

BTI 2012 | Armenia Country Report

Status Index	1-10	5.59	# 65 of 128	
Political Transformation	1-10	5.25	# 71 of 128	➔
Economic Transformation	1-10	5.93	# 55 of 128	⬇️
Management Index	1-10	4.68	# 75 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

More on the BTI at <http://www.bti-project.org>

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Key Indicators

Population	mn.	3.1	HDI	0.716	GDP p.c.	\$	5463
Pop. growth ¹	% p.a.	0.2	HDI rank of 187	86	Gini Index		30.9
Life expectancy	years	74	UN Education Index	0.760	Poverty ³	%	12.4
Urban population	%	63.7	Gender inequality ²	0.343	Aid per capita	\$	171.1

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

Executive Summary

Hindered by the lingering effects of the country's 2008 post-election crisis, the Armenian government continues to struggle to overcome a daunting set of challenges, including a pronounced lack of legitimacy, a deeply polarized population, and general mistrust and unpopularity among the majority of the population. The past two years were also marked by a serious economic crisis, as declining remittances and reduced investment triggered new fiscal and budgetary pressure.

On a broader level, despite the country's democratic shortcomings, the political crisis alone was not sufficient to pose a significant threat of governmental change. As the government sought to move beyond the post-election crisis of 2008, the opposition was unable to harness public discontent and failed to offer any real political alternative. In this way, Armenian politics throughout the past two years could largely be characterized as a stalemate, with a deadlock between the authorities and the opposition in which neither side emerged as the clear winner.

Beyond the political stalemate, however, the government's lack of legitimacy and popular support undermined its capacity to manage the impact of economic crisis. Related obstacles to economic reform during this period were seen in the country's widening disparities in wealth and income, the negative effects of entrenched corruption, and the barriers to market reform from powerful commodity-based cartels or semi-monopolies, commonly referred to as oligarchic groups.

However, even in the face of these related political and economic challenges, there has been some notable progress in reform. The Armenian government has demonstrated a seemingly more substantial level of commitment to deepening reform and a new sense of political will, driven by recognition of the necessity for political and economic reform. Key questions remain, however, as it is not yet assured that this new reform drive will be sufficient to overcome the country's structural economic problems or strong enough to tackle entrenched corruption and the powerful

vested interests rooted in the incestuous relationship between business and politics. The public has shown similar doubts as to the value of the Armenian government's new sense of political will, which may prove to be too little, too late for effective reforms.

History and Characteristics of Transformation

With the sudden collapse of the Soviet Union, Armenia, like most of the former Soviet states, was ill-prepared for the onset of abrupt independence. After seven decades of Soviet rule, Armenia struggled to create the institutions necessary for statehood and sovereignty, and to adapt to the demands associated with introducing new political and economic reforms. From the onset of independence, Armenia faced additional challenges, ranging from an ongoing war with neighboring Azerbaijan that led to a blockade of the country's eastern and western energy, trade and transport links, to the devastating impact of a severe earthquake.

Against that backdrop, Armenia's political and economic transformation was largely defined by the specific circumstances of the time, which greatly impacted the trajectory of reform. More specifically, these factors included politics that were defined by strident nationalism that imposed informal limits to political discourse, debate and tolerance, and which tended to reinforce a trend toward authoritarianism. A second factor was an economy deformed by "conflict economics," in which the closed borders and blockade of the country led to a severe scarcity of goods, which in turn fostered widespread corruption and distorted market-based prices and economic activity.

Through the 1990s, the country gradually adapted to these impediments, overcame the isolation from a blockade that closed two of its four borders, and by the latter half of the decade, ultimately garnered an impressive record of double-digit economic growth. Despite that record and a gradual decline in poverty, there was a "paradox" associated with Armenia's economic growth, whereby several years of growth tended to result in an uneven and unequal distribution of wealth rather than any real improvement in living standards for the overwhelming majority of the population. Moreover, widening disparities in wealth and income have led to a serious socioeconomic divide on several levels, most notably reflecting a deep disconnect between rural and urban areas.

Politically, the past two years have been marked by a serious polarization of society, associated with the conflict between opposition supporters and an increasingly unpopular government. This political polarization has been exacerbated by a parallel socioeconomic divide between a small wealthy elite and a much larger population struggling with limited economic opportunity and declining purchasing power.

A final key characteristic of Armenia's transformation is rooted in what has now become an increasingly unsustainable economic system. More specifically, the vulnerability of the Armenian economy, despite its relative "incubation" due to closed borders and limited links with

the broader global economy, is associated with an inherent structural fragility. This in turn is composed of three elements: first, a dangerous dependence on the influx of remittances, or money from Armenians working abroad; second, a narrow reliance on the country's service and construction sectors as the main drivers of economic growth; and third, a closed "oligarchic" economic network centered on several informal commodity-based cartels or semi-monopolies.

For the Armenian government, a lack of legitimacy and low level of widespread popular support have further imperiled its attempts to overcome the combination of structural fragility, entrenched corruption and the influence of powerful business interests, known as oligarchs, who have extended their power and influence to the political arena. The political context over the past two years was also defined by the memory of tainted elections, which has accelerated the erosion of public trust and support. Moreover, much of the Armenian population has now grown accustomed to flawed elections, economic inequality and a lack of democratic governance. Over time, this has increasingly fostered apathy and cynicism among the population, which has disengaged from politics and is mistrustful even of real achievements of reform. Even the virtual "awakening" of the normally passive population during the tragic and violent post-election crisis of 2008 seemingly proved to be temporary. But the return of widespread apathy and public mistrust has emerged as one of the most significant obstacles to meaningful political change and economic development. And despite the passivity, simmering discontent, frustration and anger over mounting disparities of wealth and income in Armenia cannot be easily overlooked.

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

Transformation Status

I. Political Transformation

1 | Stateness

Bolstered by a powerful underlying element of ethnocentric nationalism within a highly homogenous society, the Armenian state has traditionally benefited from essentially unchallenged authority. The Armenian state holds a strong, well-established and unquestioned monopoly on violence that is affirmed both by the stability of civil-military relations and the general absence of private weapons or arms in the possession of private citizens or groups. The state's monopoly on the use of force is also strengthened by the professionalism of the country's armed forces, which are completely subordinate to civilian state control and oversight, and refrain from taking any direct role in politics.

Although the state's monopoly on the use of force faces no real threat of revolution or civil war, the potential for internal unrest or political instability has increased over the past two years. The police services have accumulated a record of abuse of power and excessive use of force against unarmed civilians. Moreover, there is a growing risk that fundamental socioeconomic discontent will emerge as a challenge to state authority, especially if popular demands for change and reform remain unmet and unaddressed.

In terms of state identity, there is a generally accepted consensus on the issue of citizenship, mainly stemming from the country's homogeneity and monoethnic society. There is little or no record of ethnic division or discrimination facing native, non-Armenian minorities (Kurds, Russians and some Jews). Similarly, several thousand foreign students, mainly from Iran and India, have also enjoyed relatively easy coexistence with both the Armenian state and its citizens. 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 have been some signs of a growing discrepancy in rights between certain groups, based both on political polarization between supporters of the

Question

Score

Monopoly on the use of force

9

State identity

9

opposition and government, and on a class basis, with widening divisions between a small wealthy commercial and political elite and the larger, more impoverished general population.

The dominant position of the Armenian Apostolic Church within Armenian society stems from two main factors. First, the church holds an informal but powerful relationship with the Armenian state, endowing the authorities with a degree of legitimacy and support. This legitimizing support has been especially helpful for the rather unpopular government, which has also sought to leverage the church's regard among the ordinary population as one of the "cleanest" and most respected institutions in Armenia. Formally, the state maintains a secular policy of separation between church and state, with religious dogma barred from taking any direct role in politics. 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. In these cases, the Armenian government has failed to enforce the separation of church and state effectively.

No interference of religious dogmas

9

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. The church has traditionally kept a distance from partisan politics, but a shift in this aspect has been seen in recent years. 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 cases of discrimination against non-traditional religious groups and sects such as the Jehovah's Witnesses. All formal churches and religious groups outside the Armenian Apostolic Church are required to register officially with the government, and proselytizing is forbidden by law.

In terms of basic administration, the Armenian system is fairly well-developed, with generally competent administrative structures operating on many levels of government. Despite a series of recent civil service reforms, corruption within administrative structures remains a serious challenge. Administration remains hindered by the legacy of Soviet-era practices, many of which are grossly inefficient and overly bureaucratic. Administration of justice functions reasonably well, although adjudication remains contingent on political, personal or financial interference. This is largely related to a fairly weak and arbitrary rule of law, matched by a flawed system of law enforcement and a sometimes checkered record of justice. This is primarily true in the less developed regions of the countryside, but incidents do take place in major cities as well. Similarly, the lack of an independent judiciary tends to weaken the efficacy of the state administrative bodies and fosters

Basic administration

7

a general public mistrust in the system. Other areas of administration in specific need of reform include customs and tax revenue monitoring and collection, water and electricity utilities, and health care providers.

2 | Political Participation

In terms of free and fair elections, Armenia's first election in the early 1990s was its best. But that first election was also the country's last free and fair balloting. Moreover, for much of the last decade, the Armenian population has grown accustomed to flawed elections, and has become increasingly disengaged from politics. Despite electoral and constitutional reforms over the past two years, the country's political system remains rigid and closed, and seriously impeded by entrenched corruption and political patronage.

Free and fair
elections

5

Overall, Armenia has continued to be defined by the legacy of a violent 2008 post-election crisis, although the government faces an increasingly weak and ineffective challenge from the opposition. Against this backdrop, the next round of parliamentary and presidential elections, respectively set for 2012 and 2013, will be measured by a higher standard amid raised expectations.

Despite fundamental flaws in the country's closed political system and the absence of free and fair elections, the Armenian authorities have normally held virtually unchallenged authority. But over the past two years, there has been a marked change, as the tainted presidential election of February 2008 sparked a serious crisis of confidence that has eroded confidence in the government, which now faces a further challenge in the form of public demands for change.

Effective power to
govern

2

However, the basic impediment to governmental power stems from within the regime itself, as authorities remain locked in a short-sighted defensive stance that sees dissent as a direct threat to the state rather than as characteristic of a healthy democracy. Most significantly, the past two years have also witnessed a fundamental shift in domestic politics, suggesting the start of a deeper and more profound political confrontation. This internal confrontation is especially significant because it is very different than the traditional clash between the authorities and the opposition. Rather, this political confrontation has been located within the ruling pro-government coalition itself, marked by a heated and increasingly public campaign by President Serzh Sarkisian and his ruling Republican Party against the country's second-largest party, Prosperous Armenia, which is widely seen as a political creation of Sarkisian's immediate predecessor, former President Robert Kocharian. But the clash is more than a rivalry between the former and current presidents, however, as other powerful political actors have been drawn into the contest. From this perspective, many see the most serious threat to Sarkisian

emanating not from former President Levon Ter-Petrosian or his opposition alliance, but from Kocharian, who has never ruled out a possible “return” to the political arena.

Through this period, Sarkisian has also stepped up efforts to consolidate his control over the Republican Party, which as the largest faction in parliament, serves as the foundation for his political power. But although the death of one of the party’s founders, former Prime Minister Andranik Markarian, allowed Sarkisian to assume the party’s leadership, many rank-and-file members and activists were never completely content with this turn of events. That undercurrent of discontent and mistrust, exacerbated by a core group of Markarian loyalists led by former parliamentary speaker Tigran Torosian, has plagued Sarkisian and tended to cast doubt on the loyalty and organizational reliability of the party as the president’s personal political power base.

Although Armenia has a vibrant civil society, comprised of a wide array of civic groups and non-governmental organizations (NGOs), the last two years have seen stricter limits on political groups and parties in terms of exercising the right to assemble freely. These restrictions on the freedoms of assembly and association were introduced in response to the post-election crisis of 2008, but have also reflected a deeper trend toward authoritarianism in the country that began well before the February 2008 election.

The Armenian government’s efforts to amend the laws regulating the registration and activities of non-governmental organizations (NGOs) have also triggered concern. In a statement issued in December 2010, Janez Lenarcic, director of the Organization for Security and Cooperation in Europe’s (OSCE) Office for Democratic Institutions and Human Rights (ODIHR), criticized the draft amendments as “heavily tilted in favor” of the authorities, for seeking “to strengthen the control of the state over public organizations,” and for imposing “additional burdens” on NGOs and civic groups. The critical assessment went on to warn that “some of the provisions are therefore difficult to justify, and are in tension with international standards and practices which even further buttresses the need for additional deliberations” with members of Armenian civil society.

Most notably, ODIHR expressed serious concern over two of the proposed amendments, one that would require Armenian NGOs to reregister with the Ministry of Justice in every case of an address or leadership change, and a second that would impose costly and complicated requirements for NGOs to disclose much more detailed information on their finances, membership and activities than was previously necessary. In response to the criticism, which included strong outcry

Association /
assembly rights
5

from some 150 civil society groups, the Armenian parliament temporarily suspended its plans to introduce the draft legislation, although it could reschedule consideration of the amendments at any time.

The noticeable decline in basic civil freedoms in recent years has been matched by efforts to constrain and restrain the Armenian media, leaving the sector increasingly subject to a troubling pattern of state control and intimidation. Over the last two years, the state has moved even more assertively against media organizations seen as being critical or even independent of the authorities. This has also encouraged a degree of self-censorship, in which the media has backed away from producing bolder journalism.

Freedom of
expression
4

In a broader context, the lingering domestic tension rooted in the unresolved post-election crisis of 2008 has been accompanied by political violence and intimidation that has targeted journalists as well as opposition supporters and activists.

Highlighting the trend of such violence against journalists, a prominent media law expert expressed concern in February 2010 over what he said was an attempt by the government to prepare for possible electoral irregularities during the next parliamentary election by advocating new legislation imposing serious restrictions on local journalists' work and activities. Mesrop Harutiunian, an expert affiliated with the Committee for the Protection of Freedom of Speech, noted the latest criticism issued by the New York-based Committee to Protect Journalists regarding the record of physical violence and attacks directed against journalists in Armenia. Pointing to specific shortcomings in the government's new amendments, the media expert went on to say that the "heavy fines proposed for libel and 'disparaging' reporting" would only encourage greater "self-censorship" among journalists, resulting in a fearful atmosphere in which "journalists will no longer be beaten, but will be summoned to court." There was also an economic aspect to the legal coercion as well, which Harutiunian attributed to the vulnerability of media outlets and newspapers to exorbitant fines, arguing that the "imposition of several heavy fines on a newspaper will make it go out of business."

3 | Rule of Law

In 2005, the adoption of several amendments to the Armenian constitution imposed new structural curbs on the powers of the president, while enhancing the authority of both the legislature and judiciary. But despite these enhancements, the executive branch retains a dominant position over the other branches of government, with control over nearly all the main instruments of state power. The lack of any effective "checks and balances" or a separation of powers remains one of the most serious impediments to Armenia's democratic transformation.

Separation of
powers
4

In the face of a dominant presidency, with the executive branch remaining unquestionably the strongest branch of government, the judiciary can best be described as overly compliant with the demands of the executive. Officially, an independent judiciary branch does exist in Armenia, but it is still largely subordinate to the executive branch, and its effectiveness is undermined by widespread corruption and general incompetence.

Independent
judiciary
4

Abuse of power among Armenian officials remains rampant and unchecked. Reflected in the authorities' rather crude "arrogance of power," such abuse manifests partly as entrenched corruption within state institutions. Over the past two years, however, there were several cases in which policemen and other mid- to low-level state officials were dismissed or arrested for corruption, suggesting at least an attempt to reign in the more flagrant abuses of office.

Prosecution of
office abuse
5

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, successive incidents of the state's blatant violation of civil rights, largely in terms of political incidents, have reaffirmed the need for proper oversight by an independent judiciary. The sole positive step has been the institution of the human rights ombudsman, which has actively challenged the state's inability to protect and even active violation of civil liberties.

Civil rights
6

The lack of any real accountability for the abuses and excessive force by the police and security forces during the 2008 electoral crisis, as well as the dubious judicial processes and questionable investigations subsequently conducted by the authorities, has exacerbated a public climate of fear. This has been compounded by the fact that more than 40 opposition supporters and activists were detained and later convicted on the questionable charge of organizing "mass disturbances" related to the March 2008 clashes. Disturbingly, most of these verdicts were based on incriminating testimony given by police officers or witnesses who later recanted their testimony on the grounds that they were coerced or coached by police and prosecutors into making false allegations.

4 | Stability of Democratic Institutions

Armenia's institutions are generally underperforming, which reflects their lack both of true democracy and their inherent weakness in institutional terms. Each of these factors is compounded by a lack of legitimacy and of popular electoral mandate. Over the past two years, the most notable deficiencies have been the subservience of the judiciary and the ineffective nature of the parliament, neither of which has acted as a true check or balance on an overly strong executive branch.

Performance of
democratic
institutions
3

Armenia's commitment to democratic institutions is limited and largely superficial. However, over the past two years, a new challenge to the state has emerged as a polarized stalemate between the unpopular government and a newly unified opposition movement has resulted in new pressure for real change. More crucially, the deeper flaws in the political system itself, most 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.

Commitment to
democratic
institutions
3

5 | Political and Social Integration

The review period was marked by a further deepening of the existing party system. Although this has brought a degree of stability, it has also contributed to a static and limited political discourse defined by narrower parameters. There are also a large number of parties that are officially registered but largely inactive. The core deficiency in the party system is the fact that most main political parties lack ideological grounding or political platforms, and are instead defined by the personality or personal appeal of one or two of their prominent leaders.

Party system
6

The one exception is the country's sole opposition party, the Heritage Party, which represents a "constructive opposition" and is actively engaged in a broader effort to elevate political discourse by challenging the government on a higher plane of public policy. Unlike the opposition movement led by Ter-Petrosian, which remains more marginalized outside the parameters of the political system, the Heritage Party has sought to leverage its position within political institutions such as the parliament and the Central Election Commission to forcefully challenge and confront the government. Yet even this sole opposition party has been plagued by internal weakness, and due to its small size (seven deputies within the 131-seat parliament), has been marginal in terms of influencing legislation or public policy.

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

Interest groups
6

Although no reliable survey data is available, the overwhelming majority of the population seems in principle to be strongly committed to democratic norms and procedures. This tendency has remained stable despite widespread political apathy, the frustration from the flawed 2008 presidential election and growing disillusionment associated with the slow recent pace of democratization. Despite the evident political shortcomings, public opinion ironically seems more committed to

Approval of
democracy
n/a

the constitutional system than most of the political parties. However, this confidence in and approval of democracy as a system does not translate into public faith or trust in specific Armenian institutions.

Given the country's vibrant and dynamic level of civic activism, social capital has been an increasingly significant factor in the last two years of Armenia's transformation. But it remains to be seen whether social capital can play a more effective role within the closed political and economic system that has become entrenched in Armenian society.

Social capital
6

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Although the record of economic reform in recent years has been fairly impressive, most assessments of the Armenian economy concentrate exclusively on the country's statistical record of double-digit economic growth and the gradual, yet consistent, decline in overall national poverty. However, widening disparities in wealth and income have led to a serious socioeconomic divide.

Socioeconomic
barriers
4

For the past two years, structural weaknesses have hindered the Armenian economy. These weaknesses have ranged from a steep decline in the inflow of remittances to a dramatic fall in economic activity, culminating in negative GDP growth. Negative developments have included increasing social pressure driven by rising costs for basic goods and energy. One notable example was the sudden upsurge in the price of lamb, driven by a sharp rise in exports of Armenian sheep to Iran. This has resulted in a tripling of the retail price for lamb since May 2009.

The serious socioeconomic divide also has a rural-urban geographic aspect, marked by an overconcentration 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 the countries' outlying rural areas.

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	9206.3	11662.0	8648.0	9371.2
GDP growth	%	13.7	6.9	-14.1	2.1
Inflation (CPI)	%	4.4	8.9	3.4	8.2
Unemployment	%	28.4	28.6	-	-
Foreign direct investment	% of GDP	7.6	8.0	9.0	6.1
Export growth	%	-3.5	-13.1	-10.4	21.7
Import growth	%	13.0	7.3	-19.2	13.8
Current account balance	\$ mn.	-589.6	-1382.8	-1369.5	-1373.2
Public debt	% of GDP	16.1	16.2	40.6	39.4
External debt	\$ mn.	2898.1	3405.8	4885.5	6102.9
Total debt service	\$ mn.	189.0	365.3	423.3	967.7
Cash surplus or deficit	% of GDP	-0.6	-0.5	-7.5	-
Tax revenue	% of GDP	16.0	17.3	16.5	-
Government consumption	% of GDP	10.2	10.2	13.3	13.1
Public expnd. on edu.	% of GDP	3.0	-	-	-
Public expnd. on health	% of GDP	3.9	3.8	4.7	-
R&D expenditure	% of GDP	0.21	-	-	-
Military expenditure	% of GDP	3.0	3.4	4.2	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

7 | Organization of the Market and Competition

Over the last two years, 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. Armenia is consistently rated as having one of the most “open” economies among the former states of the Soviet Union, and it is praised for its positive trade and investment policies as well as its lack of restrictions on capital. However, over the longer term,

Market-based
competition

7

the country will face a serious problem related to the powerful influence of several commodity-based cartels and monopolies that restrict free trade and market-based competition.

Commodity-based cartels and monopolies pose a potentially serious problem for the country's economic development. In February 2010, the annual report of the European Bank for Reconstruction and Development (EBRD) called for a more effective application of anti-monopoly mechanisms, as well as for reduced administrative costs for small and medium-sized enterprises.

Anti-monopoly
policy
4

Despite having one of the most advanced regulatory systems among the former Soviet states, Armenia still needs to improve transparency. As things now stand, Armenia lacks the necessary combination of critical laws and effective enforcement, particularly in the area of anti-monopoly and anti-trust laws. This weakness is exacerbated by excessive state control over some key sectors of the economy.

The main challenge is to address state officials' vested economic interests. In late 2009, Prime Minister Tigran Sarkisian complained that existing laws made it nearly impossible to expose and punish officials who maintained extensive and illegal business interests. Such concerns were also shared by the then-head of the World Bank in Yerevan, Aristomene Varoudakis, who reiterated calls for the authorities to improve the country's business environment, break up "oligopolies" and tackle corruption. Speaking at a press conference in December 2009, he noted that it "requires political will to make the links that exist between some of the oligopolies and some public officials transparent, and to eliminate the situations of conflict of interest that currently exist."

Armenia has been a WTO member since 2002. Despite its liberalized trade regime, the country has several very serious economic vulnerabilities. Closed borders and limited links to the broader global economy produce 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 distressing – the closed "oligarchic" economic network centered on several informal commodity-based cartels and semi-monopolies. However, in the period under review, Armenia made cross-border trade easier by introducing self-declaration desks at customs houses and by improving border operations.

Liberalization of
foreign trade
9

For the past two years, the Armenian banking system has stood out as the sector most in need of reform and development. The banking and financial-services sectors are fundamentally limited by the small size of the country's financial sector (e.g., total assets are still well below 20% of GDP), the infancy of capital markets,

Banking system
6

and the need for greater transparency and regulation. Although there have been some advances in terms of strengthening creditor rights, improving banking supervision and increasing minimum capital requirements for existing banks (from \$2 million to \$5 million), there is still a lack of adequate corporate governance. However, there are plans for reform measures aimed at redefining and separating the duties and rights of bank shareholders, boards of directors and executives, as well as at enhancing creditors' rights by improving the efficacy of court procedures and strengthening the registration system for secured lending.

This need for reform notwithstanding, the banking sector has shown remarkable stability during the financial crises. The ratio of non-performing loans has increased only slightly, from 4.4% (2008) to 5% (2010), reaching a short-lived peak of 11% in 2009. The banking sector's capital-to assets-ratio has remained stable at a high level. The non-bank financial sector remains largely undeveloped.

8 | Currency and Price Stability

Although Armenia's central bank has strictly adhered to a policy of fiscal discipline, and has followed prudent monetary policies aimed at ensuring macroeconomic stability, some unresolved problems persist. Driven by stronger economic activity, money demand has steadily increased, and a flexible exchange rate regime has been important for mitigating the adverse impact of external shocks. Over the past two years, appreciation of the national currency (the dram) has raised questions about how appropriate it was for the state to intervene in supporting the currency's value well beyond normal market considerations. This move has resulted in an appreciation of the dram by more than one-third in nominal terms against both the euro and the U.S. dollar, which has weakened external competitiveness and seriously impacted a large segment of the population relying on dollar-denominated remittances for basic living expenses.

In the past two years, Armenia has suffered one of the world's most dramatic economic declines, with GDP falling by 14.4% in 2009. In the best-case scenario of an upturn, the World Bank and International Monetary Fund (IMF) project a meager GDP increase of 3% in 2011. Armenia's economic downturn has also been exacerbated by a sharp fall in the level of remittances and a 30% decline in foreign direct investment. Investment in Armenia from Russia alone, Armenia's leading foreign investor, declined by about 70% through the end of 2009 as compared to the previous year.

In response to the crisis, Armenian officials have turned to foreign lenders who provided \$1.3 billion in emergency financing; resorted to sharp cuts in state spending; and introduced measures aimed at stimulating the domestic economy, including controversial loan guarantees of some AMD 20 billion (\$52 million)

Anti-inflation /
forex policy

8

Macrostability

6

made primarily available to state-connected construction firms. As a result, however, Armenia's level of foreign debt in 2009 spiked to about \$3 billion, or roughly 37% of GDP, and was projected to rise to between 46% and 50% of GDP by 2010. The dramatic increase in the country's foreign debt poses a new structural challenge, especially as the debt-to-GDP ratio stood at a much more manageable 13% in 2008.

Also raising warning signs was the December 2010 announcement by Prime Minister Sarkisian that Armenia intends to seek another \$500 million in new loans from a special \$9 billion anti-crisis fund set up by Russia and the Eurasian Economic Community (Eurasec). The new loan will be used to finance infrastructure projects in the energy and industrial chemical sectors, most of which are owned or controlled outright by Russian firms. Armenia already received more than \$1.3 billion in external loans from Russia, the International Monetary Fund (IMF), the World Bank and other multilateral institutions in 2010 alone. Ironically, the prime minister also defended the government's response to the crisis, claiming that Armenia has already begun to emerge from the economic slump with "minimal losses."

For its part, the Armenian parliament addressed the economic crisis by adopting a new state budget in December 2010 that actually boosted spending for the coming year. The 2010 budget set expenditures at AMD 935.5 billion (\$2.44 billion) and revenues at AMD 742 billion, representing a budget deficit of about 6% of GDP. The boost in planned spending is almost 9% higher than that contained in the initial draft budget. Defense spending holds the priority position in the revised budget, with a target of AMD 131 billion for 2010. But even that amount is less than the AMD 149.6 billion in defense spending for 2009.

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 this was marred by incidents of privileged control and corrupt practices, partially undermining the efficacy of the overall privatization program. The government has continued to make progress by reducing state interference in business formation and strengthening property rights.

Property rights
8

Armenia has a flourishing private sector that has expanded further over the last two years. The government has recognized the role of the private sector as the engine driving sustained growth, and has improved the business environment by reducing regulations, improving the bankruptcy law and the administration of customs, and

Private enterprise
8

strengthening the banking system. However, burdensome bureaucratic procedures still tend to hamper private-sector commerce.

10 | Welfare Regime

Although the state provides the basic elements of a social safety net, the general overdependence on external remittances and the serious appreciation in the national currency's value (which by extension lowered the exchange value of the dollar, the euro and the ruble, the most common currencies used for remittances) have reduced the value and adequacy of the social safety net for most families. Structurally, social assistance in Armenia is based on the provision of limited cash benefits (based on a system of targeting along regional, community and indicator lines) as well as some limited state subsidies for energy (e.g., the "lifeline" utility tariffs). Social insurance (e.g., unemployment and pension pay) are both flat-rate benefits.

Social safety nets

6

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 economic crisis in Russia has exacerbated the lack of economic opportunity.

Equal opportunity

5

11 | Economic Performance

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

Output strength

5

During the period currently under review, however, Armenia was plagued by the fallout from the country's economic crisis, with structural deficiencies still unaddressed. Economic problems have become even more firmly entrenched, following several months of declining economic activity, continued declines in remittances and foreign investment, and systemic shortcomings in tax revenues. Armenia suffered one of the world's most dramatic economic declines, with GDP falling by a staggering 15.6% in 2009, according to the IMF and World Bank.

In terms of economic policy, the decline in GDP also poses a challenge to the government's commitment to a "second generation" of economic reform. The

government's policy response to the economic crisis, generally limited to an overemphasis on seeking external lending, was of questionable value. Although over the short term, the roughly \$1.3 billion in new loans has allowed the government to meet its planned spending and budget commitments, the combination of mounting debt, inefficient tax collection and a downturn in exports has served to exacerbate the economic crisis over the longer term. Armenia's foreign debt, estimated at a total of \$3 billion or roughly 37% of GDP for 2009, rose to between 46% and 50% of GDP in 2010.

12 | Sustainability

Over the last two years, environmental considerations have been increasingly taken into account as part of the government's overall reform program. The government has identified specific concerns relating to overexploitation of natural resources, including the depletion of water resources, soil erosion and the loss of biodiversity, for example. 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 recognition, the trend has been toward policies promoting growth rather than policies of conservation.

Environmental
policy

6

Armenia has three main challenges in developing its education and R&D sectors: an inability to sustain adequate levels investment and state spending, aging facilities, and the severe effects of the country's "brain drain" during the early to mid-1990s. The decline in state investment in education has predictably led to a decline in the overall quality of education. Nevertheless, Armenia has succeeded in maintaining its system of universal basic and secondary education. Enrollment rates at both levels remain high, and over 99% of the population is literate.

Education policy /
R&D

5

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 communication technologies (ICT), life sciences, food security and quality, environment and energy, and nanotechnology. The information technology sector has also attracted some investment and continues to serve as a strategic priority for the state.

Transformation Management

I. Level of Difficulty

Since the collapse of the Soviet Union, independent 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 has 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 overall, it is the lack of overall good governance that remains the most fundamental obstacle to political and economic transformation.

Structural
constraints
6

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. Entrenched corruption and incomplete reform now threaten the economic system itself, rendering its ability to sustain itself in the face of mounting challenges questionable.

The influence of Armenian civil society is generally constrained by the state's failure to engage it in constructive dialogue 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. While there has been continued progress in both the number and activities of civil society groups, with a greater breadth of civic and non-governmental organizations (NGOs) dealing with a wide range of issues, only a handful of these operate with any consistency.

Civil society
traditions
5

The post-election crisis in Armenia, after the wave of demonstrations and public protests over the presidential election, clearly sparked two specific trends for civil society. First, the fundamental underlying reasons for the post-election crisis (beyond the tainted presidential elections) remain unresolved and unaddressed. Further, simmering tensions and brewing discontent has made civil society more assertive and bolder. Second, the post-election crisis has moved beyond the initial stage, and over the last two years, has led to steadily growing levels of activism and expectations for change and reform. This has been bolstered by the growing level of

public discontent, frustration and anger over the mounting inequalities and disparities in wealth and power.

Internally, there is no real evidence of ethnic, religious or social conflict. Yet over the last two years, 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 at least in part rooted in the opaque nature of the Armenian political system, where dissent is seen as a direct threat to the state rather than as characteristic of a healthy democracy. Within such a closed political system, there is no mechanism for expressing political discontent, a lack that exacerbates underlying tensions.

Conflict intensity
3

II. Management Performance

14 | Steering Capability

Although not as outwardly visible as the ruling elite, a new, wealthy political elite, the so-called oligarchs, have managed to secure a sizeable number of seats in the Armenian parliament. They represent a convergence between corporate, state, and in some cases even criminal interests. In addition to gaining serious influence over the formulation of public policy and garnering substantial leverage over the course of governmental policies, this new oligarchic elite has come to embody the difference between the power to rule and the responsibility to govern.

Already weakened by a pronounced lack of legitimacy and a prolonged political crisis of confidence, the Armenian government is facing a new challenge associated with the global financial and economic crisis. Against this backdrop, the current government faces a number of external challenges, ranging from a decline in remittances from Armenians working abroad to an economic downturn that seems to be getting worse.

However, the set of unique problems associated with the country's economic distortions are even more destructive for Armenia's long-term economic health. These internal problems include deficiencies in tax collection, an inadequate customs regime, an artificial bubble in the real estate market and insufficient job creation. Still deeper danger stems from structural shortcomings, with economic growth reliant on limited sectors such as the service industry or diamond polishing,

Question
Score

Prioritization
5

for example, and economic survival dependent on money coming into the country from abroad.

Nevertheless, the Armenian government has demonstrated the capacity to formulate, adopt and implement a political strategy. This has been most evident in terms of rural development, as well as early efforts at customs, tax and pension reform, each reflecting difficult political decisions.

Although Armenia has established the basic framework for a modern market economy and has demonstrated sound macroeconomic policy-making, the sustainability of these previous achievements now depends on carrying out the next generation of reform. If sustainability is to be attained, a greater degree of political commitment to the implementation of these reforms must be shown, with the government demonstrating it can withstand short-term political tendencies and temptations in pursuit of strategic economic development and reform. The two areas most glaringly in need of further reform are the banking sector and the social sector, each of which demands policies designed to correct the widening disparities of income and wealth. Also critical are improvements in the judicial sector that would foster greater efficiency and effectiveness in enforcing contracts and regulating commerce.

Implementation
5

One of the most startling lessons of the past two years is the fact that the Armenian state can no longer maintain the current economic system. 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. Faced with an already apparent shortage of political legitimacy, the Armenian state can no longer sustain the closed economic system that has deformed and distorted the country in recent years.

Policy learning
4

15 | Resource Efficiency

Although the Armenian government has developed a fairly effective resource base and has made some gains over the past two years from 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 meritocratic advancement. Positions and benefits have flowed to those with connections, and an inadequate pay scale has fostered a greater cronyism that limits the state's ability to utilize its resources effectively.

Efficient use of
assets
6

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 the onset of serious external economic pressure. For the Armenian authorities, the past two years have only reaffirmed the overwhelming need for "good governance," including aspects such as transparency,

Policy
coordination
5

ethics, accountability and competent administration. These prerequisites are notably lacking today, exacerbating the danger of the fresh crisis.

Shortcomings in Armenia's anti-corruption policies have been most clearly demonstrated by the powerful role of Armenia's small wealthy political elite, the so-called oligarchs, who exercise not only commercial and economic power through commodity-based cartels and virtual monopolies, but who have also acquired political power after becoming parliamentary deputies. Left unchecked, their corruption-originating wealth and political power only threatens democratization and the rule of law, and allows them to further consolidate and protect their informal networks of power.

However, the review period witnessed a new recognition of the need for more effective, highly prioritized anti-corruption measures. In late January 2010, President Serzh Sarkisian ordered the parliamentary oversight body, the Audit Chamber, to "work more actively" with law enforcement to prosecute state officials suspected of embezzling public funds or of engaging in other corrupt practices. The president also directed the head of the body, Ishkhan Zakarian, to ensure the Audit Chamber was able to "resist pressure" from corrupt officials. For his part, Zakarian reported that the Audit Chamber had already carried out full "inspections" of most ministries and state bodies, and had formally reported 21 criminal cases of embezzlement. Zakarian further noted that the body's investigatory work had succeeded in returning some \$3 million (about AMD 1.13 billion) in "embezzled or wasted public funds" to the state budget in 2008 and was currently "recovering money allegedly misused" in 2009. President Sarkisian has already openly admitted that the lack of prosecution for state-related corruption has undermined public trust in state institutions and threatened the efficacy and integrity of his government's official anti-corruption campaign.

Anti-corruption
policy

5

16 | Consensus-Building

While the need for consensus in Armenia is greater than ever before, the widening political polarization, characterized by a newly united political opposition and an increasingly unpopular government, makes such consensus ever more unlikely. The authorities' capability to forge even the most basic consensus is further challenged by the socioeconomic divide between the country's small wealthy oligarchic elite and a much larger population that has limited economic opportunity and even less political power.

Consensus on goals

6

Although there are no real “anti-democratic” actors present in the country, a power competition is underway between political and economic elites. This struggle may devolve or expand to include some new form of actor capable of confronting the reformers outside the confines of the existing system.

Anti-democratic
actors
6

Over the last two years, Armenia has slipped into an unresolved political crisis rooted in a polarized deadlock between the authorities and the opposition. The deadlock is driven by an unpopular government that stubbornly 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 and absence of any popular mandate have exacerbated its tendency to favor authoritarian rule over accountable governance, and it has retained a myopic view that sees dissent only as a direct challenge to its authority. Similarly, the opposition movement, which is united behind a broad but disparate coalition led by former President Levon Ter-Petrosian, has voiced a strident criticism of the government while offering little in the way of real alternatives.

Cleavage /
conflict
management
3

In the wake of a domestic political crisis, the Armenian state has become even more resolute in refusing to engage civil society. This position is also rooted in the opaque nature of the Armenian political system, where dissent is seen as a direct threat to the state rather than as a characteristic of healthy democracy. The government does not overtly block or impede civil society organizations, but offers no avenue enabling them to work within the system. Within such a closed political system, there is little mechanism for expressing political discontent, a fact that exacerbates underlying tensions.

Civil society
participation
3

In the absence of any attempt to forge a new national dialogue, reconciliation remains unlikely. But with neither the authorities nor the opposition seeking to enter into a dialogue, the political crisis will most likely remain unresolved, and will likely therefore continue. But this ongoing polarization may ultimately reach a point of stalemate that demands reconciliation capable of forging unprecedented change.

Reconciliation
4

17 | International Cooperation

Over the last two years, Armenia has continued to use outside support and sustain its record of international cooperation, stemming from its economic ties with international institutions and the nation’s diaspora community. It has been a leading recipient of foreign assistance. Yet at the same time, Armenia has faced new difficulty in overcoming the link between domestic political instability and economics. This was further demonstrated by the December 2008 decision by the U.S. Millennium Challenge Corporation (MCC) to maintain its suspension of \$236.5 million in economic assistance on the grounds that the Armenian

Effective use of
support
7

government has failed to address its concerns about “the status of democratic governance” in the country. The decision followed a similar move in May 2008, when the latest installment in the five-year Millennium Challenge Account (MCA) program was frozen in the wake of Armenia’s post-election political crisis.

The onset of the economic crisis spurred the Armenian government to seek increased amounts of external lending. While in the short term, the country’s roughly \$1.3 billion in new loans has allowed the government to sustain its spending plans and meet its budget commitments, the severity of mounting debt, inefficient tax collection and the sharp downturn in exports have only exacerbated the economic crisis over the longer term. Armenia’s foreign debt, estimated at a total of \$3 billion or roughly 37% of GDP for 2009, is projected to rise to between 46% and 50% of GDP by 2010. In addition, Armenia has been hurt by a serious decline in the amount of remittances received from abroad, and by a 30% decline in foreign direct investment (FDI) levels.

Although Armenia’s credibility suffered a serious blow from its handling of the post-election crisis in 2008, it has managed to secure some help in meeting the global economic crisis. In January 2009, the country was able to persuade the World Bank to more than double its low-interest loans to Armenia over the 2009 – 2012 period, from \$220 million to at least \$525 million. In addition, Armenia has also turned to Russia for help, securing a \$500 million “stabilization credit” earmarked for helping the country surmount the initial impact of the global crisis. Such external aid is not a cure-all for Armenia’s economic woes, however. For one, the funding is to be used to support the Armenian government’s ambitious plans for infrastructure projects, and to offer small- and medium-sized businesses greater and more favorable access to credit from Armenian commercial banks. The problem is that the jobs from the infrastructure projects will not be available for at least several months, offering little assistance to people in need of immediate help. With Armenian laborers already returning to Armenia from Russia, the number of unemployed workers competing for those new temporary jobs will be very high.

Credibility

7

In terms of cooperation with neighboring countries and regional organizations, there has been no real change in the last two years. Although Armenia seeks greater cooperation, seeking to overcome the effects of external isolation and a blockade that is particularly damaging for the landlocked country, the unresolved Nagorno-Karabakh conflict has led to frozen relations with both Azerbaijan and Turkey. Armenia faces further isolation as a result, and needs a normalization and restoration of regional trade and transport links. A new degree of hope has emerged in the form of a breakthrough in Armenian-Turkish relations, which if successful may result in the opening of the long-closed border between the two countries.

Regional cooperation

7

During the review period, the Armenian government was able to strengthen its anti-crisis stimulus response with the announcement of a \$120 million road construction

program, with some links to a broader regional development plan. The new construction, part of a massive eight-year, \$962 million project funded by the Asian Development Bank (ADB), will modernize the country's main highways and other transportation arteries connecting Armenia to neighboring Iran and Georgia. The ADB project will also repair and expand the road network running from the Armenian-Iranian border to one of the two main Armenian-Georgian border crossings. As a supplemental part of the project, the ADB is also providing another \$500 million in funding to complete ongoing road construction in southern Georgia and along Georgia's Black Sea coast, making improvements that are intended to shorten travel time substantially between Armenia and the Georgian Black Sea ports. Armenian officials also hope to leverage this new infrastructure project to attract greater volumes of cargo and freight from Iran, using Armenian territory as a transshipment hub to reach Georgian ports and European markets.

Strategic Outlook

Although more than three years have passed since the eruption of a significant political crisis in Armenia, the outlook for long-term stability seems as bleak as ever. Although triggered by a flawed election in February 2008, the country's domestic political crisis remains far from resolved today. Lingering discontent amid a population that has lost a degree of apathy, along with the government's lack of legitimacy, has led to a serious crisis of confidence that has magnified the country's already pronounced deficit of democracy. But the political crisis of the last year is only a symptom of a much deeper and more troubling impediment to democratic reform in Armenia.

Specifically, Armenia's unresolved political crisis stems from a polarized stalemate driven by a deadlock between the authorities and the opposition. This deadlock is largely driven by an unpopular government that stubbornly refuses to recognize the country's new political reality, and an opposition movement that seems devoid of clear policy alternatives.

But the roots of that anger and frustration lie not only in electoral politics or the sense of being denied a political voice. The eruption of public anger and outrage was equally attributable to years of widening disparities in wealth and income, and a pronounced lack of economic opportunity or even hope for the future. The division between the small wealthy oligarchic elite and the much larger, much poorer general population is all too obvious, seen every day, everywhere and in every way.

This economic undercurrent of discontent is increasing, especially as Armenian authorities now face the effects of the global financial and economic crisis. Although the record of economic reform in recent years has been fairly impressive, it is not enough to save the situation, as one of the more negative aspects of Armenia's economic reality is the "paradox" of inequitable economic growth, whereby several years of double-digit economic growth have resulted in an uneven rise in wealth and living standards. Widening disparities in wealth and income have led to a serious socioeconomic divide.

The most serious obstacle facing Armenia's democratic development is rooted less in either the authoritarian government or the marginalized opposition than in the political system's structural deficiencies. The government's lack of legitimacy and the absence of a popular mandate have revealed deeper flaws in the political system itself, including the weak rule of law, a compliant judiciary and an ineffective parliament. Most crucially, these structural flaws demonstrate 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. This also means that the only viable avenue toward true sustainable democratic development is through reforms that force open the country's closed political system.

In order to make lasting gains in Armenia's political and economic transformation, the internal threats to statehood must be overcome. Leaders must be found who govern rather than simply ruling, and the "cancer of corruption" must be defeated. Legitimacy is a key determinant of durable security and stability, and the strategic reality of the region is defined less by geopolitics, and more by local politics and economics. But most crucial is the lesson that institutions matter more than individuals for real democratization.

The period under review did see some new signs of optimism. Only weeks before Armenia's traditional week-long New Year holiday in 2010 – 2011, Armenian President Serzh Sarkisian surprised many by instituting a significant cabinet reshuffle. The surprise announcement of a reshuffling of three key ministries (economics, finance and justice) followed the firing of the mayor of Yerevan, the Armenian capital, and the gradual introduction of an amnesty for a group of 10 opposition activists detained during the country's March 2008 post-election crisis. With rumors of even more officials set to be dismissed, President Sarkisian also formally pledged in a rare weekend speech in December 2010 to "democratize Armenia's political system" and called for a "civilized dialogue" among all political parties and groups.

After securing the unanimous backing of his ruling Republican Party, Armenian President Serzh Sarkisian dismissed Economy Minister Nerses Yeritsian, appointing Finance Minister Tigran Davtian as his successor, and named Armenian central bank official Vache Gabrielian as the new finance minister. Party leaders also endorsed the president's choice of Hrair Tovmasian as the new justice minister, filling a position that had remained vacant since early December 2010 after Gevorg Danielian was fired for what the government described as his "failure to punish" a senior subordinate allegedly involved in "violent and abusive conduct" (although as of the time of writing, that lesser official had not yet been dismissed or reprimanded).

The appointment of the new justice minister was widely welcomed, as Tovmasian is recognized as a prominent expert on constitutional law and has been outspoken in his calls for deeper reform and the need to strengthen the rule of law in Armenia. In another move, the ruling party also approved the president's selection of Karen Karapetian, the current chief executive of the Armenian-Russian gas distribution company ArmRosGazprom, as the party's candidate for the position of Yerevan mayor. During the May 2009 Yerevan municipal election, the 47-year-old Karapetian was fifth on the Republican Party's official ticket during the May 2009 municipal elections, but subsequently refrained from assuming his seat on the 65-seat Yerevan city council (known as the Council of Elders). In a 17 December 2010 vote by the Council of Elders, Karapetian was duly elected, replacing Gagik Beglarian, who was forced to resign on December 8, after a scandal involving an alleged assault of a presidential administration official.

More signs of political opening followed the personnel changes, and in a December 2010 speech during the celebration marking the 20th anniversary of the founding of the Republican Party, President Sarkisian warned that the current political situation could lead to "stagnation" without a "deepening of democracy" and the "consistent introduction of European standards into all spheres of our state, public and economic life." The president called for the introduction of

“European-style democracy and the rule of law” as a basic “requirement of society,” adding that “European rules of the game” must prevail.

Signaling a new political opening, President Sarkisian also praised some elements of the Armenian opposition for “honestly” criticizing the government, stating that “we respect such forces” and noting that “their word carries a lot of weight in the elaboration of our programs.” Although implicitly referring to the opposition Armenian Revolutionary Federation (ARF-Dashnaktsutiun) and the Heritage (Zharangutiun) party, the president was harshly critical of the Armenian National Congress, an opposition alliance led by former President Levon Ter-Petrosian, for its partisan and “unconstructive” approach. Nevertheless, the speech suggests a new political opening by the authorities, confirmed by the introduction of a gradual amnesty for 10 of the country’s 12 opposition activists and supporters (defined by some as “political prisoners” based on the political nature of their charges) detained during the country’s March 2008 post-election crisis.

Clearly, the Armenian president’s recent moves to implement an amnesty for opposition detainees, dismiss the Yerevan mayor and shake up the cabinet represent a significant step forward. Moreover, these moves suggest a new sense of political will, offering new hope that the government seeks to move beyond the political parameters of the March 2008 post-election crisis that have hindered Sarkisian since his inauguration. At the time of writing, it seemed quite likely that additional dismissals were coming, with signs that several other cabinet-level officials (the ministers of agriculture and health, as well as the national police chief, etc.) would be replaced within the coming weeks.

The president was also able to further strengthen his position by forging a new coalition agreement on February 17, whereby the Republican Party garnered a pledge of support from the Prosperous Armenia and Orinats Yerkir parties, all three vowing to campaign for the incumbent president’s reelection in 2013. That coalition agreement also stated that the three parties would not seek to change “the correlation of forces within the coalition” in the May 2012 parliamentary election. With the coalition enjoying effective control of more than 100 seats in the 131-seat parliament, this new agreement was criticized by the opposition as a move to predetermine the election outcome and weaken the opposition within parliament. Several deputies from the opposition Heritage party walked out of a February 28 parliamentary session of parliament after accusing the president of using the coalition agreement as an “unconstitutional” means to prolong his rule illegally.

Most notably, these moves also hint that the president may call early parliamentary elections in the coming year, in order to consolidate his power and position more fully prior to the 2013 presidential election, and further distance himself from his lingering lack of legitimacy stemming from the 2008 post-election crisis. But with a massive rally attended by between 30,000 and 40,000 demonstrators, timed with the third anniversary of the March 1, 2008 violence, former President Levon Ter-Petrosian reignited the opposition’s strident challenge to the president. Ter-Petrosian presented a 13-point ultimatum to the authorities demanding the release of all remaining opposition supporters still in detention, advocating a new, independent inquiry into

the bloodshed associated with the post-election violence of 2008, and calling for the firing of several high-ranking state officials, including Prime Minister Tigran Sarkisian. Clearly, with simmering tension within the ruling coalition and mounting pressure from the opposition, the Armenian government will face a heated and tense period prior to the country's next round of elections.