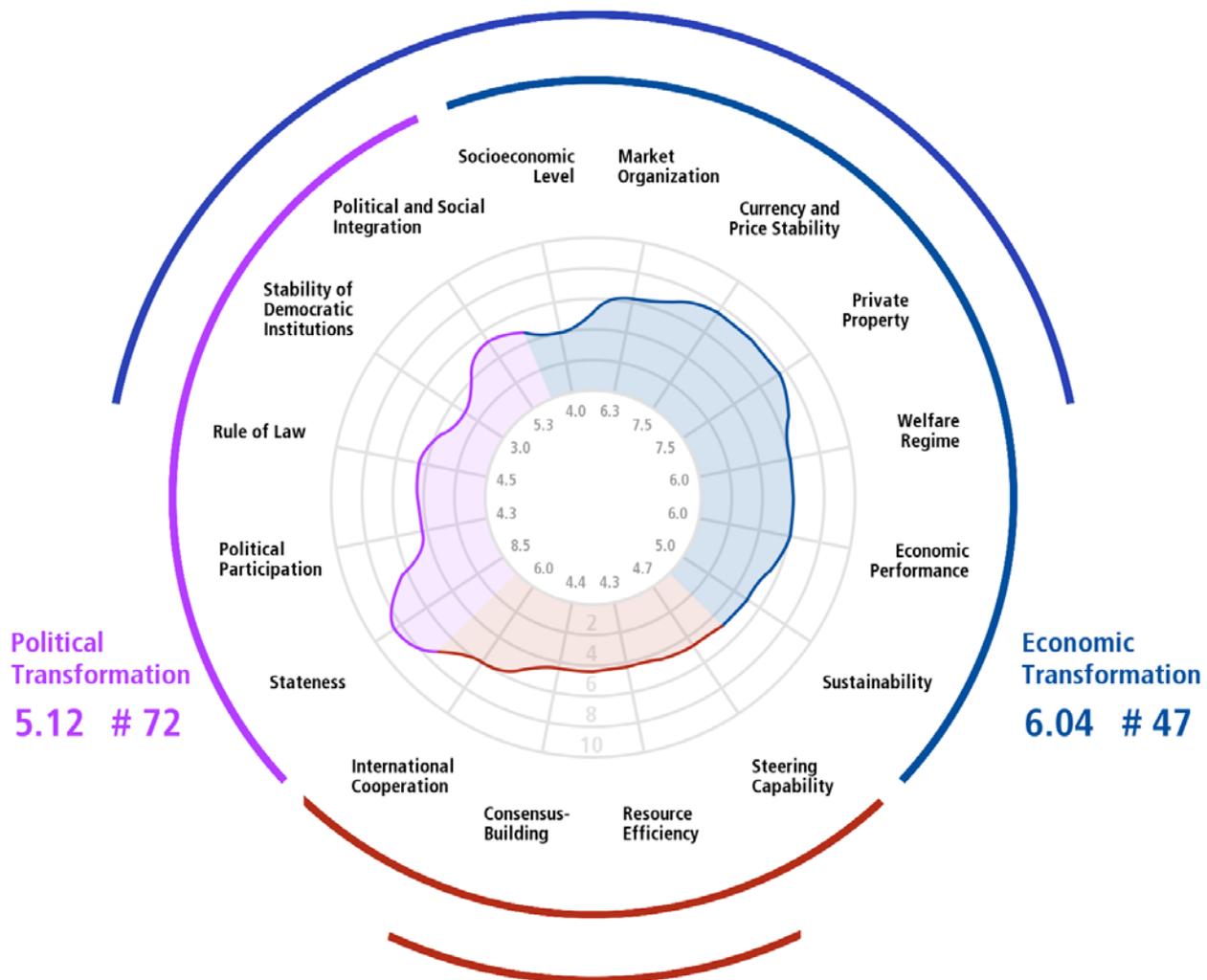


Armenia

Status Index

5.58 # 61

on 1-10 scale out of 129



Political Transformation
5.12 # 72

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on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

| | | | | | | |
|--------------------------|--------|------|--------------------------------|-------|----------------------|--------|
| Population | M | 2.9 | HDI | 0.743 | GDP p.c., PPP \$ | 8818 |
| Pop. growth ¹ | % p.a. | 0.3 | HDI rank of 188 | 84 | Gini Index | 32.4 |
| Life expectancy | years | 74.2 | UN Education Index | 0.737 | Poverty ³ | % 13.5 |
| Urban population | % | 62.6 | Gender inequality ² | 0.293 | Aid per capita \$ | 119.2 |

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

Armenia's constitutional referendum held on 6 December 2015 has stimulated a debate about the future of the country's political regime, including the issue of succession after President Serzh Sargsyan's second and last term in office. The constitutional amendments will change the country from semi-presidentialism to a parliamentary republic. According to expert opinion, these changes will paradoxically preserve the political system in Armenia and consolidate the position of the ruling Republican Party of Armenia (RPA). The party aims to control the Armenian political landscape in the long term, which will in essence pave the way for a formal multiparty system with a de facto strongman rule, similar to Russia and several neighboring countries.

The opposition perceived the referendum as an opportunity to initiate a power shift. However, in light of the opposition's limited resources and the growing influence of Russia on Armenia's political environment, significant changes in the country seem highly unlikely. Nevertheless, the dissatisfaction with the political system among the population and civic activist groups is growing. They often opt for risky undemocratic methods, such as the armed attack on a police station in Yerevan in July 2016, where the opposition group Founding Parliament demanded the resignation of the president as well as the release of the group's leader Zhirayr Sefilian, who was arrested in spring 2016 on charges of seeking to overthrow the government by force. Surprisingly, sympathy among the population seemed to be with the hostage-takers.

In response to these developments, President Sargsyan made the decision to reshuffle his government. On September 13 the National Assembly, upon the president's request, voted in Karen Karapetyan as the new prime minister. Karapetyan's previous professional activities at Gazprom have led some analysts to suggest that his appointment was approved by Moscow as a precaution against a possible change of Armenia's foreign policy course. It is not yet clear if Karapetyan's appointment will seriously undermine the political sovereignty of Armenia. However, several ministers in the new cabinet are unknown to the public and many have had connections with Russian commercial enterprises. Experts assume the new government is likely

to be temporary and the final constellation will emerge only after the 2017 parliamentary elections and the end of Sargsyan's second term in 2018, when the transition to a parliamentary republic will be completed. The current foreign policy course based on loyalty to Russia and its Eurasian project will probably remain unchanged, despite its dire economic consequences.

In the early hours of April 2, 2016, fighting between Karabakh and Azerbaijan broke out along the line of contact. Both sides accused each other of launching a military assault, although evidence points to Azerbaijan. As a result of the fighting, Azerbaijan managed to slightly shift the border in its favor. Both sides used heavy weapons; dozens of soldiers from both armies were killed, and several civilians as well. The clashes continued until April 5, and ended with both sides unexpectedly announcing a ceasefire, brokered by Moscow. At the same time, a resumption of peace talks was announced.

History and Characteristics of Transformation

Questions of state reform and state territoriality have dominated Armenia's post-Soviet history. In particular, the insufficient consolidation of state territory has had a great impact on overall state capacities, often characterized by large military budgets and low social spending. The demise of the Soviet Union triggered an enormous wave of transformations at the social, ethnic, national and state levels. Armenia was one of the first countries to witness a national movement and declared independence in 1991, before the formal declaration of the dissolution of the Soviet Union. Upon gaining independence Armenia was immediately confronted with numerous problems requiring urgent solutions, such as economic recovery, political stability and the Nagorno-Karabakh conflict. This period was marked by collapsing standards of living, a rapid surge in unemployment and unprecedented inflation, which combined to spur large-scale emigration from the country. These factors forced Armenia to implement strident economic reforms, ranging from land privatization to an expansion of the private sector, which now accounts for more than 80% of GDP.

The post-Soviet transformation also catalyzed the reinterpretation of the historical past and memory. Ethnopolitical conflicts in the South Caucasus region became definitive in the creation of new dividing lines and enemy images; xenophobic rhetoric became rampant. This was actually the greatest political challenge for Armenia in the post-Soviet period. Then the Nagorno-Karabakh conflict determined the political and economic transformation of the country and has since remained an obstacle to democratic development.

In Armenia the development of the state was very slow in terms of institutionalizing democratic state structures and tackling endemic corruption. A semi-presidential system was formally established in 2005 based on an amendment made to the 1995 constitution. It included the formal strengthening of the rule of law, civic rights and institutional oversight. This, however, has not been translated into reality. A first and important point is that executive agencies dominate the country, which provides opportunities for corruption and elite pacts that remain uncontrolled by

formal structures. Despite the strong character of the state in Armenia, institutional performance remains weak. Considering post-Soviet political developments, the country exhibits similarities to other CIS countries, such as economic decline and state structures that do not function for the public's well-being. For instance, the parliament, the legitimacy of which remains highly contested, consists mainly of representatives of the oligarchy and big business, who exercise considerable control over the political and economic life of the country and who are highly averse to any democratic developments. Political life is marked by unconstitutional interference in governing institutions by the president and other influential politicians.

The situation of the media continues to be a cause for concern. Despite some positive developments in press freedom, there has hardly been any change in the real situation. Although the regime avoids resorting to open force against the mass media that is critical of the government, it imposes a wide range of restrictions.

The justice system remains dependent on the executive branch and entrenched in a tradition of human rights violations. No significant structural improvements were made in 2016. Despite the many positive developments that have taken place in the country, its intrinsic democratic deficits and the lack of the rule of law means that sustainable political and socioeconomic development remains still a remote prospect after 20 years of transformation.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Since independence, the Armenian transition has experienced many difficulties in implementation. Internally, the consolidation of democracy at the institutional and decision-making levels has limits, in a society used to strong leadership, and where the power of the local elite is substantial. These old-style practices render the development of a civil society and the enhancement of rules regarding transparency and accountability very difficult. The constitution included the formal strengthening of the rule of law, which stands in contrast to reality. A first and important point is that the executive dominates the country, which creates room for corruption and elite pacts that remain uncontrolled by democratic institutions. Despite the strong character of the state in Armenia, institutional performance remains weak.

Nevertheless, growing poverty and socioeconomic discontent have led to growing unrest: Since 2010, protests sparked by civic initiatives have become very common in Armenia's capital Yerevan and, to a lesser extent, in the smaller cities of Gyumri and Vanadzor. Civic initiatives in Armenia address a range of issues including the environment, cultural preservation, consumer rights, labor and employment issues, as well as human rights. In 2013, demonstrators protested against price hikes in the cost of public transportation. In 2014, it was pension reform. In 2015, what started as a protest against higher electricity bills became the Electric Yerevan Movement. The dissatisfaction with the political system culminated in an armed attack in July 2016 on a police station in Yerevan. The Founding Parliament opposition group stormed district police headquarters demanding the resignation of the president as well as the release of the group's leader Zhirayr Sefilian, who was arrested in spring 2016 on charges of seeking to overthrow the government by force. Usually in a hostage crisis, the public sympathizes with the hostages, but in Armenia greater sympathy seemed to be with the hostage-takers. On July 20 and 29 the police brutality attacked peaceful protesters and journalists. The July Crisis has given many the impression that democratic politics is exhausted and that the use of force is permissible. It has made clear that the country has a deeply unpopular government; and the police and security

Question
Score

Monopoly on the
use of force

9



1

services are equally unpopular and enjoy very little trust, as a result of a record of abuse of power and excessive use of force against detainees and civilians.

In terms of state identity, there is a generally accepted consensus on the issue of citizenship, mainly stemming from the country's mono-ethnic Armenian society. There is little or no record of ethnic division or discrimination facing native, non-Armenian minorities (Kurds, Russians and some Jews). However, the ethnic minorities have limited representation in Armenian government. For example, the largest ethnic minority in Armenia, Yezidis, as of 2016, still has no representation in the National Assembly. In theory, all citizens are endowed with the same civic rights, and the Armenian state ensures equal access to education, the courts and public welfare. In practical terms, however, there are signs of a growing discrepancy in rights between certain groups. This discrepancy manifests itself, for example, in both political polarization between supporters of the opposition and government, and on a class basis, with an obvious, widening division between a small, wealthy and politically connected elite and the larger, more impoverished general population.

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

The second factor contributing to the dominant position of the Armenian Apostolic Church, to which nearly 95% of the country's religious believers belong, is rooted in its historical standing as a defender of Armenian identity and cultural norms. However, according to the Caucasus Research Resource Centers (CRRC) 2011 survey, over 60% of Armenia's population, despite emphasizing the importance of religion in their daily life, attends religious services only on special holidays or less often.

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

The protection of the fundamental freedom of religion is incomplete in Armenia, and over the past two years, there have been repeated cases of discrimination against nontraditional religious groups and sects such as the Jehovah's Witnesses and the Mormon missionaries active in the country. All formal churches and religious groups

State identity

9



1

No interference of religious dogmas

9



1

outside the Armenian Apostolic Church are required to register officially with the government, and proselytizing is forbidden by law.

Armenia has limited experience with civil service. Administration remains hindered by the legacy of Soviet-era practices, many of which are grossly inefficient and overly bureaucratic. Development of a civil service has not been encouraged, and the importance of civil service institutions largely ignored, even in the constitution. The absence of social and legal civil service institutions in public administration has had a number of negative consequences. Despite a series of recent reforms many weaknesses remain: instability in state organizations and their frequent restructuring, arbitrariness in recruitment and an inflated state apparatus, lack of inadequate professionalism and qualifications among civil servants, and corruption within administrative structures are all a serious challenge.

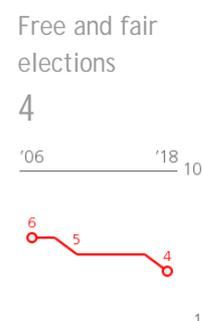
Civil servants are not sufficiently protected. The recruitment of civil servants is in principle based on merit, but the practice is less transparent. The body that coordinates recruitment, the Civil Service Council, appears strong, but in practice its strength is diminished. A government-wide plan to mainstream gender in the public sector is in place. However, this has not yet resulted in a balanced number of women and men in higher-ranking positions. Women outnumber men on the reserve lists and in a number of fields of public administration.

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

2 | Political Participation

Armenia's first election in the early 1990s was the country's last free and fair balloting. Thereafter, beginning with the 1995 parliamentary elections up to the most recent presidential vote in 2013 and parliamentary elections in 2017, elections have become, or are perceived as having become, steadily more corrupt and less fair. All elections have been marred by widespread violations. This has created immense public criticism and apathy toward the elections as well as democracy in general. For much of the last decade, the Armenian population has grown accustomed to flawed elections, and has become increasingly disengaged from politics.

The electoral campaign for the May 2012 parliamentary elections, although dominated by controversy over the proposal to eliminate a majoritarian vote in favor of a fully proportional system, which was eventually rejected by the parliament, was fairly smooth and uneventful. After some modest improvements in the parliamentary



elections, the campaign for the 2013 presidential elections was marked by a number of irregularities: hunger strikes, an assassination attempt on a candidate, and appeals to postpone the election.

Armenia's Constitutional Referendum on 6 December 2016 was also marred by an unprecedented number of violations. It was driven by political interests to maintain the ruling regime and the power of the current oligarchy. These constitutional amendments will change the country from semi-presidentialism to a parliamentary republic. According to expert opinion, the reforms will paradoxically preserve the political system in Armenia and consolidate the position of the ruling Republican Party of Armenia (RPA). The vote was dominated by numerous manipulations of the electoral roll, violations during voting and counting ballots, numerous falsifications of results by electoral commissions, as well as threats against Armenian journalists covering the referendum.

The parliamentary elections in April 2017 did not bring about substantial changes in Armenian politics. The ruling party, having won nearly 50% of the votes and a slight majority of seats, continues to exert full control over the legislature. According to the OSCE Office for Democratic Institutions and Human Rights (ODHIR), this was also made possible by a number of irregularities, such as vote buying and carousel voting, most notably in rural districts. Technical equipment, such as cameras and fingerprint machines, proved to be out of service at many polling stations. The opposition forces did not have a serious chance; they are weak, disorganized and unable to convert their key trump cards – the socioeconomic crisis and the population's displeasure with the current government – into political breakthroughs.

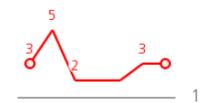
Thanks in part to fundamental flaws in the country's closed political system and the absence of free and fair elections, the Armenian authorities have typically held virtually unchallenged power and authority, despite public demands for change. Governance is based on the consensus of elite groups. Armenia suffers from the inconsistent application of the rule of law, as well as from the exclusion of civic input in legislative processes and policy formation.

The incumbent president, Serzh Sargsyan, came to power after the flawed 2008 elections and solidified his rule with brutal crackdowns on opposition and political dissent. Despite the government's efforts to establish a political dialog with the opposition in 2011, and despite a range of government concessions, in 2012 the ruling regime continued to rely on the autocratic methods of rigging elections and intimidating the opposition. His RPA is nominally conservative, but in practice is an extensive patronage coalition, combining wealthy business elites with career civil servants and senior bureaucrats. The close synergy between business oligarchs and politicians in Armenia's ruling coalition has created a competitive authoritarian structure. Oligarchs intimidate voters during election cycles into supporting the regime in their respective regions, and Sargsyan's alliances with Armenian elites ensure overwhelming favorable news coverage for the governing party. Parliament,

Effective power to govern

3

'06 '18 10



whose legitimacy remains highly contested, consists mainly of the representatives of the oligarchy and big business owners who exercise considerable dominance over the political and economic life of the country and who are highly averse to any democratic developments. Political life is marked by unconstitutional interference in governing institutions by the president and other influential politicians.

In light of that, the ruling political elites, particularly the executive, could be described as veto players standing in the way of democratic reform.

Armenia has an energetic and vibrant civil society. In contrast to the political parties, the civil groups had been perceived as harmless by the government. However, the rising influence of civil groups has harshened the authorities' attitude. After the removal of the ban on rallies in Yerevan in 2011, a series of demonstrations took place during the period under review. In 2012, environmental campaigners succeeded in persuading the authorities to cancel the construction of a shopping boutique in the central Mashtots Park in Yerevan. In 2013, mass rallies and student strikes took place after the presidential elections. In 2013/2014, a series of protests were held against Armenia joining the Eurasian Economic Union. The period from 2015 to 2016 was marked by a further intensification of street protests and formation of new civic initiative groups. In 2015, thousands of Armenians took to the streets to protest against electricity rate hikes, marching on the Presidential Palace and staging all-night sit-ins around the main square of the capital, leading to fears in Moscow of a Ukraine-style popular uprising.

Although civic initiatives in Armenia address very specific and sometimes narrowly focused issues (e.g., saving a waterfall or a public park, hikes in power prices), their emergence is informed by and articulates much broader concerns about corruption, the absence of rule of law, a lack of democracy and the rise of oligarchic capitalism. The last few summers have seen different kinds of social movements emerge against the oligarchy, its relations with those in power and economic exploitation. From the increasing costs of public transportation and electricity to decreasing pensions, Armenians have been protesting political and economic processes that are often described as producing undignified lives. One of the most important novelties in the public life of Armenia as a result of civic initiatives has become the shaping of a new collective identity. Thanks to this, the connection of participants of action with the activities around which people are united has become more defined.

Despite some progress on civil liberties in this period, the country's authoritarian approach to civic freedoms and civil rights requires more resolute reform. Although the constitution guarantees freedom of association and assembly, there has been a pattern of intimidation of civic and political groups, including such normally politically neutral groups as environmental activists and even groups fighting abuse in the military and defending historical monuments and architecture. Overall, the protection of civil rights in Armenia has remained incomplete and far too arbitrary, with deficiencies mainly due to the weak and arbitrary application of the rule of law.

Association /
assembly rights

5



One exception has been the institution of the human rights ombudsman, which has actively challenged the state's lack of protection and even violation of civil liberties.

Democratic reforms and the introduction of market forces have brought massive changes to the media in post-Soviet Armenia. Numerous competing sources of news and entertainment have become available. However, there were no major developments regarding freedom of expression and the media in the period under review. The media landscape is perceived as heavily politicized. Television remains the main source of information, while the internet, as well as social networks are rapidly gaining popularity as sources of alternative information, especially among young and educated people. A number of nationwide broadcasters are controlled by prominent political parties. Media independence remains insufficient and there are no developments regarding pluralism in broadcast media or transparency in media ownership. The National Commission for Television and Radio is the key regulatory institution for broadcast media, and its members are nominated by the president and by parliament. Private TV channels have been indirectly influenced by government institutions.

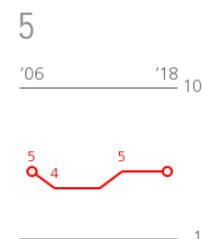
Although criticism of the government and public officials is tolerated in general, and there are no restrictions on the use of the internet, a number of issues still remain taboo. Human rights defenders, journalists and the opposition continue to face intimidation, harassment and threats. The safety and security of anti-government journalists and civic activists remain serious concerns.

3 | Rule of Law

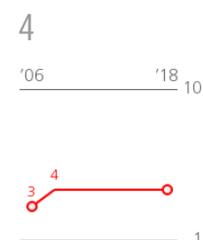
The Armenian constitution guarantees the separation of powers. However, following the victory of Serzh Sargsyan in the 2013 presidential elections, the executive's dominance over other branches of government has increased, reducing checks and balances. The president is using all administrative resources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

The judiciary has a three-tier structure, comprising general courts as the first tier, appellate courts as the second, and the Cassation Court and Constitutional Court at the top. Constitutional and Cassation Court judges are elected by the National Assembly by a three-fifth majority. The same procedure applies to the election of the prosecutor general. This is a largely welcome change as it gives the parliamentary opposition leverage in the appointment of higher judges and the prosecutor general. At the same time, these procedures may potentially result in partisan bargaining over judicial appointments and hence unnecessary politicization of judicial offices. It is also not clear what mechanisms are provided against possible deadlocks during

Freedom of expression



Separation of powers



parliamentary approvals of these positions, for example, if the parliament consistently fails to secure the necessary three-fifths majority.

Given the lack of an effective separation of legislative, executive and judicial powers, Armenia's democratic transformation remains both incomplete and inadequate. Moreover, there has been no progress in the past two years, with no attempt to reform or revise the current model of a strong presidency and the resulting subservient judiciary and ineffective parliament.

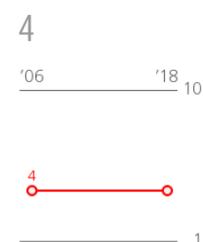
Armenia made some progress with regard to the right to free legal aid and limited progress with regard to the independence of the judiciary, in particular of judges. The procedure for appointing judges was made more transparent, but the public continues to distrust the judiciary system. Officially, an independent judiciary does exist in Armenia, but it is largely subordinate to the executive, and its effectiveness is undermined by widespread corruption and general incompetence. In the period from 2015 to 2017 no significant progress toward strengthening the independence of courts was observed. The powerful compulsory enforcement service exceeded its competencies in many cases.

In the face of a dominant presidency, with the executive remaining unquestionably the strongest branch of government, the judiciary has proven overly compliant with the demands of the executive. For instance, the president suspended a judge who issued verdicts against police and in favor of civic activists. According to the Commissioner for Human Rights of the Council of Europe, Nils Muižnieks, the president plays too great a role in the appointment and dismissal of judges. There is also a general problem of prosecutorial bias and dominance of the prosecutor within the system. The judicial and legal system are main instruments for retaining power, but without them enjoying independence, human rights violations will always have a systemic nature.

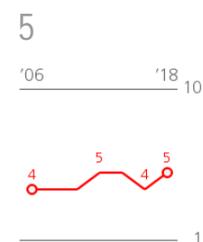
Abuse of power among Armenian officials remains rampant and unchecked. Such abuse manifests partly as entrenched corruption within state institutions. Over the past two years, however, there were several cases of arrests and prosecution of officials and even law enforcement personnel for corruption-related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

To tackle endemic corruption in Armenia, on February 19, 2015, the government created the Anti-Corruption Council (ACC), headed by the prime minister himself. Also sitting on the ACC are the ministers of justice and finance, the prosecutor general, the government's chief of staff, the president of the Ethics Committee, representatives of the parliamentary opposition, and the president of the Public Council.

Independent
judiciary



Prosecution of
office abuse



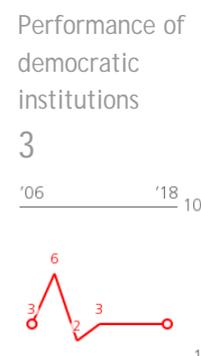
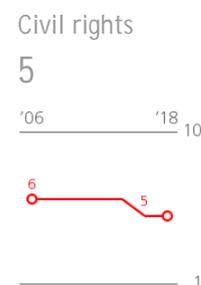
In 2016, several high-ranking military and municipality officials were arrested on abuse of power and corruption charges. However, most of these purges are a result of internal power struggles and do not represent a long-term strategy.

The protection of civil rights in Armenia remains incomplete, with deficiencies mainly due to the weak and arbitrary application of the rule of law. Over the past two years, blatant violations of civil rights by the state have reaffirmed the need for proper oversight by an independent judiciary. The lack of accountability for abuse and excessive force by the police and security forces, as well as the dubious judicial processes and questionable investigations subsequently conducted by the authorities, magnifies an environment of public fear.

Since the beginning of 2013, dozens of civic activists have been beaten by unknown violent groups. Since the Armenian police are not willing to solve the cases, there is the strong suspicion that the authorities may have been behind the beatings. The latest prominent case was an escalation in July 2016, as an armed group called Sasna Tsrer attacked a police district office in Yerevan. Armenian police employed disproportionate force and violence in response to the peaceful acts of the supporters of the rebels. Police utilized a wide arsenal of tactics to provoke peaceful protesters and to damage and confiscate the property of sympathizers of the rebels. Police used intimidation techniques and cursing, physical attacks and severe beatings, torture and humiliation of detained persons, with no regard to age, gender or state of health. About 500 peaceful citizens were apprehended without due justification and for many hours kept without food and medical assistance. Almost 60 were injured and hospitalized – both citizens and policemen. About 50 were arrested and several were detained. Most of the detainees were deprived of food, access to a lawyer and medical assistance, as well as the opportunity to inform their relatives of their whereabouts.

4 | Stability of Democratic Institutions

During the process of democratization, the supremacy of one of the actors and the prevalence of informal institutions, in addition to the rising “cooperation of elites,” has promoted the formation of a hybrid and unstable political system. In theory, democratic institutions exist in Armenia. In practice, paternalism of ruling elites, corruption and patron-client networks render them inefficient. While most of the state’s ministries are in hierarchical subordination to the executive and have little room for independent institution-building, relatively liberal institutions exist at regional and municipal levels. As of 2015, there were over 915 self-governing communities in Armenia. Although in reality many of the community heads depend on patron-client relations with regional governors and other higher-ranking state authorities, self-governing communities hold the potential for future democratic institution-building.



The Armenian government has delayed the merging of self-governing communities several times. The reforms aimed to increase the budgets of communities and improve their organizational structure, but faced also certain resistance in communities. In addition, an e-government system was launched in 2011. However, most of Armenia's institutions still remain under the patrimonial control of the executive, which continues to pose a challenge for democratic reform and institution-building.

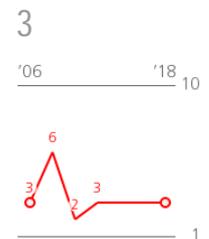
Fundamental constitutional amendments were adopted in Armenia in 2015 that will change the country from semi-presidentialism to a parliamentary republic. This entails that the president as head of state will be elected by the National Assembly for a seven-year term. Presidential power will be weak and the formation of government will depend on parliamentary majority. The reshuffle of the government system will hardly give strong impetus to the Armenian political landscape. The ruling RPA enjoys full control over local politics and is strong enough to maintain its role in the administrative structure.

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

The authorities have also been hindered by a lack of legitimacy and a crisis of confidence that have undermined its political mandate and impeded its reform program. For the past years, the Armenian government has remained fairly unpopular and unable to fully overcome these challenges, and neither the authorities nor the opposition was able to resolve the political crisis or to reach a constructive compromise.

As a result, the function of democratic institutions is impaired by both the government's lack of legitimacy and the continuous interference of the executive branch in the work of institutions. Hence the presidential office actively interfered in the work of institutions throughout 2013 and 2014, limiting their independence. The ruling party remains an extensive patronage coalition, combining politically connected business elites with career civil servants and senior bureaucrats.

Commitment to democratic institutions



5 | Political and Social Integration

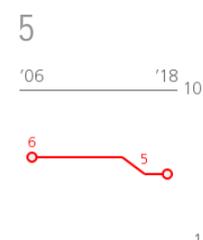
Armenia's constitution allows for a multi-party democratic system. There have been more than a hundred parties since independence, although only a dozen or so have had electoral success. The environment is polarized with parties self-identifying as "pro-government" or "opposition." The parties are mainly organized around strong personalities, with no real choice between party programs. This was again confirmed when, in 2015, President Sargsyan managed to completely put an end to the second-largest party, Prosperous Armenia, by exerting pressure on its leader, Gagik Tsarukyan. The parties are not socially rooted. Regional and local branches become active only before the elections. Clientelism and political support in exchange of benefits are widespread. Voter volatility is high, but also predictable, especially for the ruling party. The last presidential campaign was also marked by a rather primitive, low level political discourse, with little debate and even less of a choice among the candidates. Several new civil groups have tried to build political organizations and have made their first steps.

The authoritarian structures within the political parties have allowed the executive power to manipulate them. All six parliamentary parties lack popular support and have made efforts to strengthen their positions through negotiating with the incumbent president. The intense competition between President Sargsyan and his predecessors Robert Kocharian and Levon Ter-Petrosian has dissipated because of the resignation of the Prosperous Armenia leader, as the party was their main political ally and an obstacle for Sargsyan's constitutional reforms. As a result of the constitutional amendment, the Armenian political landscape will become increasingly authoritarian, with the incumbent RPA cementing its power. Parliamentary elections according to the proportional system will enable the RPA to strengthen its majority in the National Assembly and propose candidates for prime minister.

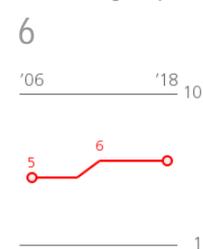
Armenian civil society has undergone some development since the collapse of the Soviet Union. While some aspects and characteristics of civic life in Armenia have changed, others remain remarkably stable. The NGO sector is consolidated and fairly well developed. It is, however, detached from broader society. An entirely new development is the rise of civic activism of a novel type: case-focused, largely spontaneous, mostly driven by youth, and powered by social media.

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

Party system



Interest groups



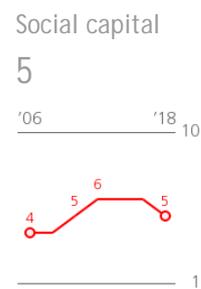
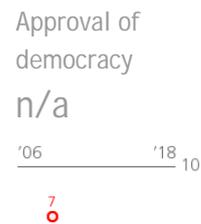
Civic initiatives, therefore, are not only rejecting the ‘NGOization’ of civil society, but they are also introducing new understandings of civil society and practices in civic activism. The individuals involved in civic initiatives describe their activism as a form of ‘self-determined’ citizenship and place great emphasis on independence, solidarity and self-organization.

In recent years civic initiatives have achieved small, but symbolically significant victories including preserving a waterfall (Save Trchkan Waterfall, 2011); halting the demolition of a public park (Occupy Mashtots Park, 2012); preventing transport fee hikes (the 100 Dram Civic Initiative, 2013) and temporarily halting the government plans for privatizing pensions (The Dem Em “I am Against” Civic Initiative, 2014). More recently there were large demonstrations against proposed electricity rate rises organized by the No to Plunder Civic Initiative in May 2015 and protest actions in support of the armed group holding the police station in 2016.

The majority of the population is committed to democratic norms and procedures. According to the Caucasus Research Resource Centers (CRRC) 2011 survey, 62% of Armenians approve of democratic governance. However, the institutions of the state are mostly distrusted; 49% distrust courts, 50% distrust the parliament, and 42% distrust the president. The latest CRRC survey data from 2013 determined that over 50% of respondents are supportive of democratic forms of government.

Commitment to democratic norms and procedures has remained stable despite widespread political apathy, frustration at the flawed 2013 presidential election, and growing disillusionment with the slow pace of democratization. Despite the country’s evident political shortcomings, the public seems more committed to the constitutional system than most of the political parties.

Social capital has been an increasingly important factor in the last years. Armenian society is characterized by high levels of social capital “bonding” and low level of “bridging,” which means that most social capital remains “locked” within family and close social groups. As a result, popular participation in organized civic activities is low. The Caucasus Research Resource Centers (CRRC) 2015 survey reported that 63% of the Armenian public does not participate in civic volunteerism or other social organizations. Trust in people is similarly low. For instance, the CRRC 2015 survey found that only 5% of Armenians trust other people. By contrast, over 45% said that they have enough people to rely on. The low trust that the respondents show in people in general, and in people close to them, combined with the low socialization in networks, implies that social capital is very limited.



II. Economic Transformation

6 | Level of Socioeconomic Development

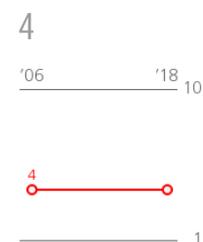
According to the European Bank for Reconstruction and Development (EBRD), Armenia's economy made a good start in 2016 but growth slowed in the second quarter; GDP growth decelerated from 4.5% year-on-year in the first quarter to 1.5% year-on-year in the second quarter of the year. Deflation in the first eight months of 2016 reflected weak domestic demand and low import prices. Armenia's economy remained exposed to spillovers from the recession in Russia. In the first half of 2016, net FDI inflow was low and remittances declined, albeit at a lower rate than in 2015. The current account deficit was contained in the first half of 2016 after a notable adjustment in 2015, which was driven by a reduction in imports. In the first nine months of 2016, the dram was mostly stable vis-à-vis the US dollar. International reserves provided approximately five months of import coverage as of September 2016. The fiscal deficit is expected to widen in 2016 on account of revenue shortfall. In response to slowing growth, negative inflation and a stabilizing exchange rate, the central bank of Armenia gradually lowered its refinancing rate from 10.5% in August 2015 to 6.75% in September 2016. In the first seven months of 2016, commercial bank lending remained mostly flat in the context of weak domestic demand and continued consolidation in the banking sector. The conflict in the Nagorno-Karabakh region presents a risk to the growth outlook.

However, statistical progress has been overemphasized and the problematic structure of economic efforts has been underestimated. Armenia hasn't done enough to address poverty, the closed nature of the market and widening disparities in wealth and income. The government has also missed the opportunity to promote the export-oriented IT and diamond-cutting industries. According to official data, the total poverty rate in 2014 totaled 30% (i.e., below the upper poverty line of 40,264 AMD/month). Compared to 2013, poverty incidence dropped by 2%. Rising refugee flows in the region are another important factor affecting Armenia's social condition. From the perspective of efforts aimed at poverty reduction, the 17,000 people evacuated from Syria due to the conflict, who applied for asylum in Armenia, became an additional challenge.

The key mid-term challenge for the government is to mitigate the economic and social impact of external shocks, while continuing political and institutional reforms. In this regard, increasing the economy's resilience to external shocks and creating new opportunities for development are important priorities. The creation of jobs in Armenia has been and will continue to be a challenge. Almost 40% of the country's

Question
Score

Socioeconomic
barriers



labor resources are economically inactive, and one-third of young men and women are neither studying nor employed. Moreover, Armenia will have to tackle the challenge of increasing economic productivity in order to protect employed people from poverty and give them an opportunity to earn decent living. Decentralization and sustainable development are further key challenges for the Armenian economy. The socioeconomic divide also has a rural-urban aspect, marked by an over-concentration of economic activity and opportunity in urban centers and the capital. This division has fostered more pronounced regional and rural income inequalities, and has been exacerbated by the wide variance in the quality of and access to essential public goods such as health care, education and other social services. The infrastructural divide between regions and urban centers has also encouraged greater migration to urban capitals from outlying rural areas.

| Economic indicators | | 2013 | 2014 | 2015 | 2016 |
|---------------------------|----------|---------|---------|---------|----------------|
| GDP | \$ M | 11121.5 | 11609.5 | 10529.2 | 10547.3 |
| GDP growth | % | 3.3 | 3.6 | 3.0 | 0.2 |
| Inflation (CPI) | % | 5.8 | 3.0 | 3.7 | -1.3 |
| Unemployment | % | 16.2 | 17.6 | 17.0 | 16.8 |
| Foreign direct investment | % of GDP | 3.1 | 3.5 | 1.7 | 3.2 |
| Export growth | % | 8.6 | 6.4 | 4.9 | 19.2 |
| Import growth | % | -2.1 | -1.0 | -15.1 | 8.8 |
| Current account balance | \$ M | -812.9 | -883.1 | -279.1 | -285.5 |
| Public debt | % of GDP | 38.0 | 41.4 | 46.8 | 53.5 |
| External debt | \$ M | 8679.1 | 8553.1 | 8928.4 | 9953.1 |
| Total debt service | \$ M | 2047.1 | 1435.7 | 1556.2 | 1483.0 |
| Net lending/borrowing | % of GDP | - | -1.8 | -4.7 | - |
| Tax revenue | % of GDP | - | 21.6 | 21.0 | - |
| Government consumption | % of GDP | 11.9 | 12.1 | 13.1 | 13.8 |
| Public education spending | % of GDP | 2.6 | 2.2 | 2.8 | - |
| Public health spending | % of GDP | 1.9 | 1.9 | - | - |
| R&D expenditure | % of GDP | 0.2 | 0.2 | 0.3 | - |
| Military expenditure | % of GDP | 4.0 | 3.9 | 4.2 | 4.1 |

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

In the period from 2015-2017, the foundations of a market-based, competitive economic system have continued to develop and strengthen, as can be seen in the steady growth of the private economy, which accounts for over 80% of GDP. The Armenian authorities continue to make efforts to upgrade commercial, tax and financial legislation in order to improve the business environment. Starting a new business has been made easier. Armenia is consistently rated as having one of the most open economies among the former Soviet states, and it is praised for its positive trade and investment policies as well as its lack of restrictions on capital.

However, significant gaps in the legal and regulatory framework remain. The absence of a liberalized economy and the existence of a monopolized economy in Armenia bear evidence to the fact that, for example, prices for imported goods do not decline in the country at the same rate as in the international market. The owners of monopolies are either those in power or people sponsored by those in power.

Over the longer term, the country faces a daunting set of problems, stemming from the powerful influence of several commodity-based cartels and monopolies that restrict free trade and market-based competition. For example, a multinational retailer company experienced serious obstacles entering the Armenian market, and it took four years to overcome the resistance of oligarchic networks.

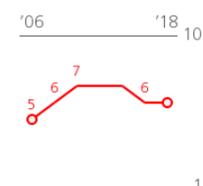
The Armenian parliament has underperformed in this area, having rejected a proposal from the opposition to introduce new sweeping anti-trust measures to curtail monopolies and improve competition. The proposed legislation would have required a new government strategy to implement “urgent measures aimed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

The Global Competitiveness Report 2014-2015 ranks Armenia good overall. It also identifies corruption as the biggest barrier to doing business, followed by access to finance and tax regulation. Competition is limited because of barriers to entry, ownership concentration, market dominance and vertical and horizontal integration.

A high concentration of monopoly power and an uneven business environment are the greatest obstacles to Armenia’s economic development. They remain a major roadblock to an improved investment climate, and represent the largest constraint to diversification. However, the authorities in Yerevan are not ready to eliminate them, because big business is dominated by high-ranking government officials. Although the Armenian constitution prohibits business activity by MPs, the majority of MPs from the ruling party are oligarchs or businesspeople. Some lucrative forms of

Market-based
competition

6



Anti-monopoly
policy

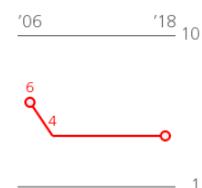
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business in Armenia, notably imports of fuel and foodstuffs, are controlled by large companies belonging to government-linked individuals. This lack of competition translates automatically into disproportionately high prices and hampers faster economic growth.

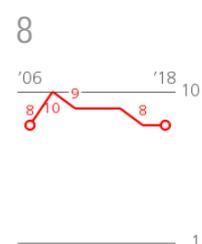
Against the backdrop of generally weak state regulatory institutions and a pronounced lack of political will to confront corruption and break up cartels and semi-monopolies, the entrenched power of the oligarchs now stands as a direct threat to reform and an indirect threat at least to the state itself. For instance, the Public Services Regulatory Commission sets prices for certain public services on the basis of calculations made by dominant companies or monopolies. This process is not transparent and does not sufficiently reflect public interests.

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

Armenia has been a WTO member since 2002. Despite its liberalized trade regime with very low customs duties, the country has several serious economic vulnerabilities. In January 2015 Armenia joined the Eurasian Economic Union (EEU), which aims to increase trade and investment with Russia, Kazakhstan and Belarus. Armenia was allowed to temporarily exempt around 800 types of imported goods from the much higher customs duties set by the EEU; these goods represent the lion's share of Armenia's imports. Ultimately, EEU membership will force a more protectionist trade policy on Armenia, once its tariffs are introduced in 2022. In the short- to medium-term, Armenia is likely to benefit from lower import energy prices, higher customs revenues and possibly increased investments from Russia. For example, Russia's removal of a 30% tariff on precious stone imports may open up new opportunities for the Armenian jewelry industry. Longer-term implications on the structure of the economy and of trade, on commitments under the WTO, on foreign investments, and on market reforms remain unclear.



Liberalization of foreign trade



At the same time, Armenia and the EU are in the process of deepening their cooperation, which has been enhanced by Armenia's participation in the Eastern Partnership program. Despite not signing the Deep and Comprehensive Free Trade Agreement (DCFTA) with the European Union, which would have offered an important new opportunity to overcome Armenia's geographic blockade and closed borders, Armenia still enjoys the preferential generalized system of preferences (GSP)+ trade status with the EU and some Armenian companies are successfully exporting into the EU. The Armenian government is seeking a new format of relations with the European Union, which would be compatible with its current EEU status. The Armenian government is also actively promoting bilateral commercial and investment ties with several European countries.

The new government is also seeking to bolster trade with Iran following the lifting of international sanctions. In January 2017 it was decided to implement a free economic zone near Armenia's southern border to boost ties in sectors that include agriculture and food production.

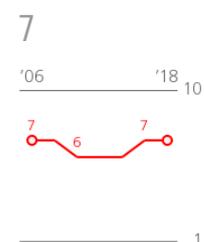
In addition to deficiencies in Armenia's investment climate, its economic development remains constrained by geopolitical and security challenges, including the blockade of Armenia by two neighbors – Azerbaijan and Turkey. The limited links to the broader global economy have produced a kind of incubation effect. But an inherent structural vulnerability can be attributed to three elements: the country's dangerous dependence on the influx of remittances from Armenians working abroad; its narrow reliance on the country's service, commodity and construction sectors as the main drivers of economic growth; and, most distressingly, the closed oligarchic economic network centered on several informal commodity-based cartels and semi-monopolies.

As of March 31, 2016, there were 21 commercial banks operating in Armenia. According to the International Monetary Fund (IMF), the banking sector has remained robust and well capitalized for over a year. As a result of the crisis in Russia, a strong outflow of foreign currency from Armenia was observed, putting pressure on the Armenian currency. Positive developments in recent years include better availability and affordability of financial services, ease of access to loans, and venture capital availability.

The banking sector is relatively fragmented and dominated by foreign-owned banks, which account for over 50% of total assets. Credit expansion has been supported by banking sector growth, which recovered well after the financial crisis in 2008, partly due to the government's anti-crisis funding to local banks. Nonbank sources of financing, such as microfinance, leasing, and private equity are limited and underdeveloped, contributing only about 9% financial sector assets.

Nevertheless, interest rates remain very high. The sector needs serious reforms, as it is still small (total assets are well below 20% of GDP), with small and undeveloped

Banking system



capital markets. According to the EBRD, Armenia's banking sector is highly dollarized. Banks were mostly sound before the devaluation, and withstood the dram depreciation relatively well. Further downward pressures on the currency could lead to capital shortfalls, increased dollarization and, potentially, deposit outflows. Non-performing loans stood at 7.9% in 2015 and the capital to assets ratio at 14.7% (2005). The central bank of Armenia tightened monetary policy during December 2014 to August 2015 by hiking interest rates and raising reserve requirements on foreign currency liabilities of banks. In January 2015, the Armenian central bank increased minimum capital requirements for banks from AMD 5 billion to 30 billion (over \$60 million) by 2017 to increase buffers and efficiency. Although there has been some progress in strengthening creditor rights and improving banking supervision, there is still a lack of adequate corporate governance. Discussions of new funding and acquisitions are under way.

8 | Currency and Price Stability

The central bank of Armenia has introduced a free float exchange rate regime, which is consistent with the principles of liberalized capital account operations and implementation of an independent monetary policy. Its intervention in the foreign exchange market is carried out based on the goals of its monetary policy.

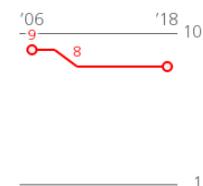
Data from the National Statistical Service of Armenia show that in 2015 Armenia reported a low rate of inflation of 3.7% as compared to its peer countries. According to an IMF forecast, in 2017 there will be 4.0% inflation. The real effective exchange rate has also been relatively stable (at 104.9 in 2015 according to the most recent World Bank data).

According to the World Bank, some of the tax policy changes pertaining to excise tax base and rate increases introduced in the fall of 2015 will positively affect revenue collection; however, the overall tax to GDP ratio is expected to decline by 1%. There are no other major tax policy and tax administration changes envisaged by the 2017 state budget as the government is leading a major endeavor to finalize and submit to parliament a unified tax code, which it is assumed will be implemented in 2018 and bring about significant policy, procedural and administrative changes. Changes in the 2017 expenditure composition refer to an increased allocation for economic sectors in the form of subsidies, increased debt service spending, which will be accommodated by the envisaged cuts in public procurements for goods and services.

The post-crisis recovery has slowed. Armenia experienced an investment-led slowdown in the aftermath of the 2008 to 2009 global crisis, with the investment share of GDP gradually falling from around 40% in 2008 to 20% in 2014. Average annual economic growth during 2010 to 2014 was close to 4%. After growing by 7.2% in 2012, the economy decelerated to around 3.5% growth in 2013 to 2014, and

Anti-inflation /
forex policy

8



Macrostability

7

is expected to grow by 2.3% in 2015. Armenia's overall government debt reached approximately 50% in 2016, as compared to 44.1% in 2014.

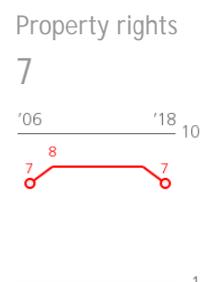
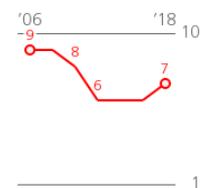
There was a deeper structural problem in the Armenian taxation system. Specifically, state revenue has traditionally relied on proceeds from the value-added tax (VAT), accounting for a little more than half of all state revenue, most of which generated from imported goods. In late September 2016 the National Assembly approved in its second reading a new tax code, which is expected to boost revenues by about 2% of GDP in the medium term. This constitutes a key step, but the government needs to implement additional measures to improve revenue administration, prevent tax evasion, and better monitor the execution of foreign financed capital expenditures.

Another positive measure was a new policy from the Armenian central bank, which has been easing monetary conditions since the second half of 2015 to help the economy abate deflationary pressures, while implementing plans to increase capital buffers in the banking system. The impact of these policies is expected to support credit conditions, providing a boost to domestic demand and growth in the coming year. In the past two years, fiscal policy has been accommodating in the face of external shocks, but consolidation will begin in 2017.

However macroeconomic fundamentals are relatively weak. In December 2016 the World Bank agreed to cooperate with Armenia on a new program, which includes macro-financial assistance in the sum of \$50 Million, new reforms and macroeconomic stabilization. The first pillar of this operation includes measures for improving the financial sustainability of key sectors and the efficiency of social protection programs while enhancing environmental safeguards in the mining industry, which accounts for over half of Armenia's exports. The second pillar focuses on strengthening the business environment and improving trade facilitation and connectivity, as well as access to credit. Key milestones include the enactment of the Unified Tax Code, which will increase the fiscal space for growth-enhancing capital investment and social spending. It includes measures to enhance revenues, improve the efficiency, transparency and equity of the tax system, and to strengthen tax administration.

9 | Private Property

Armenian property rights and the regulation of property acquisition are adequately defined and soundly defended. This stems from an initial focus on private property during the country's early stages of privatization and transformation, although incidents of privileged control and corrupt practices undermined the efficacy and integrity of the overall privatization program. The government has continued to make progress by reducing state interference in business formation and strengthening property rights. For instance, Armenia's procedures to start a business and to register



a property have been further simplified in 2012: Now it takes only three procedures and eight days, in contrast to six procedures and 15 days in 2011.

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

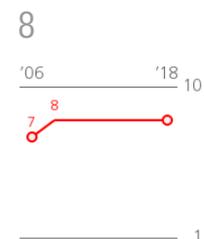
Although the government promised to promote small and medium-sized businesses (SME), the authorities have approved a set of amendments to the tax code that will significantly strengthen the control over tax reporting by small enterprises. However, the private sector in Armenia faces challenges, such as a lack of cohesion and coordination of different SME support programs, inefficient steering mechanisms for their development process, a fragmented landscape of stakeholders, and an inefficient public-private dialog, as well as an inefficient decision-making process. The interests of SMEs are in fact not reflected in decision-making processes. Supporting services are insufficiently available – both in quality and quantity. Underdeveloped capacities in the private sector are the main obstacles and barriers to the envisaged development. Innovative ideas are hardly developed and are rarely transferred into business projects. Research and development are limited, in particular in the SME sector, with hardly any cooperation from businesses and research entities.

10 | Welfare Regime

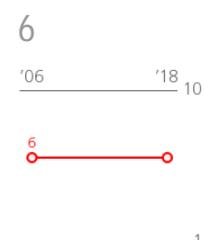
The state provides the basic elements of a social safety net. Social assistance in Armenia is based on the provision of limited cash benefits as well as some limited state subsidies for energy (e.g., the “lifeline” utility tariffs). Social insurance in the form of unemployment and pension payments are both flat-rate benefits. In Armenia, social safety nets are also based on family and kinship structures, on which individuals often rely for support in moments of emergency and need. This also applies to health care, where overall about half of all expenditures have to be financed privately.

Over the last two years, inequality of opportunity in Armenia has worsened. Social divisions distort access to state benefits and services and result in uneven availability of opportunity. Although some elements of the country’s economic reform and poverty-reduction strategies seek to correct this inequality, there are no practical or direct avenues for doing so. Moreover, the return of a significant number of migrant workers after the onset of the economic crisis in Russia and the migration of ethnic Armenians from Syria has exacerbated the lack of economic opportunity.

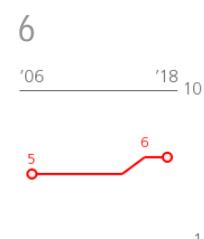
Private enterprise



Social safety nets



Equal opportunity



A number of legal acts include anti-discriminatory provisions, but there is no anti-discrimination law. Party electoral lists are required to have a minimum of 30% women. The ratio of female to male enrollment at primary and secondary schools is 102%, according to UNICEF data. The literacy rate is above 99%. However, there is a geographic aspect to the socioeconomic divide along urban-rural lines, which is marked by an over-concentration of economic activity and opportunity in urban centers and the capital. This division has fostered more pronounced regional and rural income inequalities and is exacerbated by a wide variance in the quality and accessibility of essential public services, such as health care and education.

11 | Economic Performance

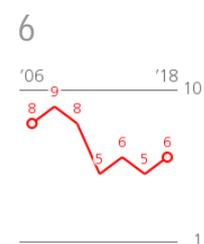
Following the launch of economic reforms, Armenia's economy posted an impressive double-digit economic growth, making Armenia one of the fastest-growing former Soviet states. This growth was matched by low inflation and an increasing level of real incomes. Investment levels continued to rise, accompanied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

According to the World Bank, real economic activity grew at nearly 4.5% in the first quarter 2016 on account of very strong exports, but weakened to just 1.5% in the second quarter as exports waned, with lower contributions from mining and agriculture. Domestic demand, although positive in the second quarter for the first time since 2014, has remained low. Deflation has continued: At the consumer level, year-on-year deflation reached 0.9% at the end of October 2016, with food prices declining by 1.2% and nonfood prices by 0.75%.

After three years of preparation, the National Assembly approved a new tax code in 2016. It aims at increasing the transparency and efficiency of the tax system, reducing compliance costs and supporting revenue collection. These include transfer pricing regulations (in line with international best practices), a system of taxpayers' single accounts, regulations pertaining to tax audits and procedures for appeal, and stricter and clearer penalties for non-compliance. The new law is expected to raise tax collection by 2% of GDP by 2021.

According to the EBRD, Armenia remains highly exposed to the regional economic slowdown via trade, remittances, investment flows and foreign investments. Continued positive contributions from agriculture and mining, which were engines of growth in 2015, would support the growth trajectory in 2016. The accession to the EEU has an enormous impact on the Armenian economic landscape. Armenian companies have faced a number of difficulties since the implementation of new EEU customs procedures. There is still some confusion over norms and standardization regulations in the EEU and some of these regulations contradict EU norms. The

Output strength



parliament has adopted a number of legislative amendments to promote the export of Armenian goods.

The World Bank estimates that Armenia needs investment of close to 30% of GDP to sustain growth rates of 6 to 7% year. Deeper integration in the global economy and further efforts to promote openness, diversification and inbound investments are crucial for Armenia's long-term development, given the country's small domestic market, scarce resources, landlocked status and geopolitical constraints. The key challenge for the Armenian government in the medium term is to strengthen the economy and its resilience to external shocks. Armenia needs to pursue policies that will improve the investment climate and public sector governance and reduce monopoly power. It also needs to improve cross-border and in-country interconnectivity and develop other forms of infrastructure, bearing in mind increased debt affordability constraints and its relatively limited fiscal space.

12 | Sustainability

As of 2015, Armenia had ratified 22 international environmental agreements. Over the past 15 years, Armenia has utilized resources made available by the Global Environmental Facility (GEF) to implement the obligations of these agreements.

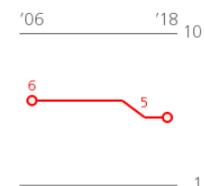
In July 2002 Armenia established the National Council on Sustainable Development chaired by the prime minister and comprising government, private sector, academia and civil society representatives. The council, in cooperation with international and national organizations, produced the Rio+20 National Assessment Report (2012) as well as the Post Rio+20 Strategy Plan (2015). The government has developed and adopted two National Environmental Action Programs (NEAPs), policy and programmatic framework documents, and a set of documents that articulate the country's national and agricultural development priorities while ensuring environmental sustainability.

Reality, however, shows a different picture: Armenia is confronted with serious environmental challenges. Environmental protection frequently falls prey to the economic interests of business elites and is characterized by lax environmental legislation. Moreover, environmental laws are frequently violated with impunity as a lack of funds and widespread corruption enfeeble law enforcement and adjudication. The high level of corruption has created favorable conditions for companies to bypass environmental standards. Numerous protests were held against the expansion of mining companies and the opening of new big mines (such as the Teghut Copper Mine and Amulsar Gold Mine). Many communities have opposed the construction of small hydropower plants.

Environmental considerations have been increasingly taken into account as part of the government's overall reform program. The government has identified specific

Environmental
policy

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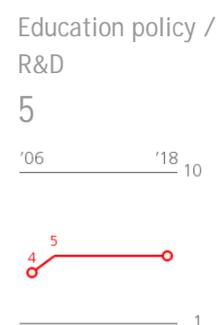
concerns relating to overexploitation of natural resources, including the depletion of the water supply, soil erosion and the loss of biodiversity. The Armenian constitution mandates that the state protect the environment and ensure the rational use and exploitation of natural resources. Yet despite this overall record of environmental awareness, the trend has been toward policies promoting growth rather than policies of conservation.

There is currently a heightened discussion about and protest against small hydroelectric power plants (HPP). Armenia has a large number of rivers that provide good opportunities for developing hydropower in the country. However, construction of hydroelectric stations is carried out by neglecting legal requirements. As a result, dozens of rivers have ceased to exist as ecosystems because they have been outfitted with as many HPPs as possible. Local communities are no longer able to use the water for irrigation and drinking. Renewable and clean energy are as of yet marginal. Armenia has a huge potential for developing solar energy; however, the government claims that solar energy production requires very large investments that the country cannot afford.

Armenia has three main challenges in developing its education and R&D sectors: an inability to sustain adequate levels of investment and state spending, aging facilities, and the severe effects of the country's brain drain during the early to mid-1990s. The decline of state investment in education has predictably led to a decline in the quality of education. Nevertheless, Armenia has succeeded in maintaining its system of universal basic and secondary schooling. Enrollment rates at both levels remain high, and over 99% of the population is literate. The Global Competitiveness Index (GCI) for 2016-2017 placed Armenia at 79th place among 138 countries with regard to quality of scientific research institutions.

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

During the last 10 years, the computer-related field in Armenia, excluding internet service providers, has grown at an annual rate of 22%. At the end of 2015, the number of computer services-related companies was approximately 450. About 13% of these companies operate in the field of high technology, while the rest are Information Technology (IT) companies. The revenues generated by the software and services sectors as well as the internet service providers were 4.3% of GDP in 2014, and increased to 5% in 2015. Information technology has also attracted some investment and continues to serve as a strategic priority for the state.



Despite this progress, the quality of education at all levels continues to be an important challenge. While quality education has been one of the most debated issues in recent years, no reliable and trustworthy performance indicators for the measurement of education quality have been available. The only internationally comparable indicators of education quality are the results of school students in the fields of mathematics and natural sciences.

Governance

I. Level of Difficulty

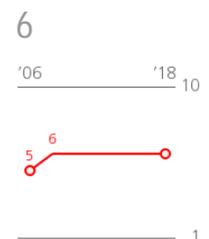
Since the collapse of the Soviet Union, Armenia has struggled to forge new institutions of statehood and overcome a daunting set of economic, political and social challenges. Economic and political reform has been especially difficult, as the country experienced a severe earthquake, a war with neighboring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

Over the last two years, the Armenian government has been unable to sustain its traditional reliance on economic growth as the sole source of legitimacy. Internal weaknesses due to a lack of popular support and an unresolved domestic political crisis have made it increasingly difficult for authorities to manage the country's structural fragility.

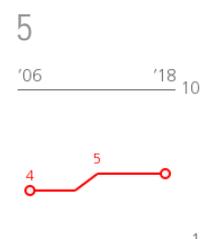
Even more serious is the emergence of cartels and monopolies that flourish within closed economies, averting the transparency and competition that dominate more open marketplaces. These cartels and monopolies also become entrenched through their negotiations with state actors. And despite the most well-intended anti-trust legislation and bodies empowered to limit or breakup monopolies, without a strong rule of law, and political will, very little can be expected. For Armenia, with its small, infant economy still engaged in a difficult transition, such a situation threatens to further destabilize and isolate the country.

Armenian civil society after 20 years of post-communist development is a curious mix of achievements and failures. The overall assessment of Armenian civil society depicts it as partially developed, with no major upward or downward trends. It has a relatively strong level of organization, but low civic engagement and weak impact. The Armenian NGO sector is described as donor-driven to the extent of becoming artificial. Public trust of NGOs is low. There have also been studies highlighting positive aspects of Armenian civil society, such as high levels of trust in small rural communities and high potential for informal volunteering. Overall the NGO sector of civil society can be described as fairly institutionalized but detached from the

Structural
constraints



Civil society
traditions

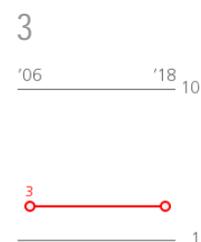


broader public. In that sense Armenian civil society still suffers from the typical post-communist “weakness.”

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

Up until two years ago, there was no real evidence of ethnic, religious or social conflict. Yet since then, confidence in the government has eroded to the point of political crisis unprecedented in Armenia’s recent history. In this way, the Armenian government’s most basic challenge stems from a distinctly new political context, insofar as the population has emerged from years of apathy to voice fresh and insistent demands for change. This is rooted, at least in part, in the opaque nature of the Armenian political system, in which dissent is seen as a direct threat to the state rather than as a characteristic element of a healthy democracy. There is also a high level of social polarization in society with a certain risk of deepening existing social conflicts.

Conflict intensity



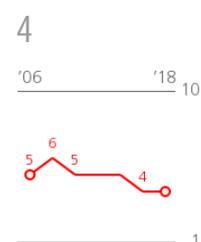
II. Governance Performance

14 | Steering Capability

On December 6, 2015, a referendum on amendments to the constitution was held in Armenia. In favor of the amendments were 63.3% of voters (with a turnout of 50.5%). The amendments will change the Armenian political system from presidential to parliamentary. This will weaken the position of the president and bring about changes to the parliament as well: the number of deputies will be reduced from 131 to 101, and they will all be elected by proportional representation (as of now, 41 have been elected in single-mandate constituencies). The opposition protested the amendments, as, in its view, they will consolidate power in the hands of the RPA. It was also noted that some of the changes will negatively affect human rights in cases of threats to national security. Paradoxically, changing the constitution will preserve the political system in Armenia, a classic oligarchic system. The RPA, which has monopolized power under President Serzh Sargsyan (in office since 2008), is an emanation of the oligarchic-bureaucratic establishment that controls the country’s political and economic life. The amendments will consolidate the system, limiting the opposition’s activities and the risk of uncontrollable political processes, both of which have been

Question
Score

Prioritization



caused by presidential elections. The short-term objective of the changes is to keep Sargsyan in power (as prime minister); his second presidential term expires in 2018.

The recent resignation of Armenia's prime minister has produced abundant commentary, most with little substance. Much of the reaction centered on the top new appointments: defense and prime ministers, Vigen Sargsyan, and Karen Karapetyan, respectively. Forming a new government about half a year before the parliamentary elections could be an attempt to placate the public, as disappointment with the government was a major reason for the radicalization of protests, such as the July 2016 attack on the police station and related demonstrations. Forming a new cabinet with members not previously state servants and therefore less likely to have been involved in corrupt practices and misappropriation of public funds could be useful. Some observers suggest that unless Karapetyan's cabinet effects some positive changes, a new mass protest campaign is inevitable. Karapetyan is hardly in a position to change the structure of governance dominated by oligarchs, whose possessions are safe as long as they remain loyal to the president, similar to the Russian model. Any attempt to change the oligarchic, monopolistic economic structure, or to tax the oligarchs' businesses could seriously destabilize the whole structure.

Armenia made progress in structural reforms. The new tax code aims to enhance fiscal revenue generation and to foster the transition toward relatively less distortionary taxation. The authorities have initiated an energy sector financial recovery plan. Steps were taken to promote better capitalization of the banking sector, although non-performing loans (NPLs) and low profitability continue to pose challenges. Armenia has established the basic framework for a modern market economy and has demonstrated sound macroeconomic policy-making. The sustainability of these achievements now depends on carrying out the next generation of reforms.

Moreover, if sustainability is to be attained, a greater degree of political commitment to the implementation of these reforms must be shown with the government withstanding political pressures in pursuit of its strategic economic objectives. The Armenian government has not been particularly effective in implementing its anti-corruption agenda during the reported period. In 2013 to 2014, no high-profile corruption-related arrests were made. Only several lower-ranking public officials were dismissed on corruption charges in 2013. Up to 2013, Armenia was ahead of its South Caucasus neighbors in adopting EU legislation in numerous sectors. Many of the new laws were connected with the Association Agreement and the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, which Yerevan negotiated up to the summer of 2013.

In recent years, the Armenian authorities have reviewed much of their core legislation to align it with international standards and to eliminate inconsistencies. A new criminal code and criminal procedure code were developed, the former being geared toward better incorporation of the principle of proportionality of sentences and

Implementation

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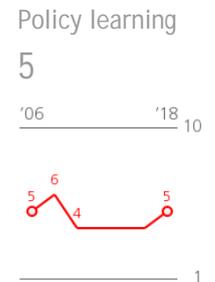
providing for alternatives to imprisonment. The Code of Administrative Offenses is also being amended. While the quality of laws improved, their consistent implementation has remained a challenge. In many cases these laws conflicted with oligarchic interests and remained only on paper.

Over the past two years, public interests have increasingly conflicted with oligarchic interests. Ministers running businesses are not willing to reform the old structures, from which they benefit. One of the most startling lessons of the past two years is the fact that the Armenian state can no longer maintain its economic system, and it also cannot ignore public opinion. If the state is to weather the current economic crisis, it must put an end to its reliance on the twin evils of corruption and oligarchic cartels and monopolies. In response to the highly corrupt system, Armenian society has started to idealize the concept of change. Changing the existing political order has become an end in itself, and no one bothers to think about the cost of doing so. A consensus is forming in Armenian society that corruption and the authoritarian regime are the main problems, and that they are destroying the economy and threatening Armenia's sovereignty.

In contrast to the government's constructive response to the 2011 opposition rallies, over the past two years, President Sargsyan has decided to suppress numerous street protests or weaken them using administrative means. The number of clashes between citizens and police forces has increased.

One reason is generational change. The generation born right before or after the Soviet Union's collapse is entering active public life. These people have only experienced national independence. Their demands are generally more extreme than those of their predecessors, and their representation in government is minimal, to put it mildly. One may say that their vision of the future is vague and hazy, but it will become more influential with each passing year.

As a result of mass protests against pension reform, the government made some concessions, such as excluding the private sector from pension reform. There were several signs suggesting a newfound political will within the Sargsyan administration aimed at reforming and bolstering the tax and customs services and seeking to combat the oligarchs' permissive approach to tax evasion. President Sargsyan used administrative power and unverified information to warn oligarch Gagik Tsarukyan not to radicalize his party and to exit from politics. The new prime minister has reiterated his commitment to defeating the power of the oligarchs by attacking the economic monopolies and cartels that fuel and finance the oligarchic system and fostering greater transparency and competition.



15 | Resource Efficiency

The Armenian state budget deficit narrowed to an estimated 3.2% of GDP in 2015 from 7.3% in 2014, due to the significant reduction in the trade deficit, which more than compensated for the 36% fall in remittances. The budget deficit is projected to remain substantial in 2016, at 3.9% of GDP, despite fiscal tightening through a combination of revenue-raising measures and moderate expenditure cuts. Public debt reached its highest level since independence at 48.7% of GDP in 2015.

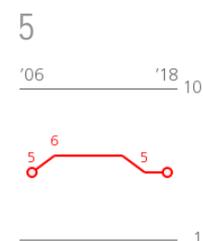
Positive developments in public organization include policies to merge self-governing communities with the goal of increasing their financial and organizational potential. Another notable development was the adoption of the Law of Public Service, which requires all government officials to regularly submit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

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

Despite these reforms in the last four years targeting the civil service, corruption within these structures remain a serious challenge and civil administration remains hindered by a legacy of inefficient and burdensome Soviet-era practices. Additionally, although there is a reasonable administration of justice, adjudication remains contingent on political, personal or financial interference (such as bribery). This is related to a fairly weak rule of law, matched by a flawed system of law enforcement and a sometimes checkered record of justice, primarily in the less developed regions of the countryside. Similarly, the lack of an independent judiciary also tends to weaken the efficacy of state administrative bodies and fosters a general public mistrust of the system.

Dominated by hierarchical bureaucracy and high reliance on informal power networks rather than formal institutions, the Armenian government is not very efficient at reconciling conflicting objectives. During the review period, one of the most glaring deficiencies in policy coordination has been the lack of a coherent government policy in the face of a new domestic political crisis and serious external economic shocks. For the Armenian authorities, the past years have only reaffirmed the overwhelming need for good governance, including better transparency, ethics

Efficient use of assets



Policy coordination

5

and accountability and more competent administration. These prerequisites are notably lacking today.

The Armenian government also had difficulties in making the appropriate choices in its foreign policy. The decision to choose the Eurasian Customs Union over the European Union DCFTA is just one example of the government's inability to effectively reconcile conflicting policy options. Irrespective of the motives behind this decision, the Armenian government not only undermined several years of intensive cooperation with the EU, but also succeeded in isolating itself from non-Russian political and economic cooperation.

In the beginning of 2015, the government decided to set up a new anti-corruption council. Interestingly, this council's actions have not assuaged popular concerns. Corruption allegations against members of Sargsyan's inner circle have shaken public confidence in his government. Sargsyan's anti-corruption campaign was undermined by the release of the Panama Papers on April 8, 2016, which revealed that Major General of Justice Mihran Poghosyan and two of his uncles had founded companies in Panama to obtain Armenian government contracts.

Some improvements in the fight against corruption have taken place over the last two years. In 2014, the government started consultations on the draft Anti-Corruption Strategy 2014-2018.

The Armenian government and the United States Agency for International Development (USAID) signed in February 2016 an anti-corruption strategy agreement as part of the efforts to assist in the country's capacity-building in the fight against corruption. The deal is part of the United States' assistance to the Armenian government's Anti-Corruption Strategy 2015-2018. The project's total cost is \$806,390. The project is aimed to offer support to the Armenian government in benefiting directly from top-class international and/or local technical assistance in the activities toward drafting a road map and implementing anti-corruption strategies in areas such as education, state revenues, health care and police services.

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

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Anti-corruption policy

3

'06 _____ '18 10



16 | Consensus-Building

There is a general consensus on the twin goals of democracy and market economy. More recently and more problematically, this consensus also extends by and large to the constitutional reform, essentially meant to tailor the constitution to the needs of the president serving his (constitutionally) final term. Having neutralized his main political rivals Vardan Oskanyan and Gagik Tsarukyan, the ruling Republican Party has removed practically all obstacles to the planned constitutional reform. The president invited all other political parties to issue a proposal for the draft concept. Only the Armenian National Congress (ANC) refused to take part in this process. The ANC, a coalition of opposition parties, emphasized democratic values as the core of its 2012 campaign. Electoral irregularities and claims of fraud repeatedly emphasized by the opposition further reduce the credibility of the incumbent in promoting democratic reforms.

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

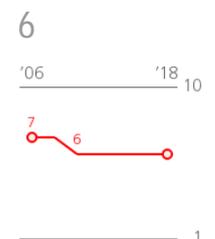
Anti-democratic actors in Armenia are often interconnected with the ruling elites. Governors or officials who commit crimes and enjoy impunity are also a threat for the democratic order and rule of law. Since the government is mostly satisfied with the status quo, it shows no determination to jumpstart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

A power competition is underway between political and economic elites. This struggle may devolve or expand to include some new actors capable of confronting the reformers outside the existing system. Some politicians and media representatives use anti-democratic rhetoric to create false dichotomies between democratic values and security issues.

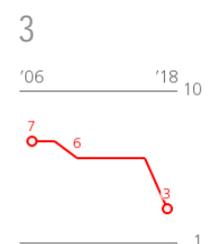
In the period from 2015 to 2016, the authorities refused to meet the opposition halfway and include their political demands in the government agenda and hence faced more conflicts with different social groups. The growing polarization of society has generated substantial unrest, primarily on the local level but in June 2015 also on a large-scale national level. As a rule, government officials and the police use conflict management tools primarily in the final phases of protests.

The constitutional referendum voting process in December 2015 was accompanied by an unprecedented number of violations, including pressure on voters, observers and journalists. The Parliamentary Assembly of the Council of Europe (PACE)

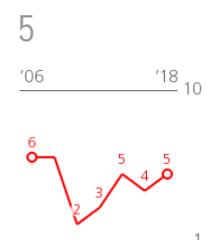
Consensus on goals



Anti-democratic actors



Cleavage / conflict management



delegation noted that the low turnout reflects the fact that the referendum was driven by political interests instead of the needs of the public, along with several other problems such as: voting lists featuring the names of people residing permanently abroad or even deceased, with the possibility of voting on their behalf; and organized vote-buying and carousel voting, as well as pressure on voters, et cetera. The opposition, including the Armenian National Congress (ANC) and the Heritage Party, whose presidential candidates (Levon Ter-Petrossian in 2008 and Raffi Hovhannissian in 2013) received hundreds of thousands of votes and managed to organize big protest demonstrations after each election, are at present hardly capable of gathering more than a few thousand supporters for street protests, despite general disappointment with the government.

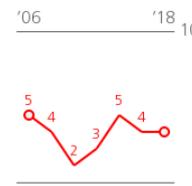
Armenia has slipped into a political crisis rooted in deadlock between the authorities and the opposition. The deadlock is driven by an unpopular government that refuses to recognize the country's new political reality and an opposition movement that seems devoid of any clear policy alternatives. The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

No significant progress has been achieved on the Nagorno-Karabakh issue. In April 2016 violence escalated along the line of contact in Nagorno-Karabakh. Fighting broke out on the morning of April 2, 2016. Azerbaijan's forces launched an offensive into the territories of the self-proclaimed Republic of Nagorno-Karabakh from the northeast and southeast. In the course of fierce fighting, both sides used all the types of weapons at their disposal (tanks, heavy artillery, rocket launchers, and, to a limited extent, air power), including the shelling of civilian targets. The Azerbaijanis also threatened to shell Stepanakert, while the Armenians threatened Azerbaijan's oil facilities. The exact number of casualties is unknown; both sides have conceded having lost at least 60 soldiers and several civilians, and it is possible that the figures have been underreported. Baku, Yerevan and Stepanakert have also been disseminating war propaganda and deliberate misinformation, so it is difficult to verify many of the reported facts (such as the alleged murder of Armenian civilians in the village of Talysh). On April 5, 2016, the parties to the conflict stated that hostilities were being suspended. As a consequence of the escalation in April, a new constitution was adopted in Nagorno-Karabakh by referendum on May 20, 2017, preferring a presidential system and renaming the de facto state the Republic of Artsakh.

The media, civil society and the business sector are the weakest institutions in Armenia's National Integrity System. There are concerns about the capacity and sustainability of civil society organizations (CSOs) in Armenia, given the treatment of CSOs as for-profit organizations for tax purposes.

Civil society
participation
4

There has also been an increase in clampdowns on civil activists. Even though civil society and the media remain constrained, there has been a recent increase in the number of civic initiatives, indicating a stronger voice emerging from the non-state sectors of society. Of particular note is the recent Dem Em Movement (meaning I am against) against a proposed rise in pension contributions, which attracted significant support from the population as well as from opposition parties.

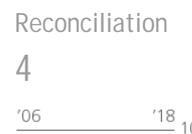


The period from 2015 to 2016 was marked by a further intensification of street protests and formation of new civic initiative groups. In 2015, thousands of Armenians took to the streets to protest against electricity rate hikes, marching to the Presidential Palace and staging all-night sit-ins around the main square of the capital, leading to fears of a Ukraine-style popular uprising. After this active phase of street confrontation, some civic groups became radicalized and others are rethinking their strategies.

While the government does not overtly impede civil society organizations, it continues to exclude civil society from participation in the political processes. Although civil society in Armenia has been both vibrant and vocal for many years, the new upsurge in civic activism stems from a wave of grassroots, youth-led momentum over issues including the environment and urban planning.

The most violent clashes took place in 2016, when armed men from the opposition group Sasna Tsrer occupied a police station in Yerevan’s Erebuni district, demanding political concessions from the government. Public support in favor of the radical group’s demands grew into a widespread protest movement in Yerevan, until the Sasna Tsrer gunmen were forced to surrender on July 31, 2016. The clash, which police tried to put down by using tear gas and batons, topped off three days of building tensions over attempts to stifle anti-government protests. Although police do not provide details, human rights organizations claim that over 200 people were arrested in different parts of the Armenian capital.

The Armenian-Turkish reconciliation process has been stalled since 2013. In February 2015, President Sargsyan withdrew the Armenian-Turkish protocols from parliament as Turkey had not taken any steps to ratify them.



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



17 | International Cooperation

Armenia is still undecided about the future framework of EU-Armenia relations. Despite this, many common reform projects continue to be implemented. Armenia stepped up its cooperation on anti-corruption efforts and judicial reform with both the European Union and the World Bank. Armenia's collaboration with the Council of Europe was focused on electoral reforms. Yet, due to the uneven and slow pace of reform, Armenia's cooperation with international partners on democratization remains inconsistent. In spite of Armenia's decision in 2013 not to initial the negotiated EU Association Agreement, Armenia and the EU continue their political and trade dialog in areas where this is compatible with Armenia's new obligations. Negotiations started in December 2015 on a new EU-Armenia legally binding and overarching agreement, upgrading bilateral relations currently based on a partnership and cooperation agreement.

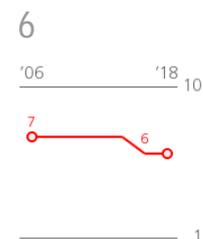
On January 1, 2014, the EU-Armenia visa facilitation agreement came into force. The agreement covers simplified procedures for processing short-stay visas for the Schengen area. The new visa liberalization agreement grants new categories of travelers, such as university students, academics and state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

The credibility of the Armenian government suffered after the unexpected about-turn toward the EEU in September 2013. Nevertheless, the Armenian government's commitment to democratic reforms, although only partially put into practice, is recognized by international actors. For instance, Armenia continues to actively cooperate on democracy-building projects with USAID, UN agencies and other international promoters of democracy. Armenia and the EU continue their political and trade dialog too, in areas where this is compatible with Armenia's new obligations.

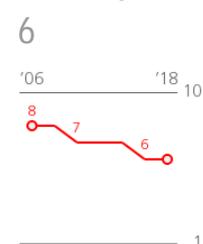
However, the irregularities observed during the 2013 presidential elections and the referendum on the constitution in 2015 have caused international concern on the part of the European Union and the Organization for Security and Cooperation in Europe (OSCE), among others. Access to justice, impunity, violations of human rights and freedom of speech were highlighted in the European Neighborhood Policy recommendations paper for Armenia (published in March 2014).

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

Effective use of support



Credibility



limited credibility and reliability of the government in its commitments to the international community.

Although Armenia seeks greater cooperation with its neighbors, trying to overcome the effects of closed borders with Turkey and Azerbaijan, there has been no real change in the period under review. The blockade is particularly damaging for the landlocked country, but normalization with Turkey could not proceed as envisaged due to a successful blockade by Azerbaijan. Georgia and Iran remain vital partners in the region. With the end of sanctions on Iran, cooperation between the neighbors has become more active.

Security concerns have historically pushed Armenia into Moscow's orbit, but that alliance has not yet translated into a full turn toward authoritarianism of the kind seen elsewhere in Eurasia. Geopolitical tensions in Europe after Russia's annexation of Crimea in 2014 have made it more difficult for Yerevan to balance its security ties with Moscow with its pursuit of greater economic ties with China, Europe and the Middle East.

Armenia's connections to Armenian diaspora communities overseas help it secure ties to Europe, North America and Russia, as well as the Middle East and even Latin America. With Armenia lacking the oil revenue of Azerbaijan or the political clout of Turkey, the diaspora is vital to Armenia's efforts to influence international public opinion and international policymakers' decisions concerning the Caucasus.

Regional
cooperation

6

'06 '18 10



1

Strategic Outlook

Armenia's constitutional referendum in 2015 has stimulated a debate about the future of the country's political regime, including the issue of succession after President Serzh Sargsyan's second and last term in office. The ruling RPA is seeking to secure its position in the long term, which will in essence pave the way for a formal multi-party system with a de facto strongman rule, similar to Russia and several other post-Soviet states. However, Armenia's current economic, social and foreign policies are unlikely to change.

The key actors in the parliamentary election 2017 are already known. The ruling party enjoys full control over local politics, opposition forces having no serious chances of consolidation. President Serzh Sargsyan's RPA is strong enough to impose its will on the other parties and is free to choose partners and reshuffle the cabinet whenever it needs. The RPA does need a partner today – otherwise, it will hardly get more than 45% of the votes in the April elections. Its actual rating is even lower. But in Armenia, election results do not have much to do with the actual popularity of the winners. The upcoming elections are crucial for the RPA, as they will test the effectiveness of their constitutional amendments. Yet, the RPA only decided to change the system, but not its personnel. In other words, the party will redistribute duties among the same people. In the new system the president will be weaker but the “leadership is key” principle will stay firm.

The leader of the RPA, President of Armenia Serzh Sargsyan, has no constitutional right to run for a third term. He has already said that he will not seek high political posts in parliamentary Armenia. But he is not going to resign as RPA leader. Sargsyan's most trusted people within the RPA are hardly electable, especially since presidential elections could result in the mobilization of protest votes. In Armenia, presidential elections have traditionally allowed the opposition to mobilize larger voter support, providing a window of opportunity for regime change. During parliamentary elections, however, voters are usually less engaged. Abandoning the practice of direct presidential elections will likely reduce the general public's participation and its ability to hold the authorities accountable.

After an active phase of street confrontation, the government has started to ignore or suppress rising civic activism. Nevertheless, the government is aware of the importance of reform-oriented and critical civil society groups. For the Armenian government, the current situation is fairly different because of generational change. The generation born right before or after the Soviet Union's collapse is entering active public life. Members of this generation grew up in conditions of national independence. Their demands are generally more extreme than those of their predecessors, and their representation in government is minimal, to put it mildly. One may say that their vision of the future is vague and hazy, but it will become more influential with each passing year.

The government's lack of legitimacy has exacerbated its tendency to favor authoritarian rule over accountable governance, and it has retained a myopic view that regards dissent only as a challenge to its authority. Overall, many conflicts within society are no longer controlled by the political parties. Decentralization and sustainable development are the key challenges for the Armenian economy.