privatization and decentralization), institutional reforms (alteration of corporate and state governance system), and private investments (development).

*Demokratizatsiya:* Did you have a model of economic transformation in mind? Did you follow a form of shock therapy? What did the experience of Eastern European countries, Russia, and other former Soviet republics teach you, if anything? What were Armenia's economic peculiarities?

**Bagratyan:** Above I have already described the Armenian model's main traits of economic reform and the specifics of Armenia's economic situation. I would like to mention that with our model, we tried to take into account the negative aspects of shock therapy, namely the lessons laid out by Poland's Leszek Balcerowicz. We found that liberalizing prices was highly unmanageable without privatization. In this case, when the producer or service provider is still the state company, inflation often turns into hyperinflation, since the liberalization of

prices becomes an end in and of itself for a state entrepreneur. First of all, he cares about himself and not the company's benefit. In other words, when the state company conducts its operations under the conditions of free prices, there is an evident clash of interests between the company (managers or employees) and a private person, and the apparent danger of a speculative economy. It is different if there is a private company. In this case such contradictions are not present. An increase in price does not always suppose an increase of a private entrepreneur's volumetric income. In other words, prices become flexible earlier than in the case of private ownership. I would like to offer an example. Beginning January 1, 1992, having liberalized prices, Russia—this marks the beginning of Russia's great reforms—was supposed

to experience a three- to five-fold increase of its Consumer Price Index (CPI). However, the result was an increase of 21.6 times. This was the main reason for the decline of the Russian reformists' reputation as they tackled this most important historic problem. During the same period, the Armenian index increased 8.3

times in all. Analysis shows that the main "culprit" for this was the land reform carried out in Armenia. Of course, now from a distance of several years it is easy to say that there should have first been privatization and then the liberalization of prices. Afterward it also became impossible to apply the principle of the above-mentioned engine in Armenia. Practical application is always more difficult. Nevertheless, this approach includes some enlightening elements.

---

***"You may think what you wish, but the peasant who owns land is more stable. I remember Pyrrhus, who explained his failures against the Romans by the fact that Roman soldiers were private land owners."***

***Demokratizatsiya:*** Given how things developed during your three-year tenure as prime minister and what you know now, what would you have done differently?

***Bagratyan:*** It is a difficult question! Perhaps I would not change many things. One thing I do surely know. I would do the same things as I did, but with a more accelerated pace. Particularly, the delay of the privatization process by the nationalist and populist part of the Parliament, in the name of fighting corruption, was unforgivable.

***Demokratizatsiya:*** There were serious criticisms regarding the character and pace of the privatization program, including charges of corruption and a lack of transparency. Any comments?

***Bagratyan:*** The privatization process has nowhere been carried out without mistakes. For around seventy years, workers, peasants, and employees were artificially proclaimed owners of the land and factories. The real owner was, of course, the party nomenklatura. It had an economic right to control state property; and as those people were not the legal owners, economic responsibility—

obligation—was absent. This contradiction between economic right and responsibility during the last years of the Soviet Union's existence created a situation where state property remained without an owner. Under these circumstances, you speak about privatization. At first everybody welcomes it, hoping to become the owner. However, as a result of the process, only some become serious owners. Others receive smaller pieces, and finally some do not participate in the process at all. Thus, immediately after the process, there were more people discontented by the privatization carried out than advocates for it. Of course, there are some methods of abating this problem: expanding the number of participants in privatization (in this case there is a danger of diffusion of the inventory to be privatized), making the process long-term with several stages of publicity (in this case the danger is clever proprietors' maneuvers), and compelling political forces to take part in the process (in this case the process of decision making is delayed).

During the first half of the 1990s, we took every possible step to decrease the number of people dissatisfied with the process, such as expansion of the privatization base (the inefficient but inevitable dispensation of vouchers to the population) and the organization of open public auctions. Separately, the phenomena of partial nonreimbursable privatization should be noted: 20 percent of the state's inventory was given to the company employees in the form of vouchers, who then had the opportunity during the years to enlarge their stake based on company profits. In order to make the process more transparent, two centers of auction were established in two cities, allowing an increase in the number of potential buyers.

It is interesting that the forces that criticized us essentially changed their approaches upon coming to power in 1998, such as the decreased role of auctions and the strengthening of conventional privatization. Thank God this time there was less discontent. The economic possibilities resulting from the activities of companies privatized in the first half of the 1990s had their impact.

With respect to corruption, more than ten years have passed since the beginning of privatization. After we left the government, there was serious talk about our "mistakes." Now we can already see that despite many trials, not one privatized company has been seized or criminally prosecuted.

*Demokratizatsiya:* Would a stringent regulatory system have helped? Would it have been possible?

**Bagratyan:** No, never. In the course of privatization, all countries' experiences bring forth interesting examples. If we follow their evolution, it becomes clear that the best management is transparent sales without limitations or social populism. For example, let us follow Armenia's experience. As I have already explained, in 1997–1998 there was an attempt to review privatization policy in Armenia. First, it was announced that it was necessary to revise the evaluation coefficients of the inventory to be privatized, and to significantly raise the sale price. As a result, the evaluation coefficients were increased. Privatization halted. After just a few months there was a need to return to the previous evaluation coefficients and then decrease them. Cheap inventory was already available for many subjects. Thus, an issue was raised: whom to give the inventory. If such an

issue is not solved through an auction system, then the other system takes effect; the inventory goes to the person who is close to the power bodies and is ready to serve them politically.

All these fomented public discontent. Soon the system had been changed. It was declared that the price of the company for sale was not important. It could even be symbolic. It was the investments to be done after that were important. Everybody referred to the experiences of East German companies following the union of the two Germanys. This, too, is an extreme. Armenia is not Germany. To count on investment projects taking twenty to thirty years in the post-Soviet regions is idle talk. Who is going to follow through on them and what would be the economic mechanisms for such a follow through? Thus, the experience following our time in office revealed that privatization, accompanied with only the promise of investment, leads to the dispensation of state property to the power-brokers in countries like Armenia, where the country was not yet integrated in the world economy.

The other defect of privatization based on promised investments is that its large-scale usage compels the state to assume the risk entailed by projected investments for the next few decades upon itself. In some ways we would return to a centrally planned economy.

At any rate, in the case of established companies, where the innovation factor is not critical, this approach may be applied effectively. However, the Armenian and Eastern European experiences of privatization show that the public sale of companies is the best among negative options.

**Demokratizatsiya:** The blockades of Armenia by Azerbaijan and especially by Turkey were seen as major impediments by the administration you served; there were voices then and now that these were not major impediments to economic development and open borders with Turkey in the future will not have a major impact on Armenia's economy. What significance did you then and do now assign to the Nagorno-Karabakh conflict in the difficulties the economy and its transformation faced?

**Bagratyan:** I would state at the outset that, all other things being equal, the absence of trade and economic relations with Turkey and Azerbaijan greatly hinders Armenia's political and economic progress. There can be no other opinion on this matter. Nevertheless, why was there before and why is there now a point of view that this trade does not have essential significance for Armenia? I think this is due to several circumstances, including political, economic, and psychological factors. I would like to distinguish between the two. One is the issue of Nagorno-Karabakh. The Armenian side worries that accepting the fact that economic development is hurt because of the blockade will make us more uncertain with respect to the political resolution of the Karabakh question. The other issue is economic reforms. Significant economic reforms carried out during the 1990s in Armenia advanced this country in comparison to the other countries of the region. Presently more than 90 percent of Armenia's GDP is produced by private companies whose economic effectiveness is notably higher than state or quasi-

state structures. In this regard, other countries of the region ceded to Armenia for a decade. Based on this, Armenia's economic growth during the past eleven years causes confusion. It seems this will continue forever. However, it is apparent that Azerbaijan, Georgia, and Turkey, by participating in programs of regional cooperation and taking steps toward the expansion of free economies will finally develop broader opportunities of development.

The issue of Nagorno-Karabakh is understood as a historical challenge for Armenians. Half the time I served as prime minister passed under the conditions of all-out war in Karabakh. In 1994, we succeeded in achieving a ceasefire. Fortunately, it has continued for about twelve years. I do not know how this issue will eventually be resolved, but I know that there will only be a solution when there is a real desire for mutual compromises.

*Demokratizatsiya:* How do you assess, at the present time, your tenure as prime minister?

**Bagratyan:** It was a chain of successes and failures. At the end, I think it will be assessed positively. In a period of fifteen years, one more society with a liberal economy emerged in the world. This, of course, is an event. Despite the fact that Armenians have an international reputation of being businessmen, it should be remembered that the institution of private ownership has been absent in this country for the past one thousand years due to the absence of statehood.

*Demokratizatsiya:* International institutions have much praise for Armenia in the economic sphere. How do you assess Armenia's road to economic transformation and development in the last decade? How successful have these been? Have there been radical departures from your policies?

**Bagratyan:** Both experts and international bodies have praised the progress of Armenia's economic reforms during the 1990s. Such beginnings made it possible to maintain the characteristics of a free economy and the continuing progress to the present. Structural reforms are slowly progressing, and it seems that infrastructure issues, irrigation systems, aviation, and transportation, are gradually being solved. However, in recent years reforms have slowed down and there has sometimes been a retreat from reforms. Thus, there has been no progress in the spheres of social security, education, and some other spheres. The armed forces need serious restructuring and the customs system is regressing. The main problem challenging present-day Armenia is that the centralized political system prevents the development of a decentralized free economy.

*Demokratizatsiya:* What, if any, relationship do you see between economic transformation and democratization, between a free market economy and democracy?

**Bagratyan:** The market economy presupposes a host of independent producers and consumers. It simply provides quantitative evaluations to economic choice. Democratization is the qualitative side of political choice. Its longtime absence leads to a coalition of state and business, power and ownership, state reg-

ulation and entrepreneurship. Economic alternatives vanish, and democratization becomes meaningless.

In Armenia, the Chinese or Chilean economic miracles are often discussed. There are also references to the advantages of the “political dictatorship plus economic democracy” formula. There is no need to compare Armenia to those countries. People forget that both Chile thirty years ago and present-day China solved the problem of industrialization. This often leads to the centralization of the political system. As long as the problem of the economy’s industrialization is solved, political democracy is inevitable under the conditions of the liberalization of the economy. Armenia passed its stage of industrial development long before Chile or China. Thus, it is more relevant to speak about the problem of the continuation of economic democratization.