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I. INTRODUCTION

Since the breakup of the Soviet Union in 1991, Armenia, a member of the Commonwealth of Independent States (CIS),[1] has progressively developed into a force in the Transcaucasus region. As of September 23, 1991, Armenia transformed into a democracy and has implemented sweeping economic reforms to spur its weak economy.[2]

Plagued by war with Azerbaijan over the disputed region of Nagorno-Karabakh and ravaged by a devastating earthquake in 1988, Armenia was faced with a crumbling infrastructure, limited natural resources, and weak agricultural and industrial bases.[3] As the war intensified, Azerbaijan and Turkey imposed an economic blockade against Armenia, allowing little or no fuel to enter the country.[4] Nevertheless, on September 23, 1991, Armenia declared its independence and shortly thereafter elected its first democratically-elected President, Levon Ter-Petrossian.[5] He instituted agricultural and enterprise privatization reforms,

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1. THE EUROPA WORLD YEAR BOOK 1998, at 434 (1998).
2. *Id.* at 434, 437.
3. *See id.* at 433–34.
4. *See id.* at 434.
5. *Id.*

introduced a new currency, reformed banking laws, and enacted foreign investment laws to facilitate foreign direct investment.[6] In addition, Armenia entered into investment treaties with the United States, France, and the European Union.[7] To alleviate the energy crisis resulting from the Azeri economic blockade, Armenia constructed a gas pipeline to import gas from Russia and Turkmenistan.[8]

Despite this economic reform, Armenia continues to face many problems, notably political unrest stemming from the Prime Minister's recent assassination. The assassination greatly diminished foreign investment into Armenia, thereby exacerbating Armenia's social welfare problems. In addition, investors remain wary of investment in Armenia because of its fragile cease-fire with Azerbaijan and corrupt business practices. During the coming years, Armenia must remain committed to market-based reforms, encourage and safeguard foreign investment, and institute more public sector improvements.

Part II of this Article details the political and economic factors that preceded the development of privatization and foreign direct investment in Armenia. Part III focuses on the reforms Armenia has undertaken to improve its economic stability. These reforms include privatization, currency and banking legislation, and investment treaties. This Article concludes by analyzing the future challenges faced by Armenia's economy.

II. ARMENIA'S POLITICAL AND ECONOMIC INSTABILITY

A. *Political Instability*

An analysis of the political and economic factors preceding privatization and foreign direct investment is necessary in order to understand the development of these concepts in Armenia. Following the coup in the former Soviet Union, Armenia joined its fellow neighbors by declaring independence on September 23, 1991.[9] A month later, Levon Ter-Petrossian became Armenia's

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6. *Id.* at 437.

7. *See* discussion *infra* Part III.C.

8. *See* MINISTRY OF ECON. (FOREIGN INV. DEP'T), ARMENIA: FOREIGN INVESTMENT GUIDE 57 (1996) [hereinafter ARMENIA: FOREIGN INVESTMENT GUIDE].

9. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 434.

first democratically-elected President.[10] Ter-Petrossian dominated Armenia's governmental structure by promulgating and signing laws, developing foreign and military policy, and signing various international treaties.[11]

The Armenian Constitution does not provide for an equitable distribution of power among the various branches of government, as the President's power has few checks and civic institutions are weak.[12] The President appoints the Prime Minister, who, along with the other Ministers, comprise "the Government," the executive branch of Armenia.[13] The President may dismiss the National Assembly and direct many of its activities (including nominating members of the Constitutional Court), propose amnesty for criminals, and ratify international treaties.[14]

While reserving much power for the President, the Armenian Constitution legitimizes the government by creating a structure for the judicial system.[15] While the Constitution has given Armenia's

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10. Glenn E. Curtis & Ronald G. Suny, *Armenia*, *in* ARMENIA, AZERBAIJAN, AND GEORGIA COUNTRY STUDIES 1, 58 (Glenn E. Curtis ed., 1995).

11. *Id.* at 58–59; THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 442.

12. Selina Williams, *Hopes Slim for Progress on Karabakh*, FIN. TIMES (London), Apr. 16, 1998, LEXIS, News Library, Fintme File. The administrative territorial units are regions and communities, with local self-government executed at the community level by community leaders, such as elders or mayors, elected for a three-year term. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 442. The government appoints regional governors to implement the government's regional policy. *Id.*

13. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 442. The Prime Minister recommends to the President persons to appoint as the remaining Ministers. *Id.* The Prime Minister also directs the activities of the government by protecting the rights of citizens and by ensuring the implementation of state policies such as education, culture, health care, and social security. *Id.* The National Assembly (legislature), however, must confirm the state budget and approve all programs introduced by the government. *Id.*

14. *See id.* The National Assembly is comprised of 131 deputies who are elected to a four-year term. *Id.* Before the Constitution was approved on July 5, 1995, the National Assembly was almost twice as large, with 248 members. *See* Curtis & Suny, *supra* note 10, at 58. The increased size of the National Assembly, however, is not an indicator of more effective representation. For example, in the early 1990s, the National Assembly failed to act decisively on major legislative issues because the majority required to enact such laws was rarely present. *Id.* Much of its duties involve the implementation of executive initiatives. *See* THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 443.

15. Before the Constitution was enacted, the powers of the legislative and executive branches had not been delineated. *See* Curtis & Suny, *supra* note 10, at 60. Presently, the Constitution stipulates that the judiciary be separate from the other branches. *Id.* The President heads the Council of Justice, and the Minister of Justice and the Procurator General are also included in the Council. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 442. The Constitutional Court determines the constitutionality of international treaties and decrees from the National Assembly as well as from the President. *Id.*

nascent democracy more legitimacy, it is unclear from recent elections whether corruption has been eradicated.[16] In fact, during presidential elections in April 1998, the Organization for Security and Cooperation in Europe (OSCE) issued an election report in which its observers remarked that they had seen "ballot box stuffing, discrepancies in the vote count . . . and instances of intimidation directed towards voters, election commission members[,] and candidate proxies."[17] Moreover, although the Communist Party is practically non-existent, crackdowns on the opposition Dashnak party and closure of many opposition papers raise doubts about Armenia's commitment to democracy.[18]

Armenia faced its gravest internal political crisis since 1991 when Prime Minister Vazgen Sargissian and National Assemby Chairman Karen Demirchian were assassinated on October 27, 1999.[19] Both officials were leading figures in Armenian politics.[20] The assassinations directly impacted foreign investment, which dropped 92.2% from 1998 to 1999.[21]

Armenia's fragile cease-fire agreement with Azerbaijan over the disputed territory of Nagorno-Karabakh also contributes to the country's political instability.[22] Nagorno-Karabakh is an autonomous region in Azerbaijan with a large Armenian population.[23] Spurred by numerous demonstrations and protests,

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16. *See* Williams, *supra* note 12, at 3.

17. *Id.* Armenia was admitted to the OSCE in 1992. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 434. Robert Kocharian is the current President of Armenia and while it is somewhat early to determine his overall effectiveness, it has been argued that he will hinder peace talks regarding Nagorno-Karabakh, having been its last President who rejected a draft settlement in 1997. *See* Williams, *supra* note 12, at 3.

18. Pyotr Vasilchikov, *Armenia: Phenomenon of Stability*, RUSSIAN PRESS DIGEST, Sept. 20, 1996, LEXIS, News Library, SPD File; Chrystia Freeland, *Economic Reforms Prompt Hopes of Renaissance*, FIN. TIMES SURVEY, June 7, 1995, at 35. Tension between the government and the Dashnak party continues to the present, and while twenty-six principal newspapers and sixteen principal periodicals are in circulation, they are not regularly available to the entire population. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 444–45.

19. *Armenia: Review 2000*, EUR. REV. WORLD OF INFO., Sept. 19, 2000, at 1.

20. *See id.*

21. Emil Danielyan, *Armenia's Stagnant Economy*, INSTITUTE FOR WAR & PEACE REPORTING (CAUCASUS REPORTING SERVICE No. 15), Jan. 21, 2000, http://www.iwpr.net/index.pl?archive/cau/cau_200001_15_06_eng.txt; *see Armenia: Review 2000*, *supra* note 19, at 2.

22. *See* Danielyan, *supra* note 21.

23. *See* THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 433. Nagorno-Karabakh was given to Azerbaijan in 1921. *Id.*

Armenia decided to incorporate Nagorno-Karabakh in 1988.[24] Azerbaijanis began to flee from Karabakh and anti-Armenian backlash ensued, leading to many casualties.[25] In September 1989, Soviet President Mikhail Gorbachev tried unsuccessfully to broker an agreement that would increase Karabakh's autonomy within Azerbaijan. Azerbaijan, however, instituted an economic blockade against Armenia, which escalated the conflict to war.[26]

In 1991, a nine-nation group of mediators from the Conference on Security and Cooperation in Europe (CSCE, now renamed OSCE) negotiated a cease-fire between Armenia and Azerbaijan. The cease-fire, however, immediately broke down and led to a stalemate.[27] In May 1994, the parties agreed to a different cease-fire proposal presented by the CSCE and Russia, which was formalized in July 1994.[28] Since then, the OSCE "Minsk Group" has drafted a settlement agreement between the parties, but Armenia has refused to accept its terms.[29]

Armenian President Robert Kocharian and Azerbaijian President Heydar Aliyev engaged in direct talks this year. The exchange of territories and economy were the main topics discussed.[30] The creation of a "common state" of Azerbaijan and Nagorno-Karabakh remains on the table (though rejected by Azerbaijan), and vital economic reforms are still not underway as Azerbaijan rejects economic cooperation with Armenia while the territorial conflict remains unsettled.[31] Despite the unresolved

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24. *Id.*

25. *Id.* In one rally, twenty-six Armenians were killed. *Id.* The problem was compounded by the refusal of the Presidium of the former Supreme Soviet to allow the transfer of Karabakh. *Id.*

26. Curtis & Suny, *supra* note 10, at 21.

27. *Id.* at 24; Freeland, *supra* note 18, at 37.

28. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 435–36. The cease-fire remains intact, despite sporadic violations. *Id.* at 436.

29. *Id.* The terms of the settlement responded to Azerbaijan's demands, requiring three principles to be addressed: the legal status of Nagorno-Karabakh, territorial integrity of Armenia and Azerbaijan, and security guarantees for the residents of Nagorno-Karabakh. *Id.* Relations with Azerbaijan have worsened since 1997, but hope for settlement arose when Ter-Petrossian, Armenia's former President, agreed to the OSCE's "stage-by-stage" settlement and even stated that Nagorno-Karabakh would never be fully independent or integrated into Armenia. *Id.*

30. *Armenia: Review 2000*, *supra* note 19, at 1.

31. *Id.* Recently, Azerbaijan's Foreign Minister, Vilayat Guliyev, reported that the peace negotiations were in a deadlock. *See* Armen Zakarian, *Azeri FM Says Karabakh Talks in Deadlock, Criticizes OSCE* Mediators, RADIO FREE EUR./RADIO LIBERTY (ARM. REP.), Nov. 13, 2000, http://www.rferl.org/bd/ar/reports/archives/2000/11/0-

territorial dispute, recent amendments to the tax code in Karabakh aim to develop small and medium-sized businesses as well as land privatization, all of which are designed to attract more foreign investment to the region.[32]

B. Economic Instability

The roots of Armenia's economic crisis are not entirely political.[33] In 1988, a devastating earthquake ravaged Armenia, causing millions of dollars of damage to its infrastructure and destroying approximately one-third of its industry.[34] The earthquake also caused a 32% loss in electrical power.[35]

The economic blockade imposed by Azerbaijan further compounded the damaging effects of the earthquake.[36] The blockade affected virtually all sectors of the economy. It hampered the sale and delivery of goods traveling to Armenia via Azerbaijan.[37] The energy sector was virtually paralyzed, as Russia and Turkmenistan halted the delivery of gas into Armenia. Until 1996, electricity was only available for one to two hours a day.[38] The gas supply was halted completely in December 1992, and Armenia was forced to use electric energy.[39] This shift resulted in a three-fold increase in the use of electric power, causing hydropower to be utilized at maximum capacity, thereby creating a water shortage in Lake Sevan, Armenia's sole long-term source

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131100.html. He criticized the OSCE Minsk Group, co-chaired by France, Russia, and the United States, for failing to present a new peace proposal and relying on hopes for successful bilateral talks between the Armenian and Azerbaijani Presidents. *See id.*

32. *Karabakh Working on Attracting Investments*, DAILY MEDIA DIG. OF USAID/ARM. ECON. REFORMS, Jan. 21, 2000 (on file with the Loyola of Los Angeles International and Comparative Law Review).

33. ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 13.

34. *When the Earth Stops Shaking*, ECONOMIST, Dec. 17, 1988, at 45; Freeland, *supra* note 18, at 35; ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 13.

35. *See* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 57.

36. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 433–34.

37. Sergei Bablumyan, *Armenia's Situation is Desperate*, IZVESTIA, May 4, 1992, LEXIS, News Library, SPD File.

38. Freeland, *supra* note 18, at 35. Some gas was available from the Georgian black market, but at inflated prices. *Armenia: The Aftermath*, ECONOMIST, Dec. 12, 1992, at 59.

39. *See* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 58. The transition to electric energy was not a smooth one because the intermittent power supply caused the pollution of surface and ground waters. Karine Danielian, *Stop Degradation of Region*, NEZAVISIMAYA GAZETA, Feb. 17, 1993, LEXIS, News Library, SPD File.

of drinking water.[40] The crisis worsened during the harsh winter months between 1992 and 1994, as Armenia experienced extreme energy shortages.[41]

Armenia has been searching for alternate energy sources, shifting to nuclear and hydropower to decrease its reliance on imported fuels. All the while, Armenia has been working toward modernizing its existing facilities and guaranteeing a supply of electricity for the first time since its independence.[42] In September 1998, ISH-Cerpadla, a Czech pump manufacturer, contracted with Armenia to supply six special pumps for the Medzamor nuclear power station, which were being reconstructed by the U.S. firm, Burns and Roe Enterprises.[43] Additionally, in an effort to combat the gas shortages, Armenia and Iran constructed an 875-mile-long gas pipeline, which supplied fuel in 1997, and also concluded accords to obtain liquefied gas.[44] As a result, gas supplies were restored to Armenian households in 1997.[45]

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40. Danielian, *supra* note 39; ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 58.

41. *See* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 58. Gross Domestic Product (GDP) fell by 52% in 1992. *See* Freeland, *supra* note 18, at 35. Armenia has since resumed the use of nuclear power. *See* THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 437. In 1995, it reopened the second generation unit of its sole nuclear power station, Medzamor, which was shut down following the 1988 earthquake. *Id.* In 1996, nuclear power increased to 44.6% of energy consumption, which was an increase from 5.5% in 1995. *Id.*

42. *See* Selina Williams, *Isolated Armenia Feels the Cold in the Transcaucasus*, FIN. TIMES, Jan. 6, 1998, at 3; *see also* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 58–59. "[O]n March 13, 1998, the Ministry of Finance and Economic [sic] of Armenia and the Dutch Ministry of Economy signed an inter-governmental memorandum on mutual understanding, providing for a joint study by Dutch and Armenian experts on the possibility of wind power usage . . . ." *First Results of Wind Power Research to Be Announced in August 2000*, DAILY MEDIA DIG. OF USAID/ARM. ECON. REFORMS, Jan. 19, 2000 (on file with the Loyola of Los Angeles International and Comparative Law Review). The two-stage study will monitor the wind stations delivered to Armenia, determine the feasibility of the construction of sites for the installation of wind-power stations, and elaborate upon the development of an investment program. *Dutch, Danish Companies Implementing Alternative Energy Development Program in Armenia*, NOYAN TAPAN NEWS AGENCY, Feb. 3, 2000 (on file with author). The Dutch government also provided $600,000 in grants to sponsor solar energy research in Armenia. *First Results of Wind Power Research to Be Announced in August 2000*, *supra*.

43. *ISH-Cerpadla Completes a Contract for a Power Station in Armenia*, ACCESS CZECH REP. BUS. BULL., Sept. 4, 1998, LEXIS, News Library, Aeebtn File.

44. *Armenia, Iran to Start Work on Gas Pipeline*, AGENCE FRANCE PRESSE, May 13, 1995, LEXIS, News Library, AFP File. Recently, the Armenian Defense Minister, Serge Sarkissian, and Iranian Foreign Minister, Kamal Kharazi, met to discuss the gas pipeline with the Armenian Defense Minister and called for an "acceleration" of the project.

Industrial production declined because the blockade prevented the importation of raw materials to Armenia.[46] Consequently, many production facilities were shut down.[47] To revitalize its industry, Armenia shifted the focus of industrial production from the traditional sectors, such as electrotechnical equipment and radio electronics, to the production of textiles and jewelry.[48]

The economic blockade also affected Armenia's exploitation of its natural resources.[49] Armenia possesses few natural resources, importing petroleum and natural gas from Russia and Turkmenistan, respectively.[50] Many of Armenia's natural resources are in the form of minerals.[51] During the blockade,

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Armenia Eager to Get Gas Pipeline Construction Underway, AGENCE FRANCE PRESSE, Nov. 8, 2000, LEXIS, News Library, AFP File. The Iranian Foreign Minister declared that Iran had completed the necessary preparations for the project and that Iran was prepared to commence the construction of the pipeline. *Id.* An additional agreement was reached in 1997 with a Russian company, Gazprom, and an international energy corporation to improve Armenia's gas infrastructure. THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 437.

45. *Low Operational Level of Gas Pipelines Accounts for Accidents*, NOYAN TAPAN NEWS AGENCY, Oct. 19, 1998 (on file with author).

46. *See* I. Komarov, *Transcaucasia*, RAZVITIYE, Apr. 30, 1993, LEXIS, News Library, SPD File.

47. *Id.* In 1992, Benetton, one of the first large international companies to set up in Armenia, was forced to shut down its two factories because raw materials could not be shipped in from Egypt and electricity was scarce. *Armenia: The Aftermath*, *supra* note 38, at 59.

48. *See* THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 437.

49. *See id.* at 436.

50. *See id.* at 437. In 1993, an American expedition tentatively identified some deposits of natural gas and oil, but exploitation of these resources was expected to take several years. Curtis & Suny, *supra* note 10, at 44.

51. *See* THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 436; ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 39–42. Copper is the most important raw material produced, but other materials are also present such as zinc, gold, silver, semiprecious stones, and building materials, in particular marble and granite. Curtis & Suny, *supra* note 10, at 44. With 700 springs, Armenia also has an abundant source of high-quality mineral water. ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 42. In March 2000, the British consultancy company, IMC Mackey & Schnellmann, began formulating recommendations for expanding the raw material supply of mining enterprises of the Zangezur ore district. *British Firm Plans Mineral Resources Project*, SNARK NEWS AGENCY, Jan. 18, 2000 (on file with author). They also advised the construction of factories producing copper and molybdenum. *Id.* Based on these recommendations, Armenia's Ministry of Industry and Trade drew up an investment program to present at the London business forum devoted to Armenia, which took place in October 2000. *Id.* The project is financed by the European Union's Technical Assistance to the CIS (TACIS) program, which was set up to aid Russia and the other republics with industrial

mineral production accounted for 18% of Armenia's total economic output, ranking fourth among the fifteen former Soviet republics, and supplying 40% of Soviet molybdenum, copper, zinc, and other minerals.[52] Periodic shortages of electricity and petroleum, however, adversely affected mining operations. Additionally, threats of violence against workers forced them to flee from their jobs.[53]

Amidst this political and economic instability, Armenia discarded Soviet ideals and moved toward a market economy.[54] The creation of banking and finance laws allows foreign direct investment and the participation of foreign enterprises in the privatization process.[55] In addition, the privatization of land and industry promotes efficiency and allows the population to become more self-sufficient.[56]

III. REFORMS

To understand Armenia's emergence as a market economy, it is important to understand its Soviet legacy. Armenia and its Transcaucasian neighbors experienced rapid industrialization and economic growth following the Stalin era.[57] Soviet rule, however, did not quell ethnic animosities existing between Armenia and Azerbaijan.[58] Furthermore, Armenia's integration into the Soviet centralized economy did not prepare it for the economic crisis immediately following the 1991 coup.[59] The economic effects of the coup exacerbated Armenia's economic situation as production declined sharply, inflation rose markedly (3730% annually), and the fiscal deficit comprised 56% of the Gross Domestic Product

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growth and environmental protection. *Id.*; *International Agreements: E.U. Signs Accords with Three Former Soviet Countries*, 13 INT'L TRADE REP. (BNA) No. 17, at 692 (Apr. 24, 1996).

52. James Dorian, *Armenia Aims to Cut Out the Middle Man*, FIN. TIMES, Oct. 3, 1991, at 30.

53. *Id.*

54. *See* THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 437.

55. *See* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 15, 26–28.

56. *Id.* at 43–44.

57. Gertrude E. Schroeder, *Transcausasia Since Stalin—The Economic Dimension, in* TRANSCAUCASIA, NATIONALISM, AND SOCIAL CHANGE: ESSAYS IN THE HISTORY OF ARMENIA, AZERBAIJAN, AND GEORGIA 477 (Ronald Grigor Suny ed., 1996).

58. *Id.*

59. *See id.*

(GDP).[60] The unemployment rate grew steadily from 3% in 1992 to 10.1% in the first half of 1997.[61]

As a result of high unemployment, workers retire early, causing a reduction in pension fund contributions, which are financed mainly through social security contributions from the working population.[62] Pensioners accounted for 44.1% of persons employed in 1996 compared to 76.9% in Hungary in the same year.[63] Moreover, Armenian industries are still adversely impacted by the Soviet system of specialization, which favored the development of certain industries for trade with other republics instead of promoting diversification.[64] Consequently, Armenia's trade was conducted primarily with other republics.[65]

Since the coup, Armenia has introduced market-oriented policies to reduce inflation and lower its budget deficit.[66] These policies aim to encourage banking law reform, which, if successful, will make Armenia attractive to foreign investors.

While it is widely acknowledged that economic reforms are more advanced in Armenia than in other republics in the region, the continued political uncertainty from the ongoing Nagorno-Karabakh conflict and recent assassinations has led to a decline in foreign investment in Armenia from $240 million in 1998 to $100 million in 1999.[67] Reforms cannot be sustained unless Armenia's internal political situation is stabilized and foreign investors regain their willingness to invest.

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60. *See* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 13.

61. INT'L MONETARY FUND, WORLD ECONOMIC OUTLOOK: MAY 1998, at 109 (1998) [hereinafter IMF 1998].

62. *See id.* at 109, 114.

63. *Id.* at 114.

64. Schroeder, *supra* note 57, at 475.

65. *Id.*

66. *See* INT'L MONETARY FUND, WORLD ECONOMIC OUTLOOK: MAY 1993, at 61 (1993) [hereinafter IMF 1993]. The IMF publishes this series bi-annually and discusses the IMF's country projection through an evaluation of market activity and exchange rates. The projection for Armenia applies to all of the former Soviet republics. *Id.* at 58. Also, the IMF classifies Armenia and all former Soviet republics as "countries in transition," not as "developing countries." *Id.*

67. Danielyan, *supra* note 21; *see also Armenia: Review 2000, supra* note 19, at 3. The political unrest and financial crisis in Russia contributed to slow economic growth as GDP in 1999 rose 3.3%, as against the projected 5%, while the 2% inflation rate remained constant, which is considered too low to strengthen the economy and increase exports. *Armenia: Review 2000, supra* note 19, at 2.

A. Privatization

In 1992, after the election of Armenia's first democratic government, Armenia passed laws allowing private property ownership and market reform.[68] The Law on State Register of Enterprises, enacted in September 1993, requires businesses to be registered with the applicable local division of the State Register where the business is to be established.[69] In addition, joint ventures and wholly-owned foreign enterprises must file additional documents to verify their financial stability and legal status, such as the founding contract and bank statements.[70] In order to register an affiliate or subsidiary, the charter or by-laws showing affiliations to the parent company and a letter of intent are required.[71]

Two principal laws governing privatization, enacted in 1996 and 1997, have replaced earlier laws.[72] The first is the Law of the Republic of Armenia on Joint Stock Companies, adopted by the National Assembly in 1996, which defines the establishment and registration of privatized companies.[73] Joint stock companies share many of the characteristics found in corporate forms in most industrialized countries providing the basis for establishing private business ownership.[74] Companies may decide on the amount of shares to issue (common and/or preferred), the value of each

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68. *See* ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 26. The precursor to this legislation is the Law on Ownership, enacted in October 1990, and it sets forth various types of ownership afforded Armenian citizens, such as ownership of land, intellectual property, and securities. *Id.*

69. *Id.* at 27–28. Pursuant to my discussion with Mr. Tigran Aloyan, Senior Legal Advisor at the Ministry of State Property Management, I was informed that a law was enacted in May 2001, which will replace this law, the title and provisions of which are as yet unavailable.

70. *Id.* at 28.

71. *Id.*

72. The laws governing privatization are frequently amended, requiring verification with the Ministry of State Property Management of the Republic of Armenia, the government agency established in July 1999 that, among other things, oversees privatization. For the most current information available, visit http://www.privatization.am.

73. *See* Law of the Republic of Armenia on Joint Stock Companies (Apr. 30, 1996) art. 2, http://www.privatization.am/lb/lb1b.html.

74. A joint stock company is defined as "a legal entity, whose Charter Capital is divided into a certain number of shares verifying the liabilities of the shareholders towards the Company." *Id.* art. 3(1). Charter capital refers to a company's working capital. *Id.* art. 33(1). It is the equivalent of a corporation as both share many features: they may own property; create subsidiaries; sue and be sued; and open bank accounts. *Id.* art. 1(2)(4)(5).

share, and the rights pertaining to each type of share that are stated on the share certificate.[75] Share ownership is made available to employees of the company, who, collectively, may own up to 25% of the working capital of the company.[76] The joint stock companies may be open or closed in nature and are required to limit a shareholder's liability to the nominal value of his or her investment.[77] The law also governs the merger, restructuring, and liquidation of companies, all of which require approval at the shareholders' general meeting.[78]

The second law, the Law of the Republic of Armenia on Privatization of State Property, enacted in 1997, establishes the rules for the transfer of government-owned enterprises, including unfinished construction sites to private owners.[79] The government decides the type of privatization (auction, tender, or direct sale) and considers several criteria, including the financial condition of a company and the amount of investment needed, to determine whether or not to privatize a company.[80] The government drafts a program of privatization, which details what properties will be privatized and the process for purchasing the properties and submits it for consideration to the Supreme Council, which must adopt the program prior to implementation.[81] Foreign corporations are allowed equal access to participate in the

75. *Id.* arts. 34(2)(5), 35(1). The total amount of preferred shares issued may not exceed 25% of the working capital of the company. *Id.* art. 34(2).

76. *Id.* art. 43(1).

77. *Id.* arts. 43, 8. Open companies are publicly-held companies that sell shares through a public offering and allow shareholders to sell their shares, whereas a closed, or closely-held, company may not have more than twenty-five shareholders who may sell shares only to board members and predetermined persons who have priority in acquiring the sold shares. *Id.* art. 8(2)(3). In accordance with the law on state property privatization program for 1998–2000, the Armenian government decided to instruct ministries and other state bodies to take relevant steps to transform closed-type joint stock companies in which state-owned shares comprise 50% of the authorized capital into open-type joint stock companies. *See Armenian Government Redistributes State-Owned Shares in Joint-Stock Companies*, SNARK NEWS AGENCY, Jan. 14, 2000, at 1.

78. Law of the Republic of Armenia on Joint Stock Companies arts. 18–32.

79. *See* Law of the Republic of Armenia on Privatization of State Property (Dec. 17, 1997) art. 1, http://www.privatization.am/lb/lb2a.html.

80. *Id.* art. 14(2).

81. *Id.* art. 4. The Supreme Council is the precursor to the National Assembly, the Parliament of Armenia. In order for citizens to purchase the privatized property, they must obtain a privatization certificate, which is not a receipt but rather securities that may be used as a method of payment for property or stock, and the conditions of the issuance of these certificates are determined by the privatization program. *Id.* arts. 6–7.

privatization process, and may bid on enterprises through a tender offer, although the government may decide whether it wants to retain full or partial control of a certain enterprise.[82] Employees of enterprises and "small" site privatization[83] are provided equal access to purchase privatized property, with preferential treatment afforded to said employees in the case of direct sales of privatized property.[84] These laws collectively demonstrate the loosening of governmental controls over the economy to allow private ownership of property and encourage foreign investment.

Armenia was the first of the former Soviet republics to eliminate collective ownership of land, allowing land purchases as of January 1, 1993.[85] The government sold the land instead of freely relinquishing it in hopes of urging citizens to become farmers, thereby maximizing the use of the land.[86] Even before Armenia declared independence, however, it commenced privatization by dissolving all state-owned agrarian enterprises (*sovkhoves*) and all Soviet-type collective farms (*kolkhoves*) into 320,000 family farms.[87] This privatization allowed the agricultural production of the GDP to grow above 40% from 1993 to 1997 compared to 18% in 1990.[88] This production prevented famine

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82. *Id.* arts. 5(2), 17.

83. "Small" sites are defined as "legal persons or their separated divisions specialized in the spheres of public catering, consumer services and commerce," the latter of which does not exceed 200m^2 at the time of evaluation. *Id.* art. 10(2).

84. *Id.* art. 10(1)(3). In addition, no more than 20% of state stock is set aside for employees provided that more than 50% of the employees agree to purchase the stock. *Id.* art. 10(2).

85. Sergei Bablumyan, *Armenia Lifts Land Purchase and Sale Ban*, IZVESTIA, Aug. 14, 1993, LEXIS, News Library, SPD File. "Foreigners are not allowed to buy land in Armenia, but they can buy real estate." Haroutioun Khachatrian, *Privatization in Armenia*, OXFORD ANALYTICA BRIEFS, Apr. 23, 1998 (on file with author) [hereinafter *Privatization in Armenia*].

86. Bablumyan, *supra* note 85.

87. Haroutioun Khachatrian, *Armenia: Agricultural Investment*, OXFORD ANALYTICA BRIEFS, July 13, 1998 (on file with author) [hereinafter *Agricultural Investment in Armenia*]. The distribution of land, livestock, and machines was based on the size of the family. *Id.* In addition, 20% of the dismantled land remained under governmental control for further distribution. ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 43.

88. *See Agricultural Investment in Armenia*, *supra* note 87, at 1. The only decrease in agricultural production occurred in 1993 because foodstuffs, imported from Russia, could not be transported into Armenia due to the ethnic conflict in Abkhazia. *Id.*; *see also* IMF 1993, *supra* note 66, at 59 (discussing Bulgaria's and Romania's dependence on primary goods imported from the former Soviet Union, and how that affected their reform efforts).

during the height of the war and blockade (1992–1994).[89] The land market, however, has developed slower because few families have the resources to invest in future development and export products, or to obtain credit.[90]

International organizations and other nations are coordinating programs with the Armenian government to strengthen Armenia's agricultural sector and promote self-sufficiency.[91] The $14.5 million Supporting Agricultural Reforms Program, sponsored by the World Bank, envisions establishing a network of consulting services throughout the country as well as providing loans to small enterprises engaged in agricultural commerce.[92] The World Bank recently developed a $20 million program to enhance the profitability, reliability, and sustainability of irrigation systems.[93] Further, the Agricultural Wholesale Market project, initiated in 1996 by the EBRD with $14.5 million in funding, envisions the restructuring of the fresh food market.[94] In an effort to strengthen the private seed industry, the U.S. Department of Agriculture and the U.S. Embassy in Yerevan donated 3,000 metric tons of wheat for auction to farmers.[95] In

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89. *See Agricultural Investment in Armenia*, *supra* note 87.

90. *Id.* Armenia is a member of the World Bank, International Monetary Fund (IMF), the European Bank for Reconstruction and Development (EBRD), the Black Sea Economic Cooperation, and is seeking membership to the World Trade Organization (WTO). THE EUROPA WORLD YEAR BOOK 1998, *supra* note 1, at 437.

91. *See British Firm Plans Mineral Resources Project*, SNARK NEWS AGENCY, Jan. 18, 2000 (on file with author).

92. *Agricultural Investment in Armenia*, *supra* note 87, at 1–2. The program was launched in 1998 and completion is expected by 2002. *Agricultural Programs Worth 88.4 Million USD Implemented in Armenia*, NOYAN TAPAN NEWS AGENCY, Jan. 13, 2000 (on file with the author).

93. Posting of Mihran Toumajan, mihran_toumaj@hotmail.com, *World Bank Projects Update on Armenia*, to Armenian News Network (Apr. 14, 2000) (copy on file with author). Currently, an irrigation system restoration project worth $55.15 million is underway in Armenia. *Agricultural Programs Worth 88.4 Million USD Implemented in Armenia*, *supra* note 92. It is funded by USAID and the International Fund for Agricultural Development (IFAD). *Id.* IFAD also loaned $12.95 million to develop agricultural services in Armenia's northwest regions. *Id.*

94. *See Agricultural Investment in Armenia*, *supra* note 87, at 2. In 1997, the government suspended the loan, arguing that it was not interest-free, like the World Bank loans, and is now seeking private investors to complete the program. *Id.* The government has since reduced the project to a much smaller scale. *EBRD Had Approved Six Investments in Armenia Totally* [sic] *EUR 145.30 [Million]*, NOYAN TAPAN NEWS AGENCY, Apr. 10, 2000 (on file with author).

95. *USDA Will Donate Wheat to Armenian Group*, 15 INT'L TRADE REP. (BNA) No. 12, at 542 (Mar. 25, 1998). On October 27, 1998, the USDA announced a preliminary

1995, the European Union's Technical Assistance to the CIS (TACIS) program and Credit Agricole of France established the Agricultural Cooperation Bank of Armenia, which provides secured short-term loans of up to $1500 to farmers.[96]

These reforms have allowed for the development of joint ventures and acquisitions in the agricultural sector.[97] For example, the French firm Pernod Ricard acquired the Yerevan Cognac Distillery for $55 million from the Armenian government.[98] Pernod Ricard invested $17 million between 1997 and 2000.[99] In addition, Grand Tobacco, an Armenian-Canadian joint venture, has invested $415,000 to develop new tobacco fermentation technologies and expand the use of Armenian-produced tobacco in the production of cigarettes.[100] As of 2001, Canada has invested approximately $4.1 million in the joint venture.[101] The joint venture has facilitated the completion of deals with three hundred farms.[102]

Industrial privatization, particularly in the mining sector, has been slower than expected. The 1998–2000 privatization program,

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allocation of funds to Armenia, which is one of fourteen countries receiving aid totaling $166 million under the Title I concessional sales program designed to promote U.S. agricultural commodities as well as develop long-term, broad-based sustainable agricultural development. *USDA Announces Pub. L. No. 480 Allocations*, 15 INT'L TRADE REP. (BNA) No. 43, at 1844 (Nov. 4, 1998). The USDA also allocates funds to Armenia through its "Food for Progress" program, which supports countries that have made commitments to introduce or expand free market elements in agriculture. *Id.* In April 1998, Armenia received 1,500 metric tons of dry whole milk that is slated to be sold to dairy producers, and the proceeds of the sales will support community health programs and ensure free distribution of dairy products to the needy. *USDA to Donate Milk for Armenian Programs*, 15 INT'L TRADE REP. (BNA) No. 13, at 585 (Apr. 1, 1998).

96. *Agricultural Investment in Armenia, supra* note 87, at 2.

97. *See id.*

98. Paul J. Deveney, *French Firm Buys Armenian Distillery*, WALL ST. J., June 9, 1998, at A12.

99. *"Pernod Ricard" Investing $17 Million in Cognac Winery*, IPR STRATEGIC BUS. INFO. DATABASE, May 7, 2000 (on file with author). The Russian financial crisis contributed to low investment projections because Russia is one of the largest importers of Armenian cognac, but sales have since increased. *See id.* Pernod claims that it suffered $15 million in damages due to the government's investment in the Ararat label. *Id.*

100. *See Grand Tobacco Plans to Invest $1 Million in Armenia's Tobacco-Growing*, NOYAN TAPAN NEWS AGENCY, Oct. 19, 1998 (on file with author).

101. *Id.*

102. *Id.* In September 2000, Mr. Hrant Vardanian, head of the Armenian-Canadian Grand Candy joint venture, and Mr. Anushavan Danielian, Prime Minister of Karabakh, commenced discussions for setting up a tobacco fermentation factory. *Armenian-Canadian Joint Venture to Create New Jobs in Karabagh*, ARMENPRESS, Sept. 6, 2000 (on file with author).

however, provides debt and tax relief for large enterprises that hope to privatize.[103] Through the privatization process, joint ventures in various industrial sectors have taken place, indicating confidence in the level of investment protections. In 1997, Kovohute Bridlicna (KB), the largest Czech aluminum processor of food, tobacco and pharmaceutical packaging, agreed to set up a joint venture with Kanas, a Yerevan-based aluminum company.[104] Kanas agreed to provide the needed technology; KB agreed to provide financing, investment expertise, and its consumer base.[105] KB regards Armenia as essential in obtaining a dominant position in the central and eastern European packaging markets.[106]

The U.S. Overseas Private Investment Corporation (OPIC) agreed to provide $160 million in loan guarantees for a new private equity fund to invest in industrial properties located in twenty-three countries, including Armenia.[107] The fund seeks to spur regional economic growth by providing business infrastructure, such as warehouses, distribution centers, regional headquarters, and sales offices, for U.S. companies.[108] The continued success of industrial privatization is uncertain given the meager $8 million invested by foreign investors in the industrial sector in 2000.[109] This trend is consistent with the drastic decrease in foreign investment since 1999.[110] Investments in certain

103. *See Privatization in Armenia*, *supra* note 85.

104. *Kovohute Bridlicna, Aluminum Processor, Will Set Up a Joint Venture in Armenia*, MLADA FRONTA DNES, Mar. 25, 1997, at 15 (on file with author).

105. *Id.*

106. *Id.*

107. *International Finance: OPIC Backs New $240 Million Fund to Invest in Ex-Soviet Properties*, 13 INT'L TRADE REP. (BNA) No. 28, at 1146 (July 10, 1996). Among the participants in the fund are MCI Communications and Bank of Boston. *Id.* The industrial properties include industrial parks, warehouses, light manufacturing sites, and retail outlets. *Id.* OPIC has also announced plans to provide $300 million in financing over the next two to three years to American companies doing business in Armenia. *Government Attempts Further Measures to Improve Economic Situation*, RADIO FREE EUR./RADIO LIBERTY (ARM. REP.), Nov. 13, 2000, http://www.rferl.org/bd/ar/reports/archives/2000/11/0-131100.html. "The first OPIC-financed project now underway involves an $18 million credit to AK Development, a company owned by Diaspora Armenians that is investing in the Armenia Hotel." *Id.*

108. *International Finance: OPIC Backs New $240 Million Fund to Invest in Ex-Soviet Properties*, *supra* note 107, at 1146.

109. *See Trade and Industry Minister Optimistic About Inflow of New Foreign Investments*, ARMENPRESS, Sept. 12, 2000 (on file with the author); *see also Armenia: Review 2000*, *supra* note 19, at 2.

110. *See id.*

industrial sectors in 2000, however, may prove to be the catalyst for privatizations in the years to come.[111]

In May 2000, the largest privatization occurred in the international tender of four electricity distribution networks.[112] This offering, valued at over $100 million, has accounted for the increase in investor activity.[113] Following this tender offer, the government passed a bill that officially adopted the privatization plan.[114] In response to past scandals linked with the sell-off of other major government owned assets, the World Bank has urged Armenian authorities to ensure fairness and transparency throughout the bidding process and to refrain from colluding with Russian firms on the tender results.[115] These concerns must be fully addressed because the World Bank's allocation of credit for Armenian budget deficit reduction is closely linked to the privatization of the electricity networks.[116]

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111. At the beginning of 2000, Nairit, formerly the largest producer of rubber in the former Soviet Union, resumed production after several years of inactivity due to insolvency. *See id.* at 5. Kanaz, one of Armenia's leading foil producers, will also resume production. *Id.* In addition, since 1999, the Armenian government has discussed plans to start a thermal power plant project with the Mitsubishi and Marubeni corporations, with an agreement likely to be reached with one of them. *Id.*

112. *Id.*

113. *Id.* While the volume of foreign investment is expected to increase, it is unlikely to increase to the level necessary to achieve an economic breakthrough. *Id.* at 3.

114. *Armenia Passes Law on Privatization in Energy Transmission*, INTERFAX RUSSIAN NEWS, Aug. 8, 2000 (on file with the Loyola of Los Angeles International and Comparative Law Review). The networks will be privatized in two packages and the two major conditions set forth by the Armenian government are that the electricity tariffs should not be subject to changes until 2002 and that the annual income of the potential buyers must be no less than $150 million. *Four Electricity Distributing Networks To Be Privatized in Two Packages*, NOYAN TAPAN NEWS AGENCY, Feb. 4, 2000 (on file with author). To date, four companies have made tenders: AES of the United States, the Swiss-Swedish ABB, Electricité de France, and the Spanish Union Fenosa. *See Privatizing in Armenia*, MOSCOW TIMES, Aug. 1, 2000, at 1. The shares will be distributed as follows: 51% to strategic investors, 20% to the EBRD, 20% to the state, 5% to other investors, and 4% to the employees of the companies. *Id.*

115. *WB Urges Fair Bidding in Armenian Energy Privatization*, DAILY MEDIA DIGEST OF USAID/ARM. ECON. REFORMS, Feb. 11, 2000 (on file with the Loyola of Los Angeles International and Comparative Law Review). Concerns regarding government collusion with Russian firms stem from reports that Russia's Gazprom monopoly, backed by the Russian government, "is lobbying hard to get preferential treatment for its subsidiary, the ITERA corporation," which plans to bid. *Id.* Armenia relies heavily on Russian gas for power generation and Armenia's entire gas infrastructure is dominated by a Gazprom-controlled joint venture. *Id.* The World Bank has strongly argued against granting ownership to Russian entities because of their financial inadequacy. *Id.*

116. *Armenia: Review 2000*, *supra* note 19, at 3. The World Bank, Armenia's largest lender since independence, closely supervises energy privatization and the last tranche of

In its attempt to privatize 2,500 small and medium enterprises, the Armenian Government faced serious challenges.[117] Due to the lack of appropriate economic information concerning the market value of firms, the government failed to find buyers.[118] Because charges of bribery and mismanagement serve to thwart foreign investment, investor confidence in Armenia will increase only if measures are undertaken to ensure open and accurate management of foreign investments.

B. New Currency and Banking Reform

In November 1993, Armenia introduced a new currency, the dram, thereby removing itself from the unstable monetary policies inherent in the ruble system.[119] The transition was rocky—citizens were permitted to exchange a maximum of 50,000 rubles for the new currency.[120] The dram, nevertheless, has become a strong currency as evidenced by the appreciation of the nominal exchange rate since May 1994.[121] The stabilization of the dram has also lowered inflation, from 150% at the end of 1993 to 5% in 2000.[122]

The present banking system was created shortly after the introduction of the dram.[123] Armenia's most developed sector is

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its structural adjustment credit ((SAC)-3 credit), worth $15 million, was scheduled to be allocated immediately after the result of the tender for the privatization of the energy networks; another $30 million, the first tranche of its SAC-4 credit, was disbursed in October 2000. *Id.*

117. *Privatization of Big Enterprises Opposed, Says State Property Minister*, ARMENPRESS, Nov. 17, 2000 (on file with author). The proposed privatization program for 2001–2003 is divided into several parts and includes enterprises that were not involved in previous programs as well as enterprises, mainly building companies and hotels, whose privatization is opposed by ministries that favor their retention under state control. *Id.* The private sector accounts for more than seventy-five percent of Armenia's GDP and official figures show that seventy-six percent (1533 total) of large and medium-sized enterprises and eighty-three percent (6829 total) of small ones have been privatized over the decade. *Id.*

118. *Id.*

119. Yuri Kalashnov, *Armenia Introduces National Currency*, KOMMERSANT, Nov. 22, 1993, at 5 (on file with author).

120. *Id.*

121. *See* Freeland, *supra* note 18, at 35. The stable exchange rate is largely due to the Armenian Central Bank acting as a monetary regulator. *See* Danielyan, *supra* note 21.

122. ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 18; *see also Armenia: Review 2000*, *supra* note 19, at 4.

123. Haroutioun Khachatrian, *Banking in Armenia*, OXFORD ANALYTICA BRIEFS,

banking, which has thirty-one commercial banks.[124] Despite the high number of commercial banks, the amount of banks was reduced twofold from 1995 to 1998.[125] This resulted in the tightening of capital adequacy, solvency requirements, and greater transparency of the banking system.[126] Indeed, in 1997, the banking sector ended with a 55% growth in cumulative assets; only seven banks reported a net loss.[127]

In 1996, the Central Bank introduced strict regulations of bad debts, including a liquidation process.[128] At the time, bad debts amounted to more than half of the assets and loans owned by banks; now, that figure is near zero.[129]

There are no limits on the amount of foreign capital investment.[130] Only three foreign bank affiliates (out of the thirty-one commercial banks), however, operate in Armenia: HSBC Armenia Bank (British), Mellat Bank (Iranian), and Areximbank (Russian).[131] HSBC has made a considerable contribution toward the creation of a stable banking system in Armenia, with $9 million in total capital investment, plans to expand the distribution of automated teller machines, and involvement with the Armenian Card Company, which issues and services credit cards.[132] One of Armenia's largest commercial banks, Converse Bank, negotiated with the EBRD to allocate $1–$1.5 million in credit in March

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May 1998 [hereinafter *Banking in Armenia*] (on file with author).

124. *Armenia: Review 2000*, *supra* note 19, at 4.

125. *Banking in Armenia*, *supra* note 123. In order to strengthen accountability and controls in the banking system, detailed internal and external audits have been performed since 1996 under the control guidance of international bank examiners. *See id.* There is cause for concern among analysts who argue that there is no banking sector in Armenia given that the total capital of the thirty-one commercial banks is a mere $60 million. *See Armenia: Review 2000*, *supra* note 19, at 4.

126. *Banking in Armenia*, *supra* note 123.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*; *see also Armenia: Review 2000*, *supra* note 19, at 4. Two laws passed by the Parliament in April 1993, the Law on the Central Bank (CBA) and the Law on Banks and Banking Activity, authorize the establishment of "foreign-owned, joint venture banks and branches of foreign banks to be established in Armenia." ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 15. Further, the World Bank granted Armenia a $16.75 million loan to strengthen the banking sector's lending capacity, "especially for export-related projects, and [to] help increase the creditworthiness of firms." *Armenian Banking Sector Loan*, 14 INT'L TRADE REP. (BNA) No. 2, at 67 (Jan. 8, 1997).

132. *Armenia: Review 2000*, *supra* note 19, at 4.

through April 2000.[133] Converse Bank will thus be one of the first participants in the EBRD program to support small and medium-sized businesses.[134]

Foreign investment in banks has liberalized foreign currency transactions.[135] In an effort to attract more foreign currency deposits, an agreement exists between certain foreign commercial banks and the Yerevan Stock Exchange to conduct foreign exchange auctions.[136] Moreover, international accounting standards are scheduled for implementation in 2000 through 2001, further modernizing the economy and increasing investor confidence.[137]

Despite these reforms and Armenia's creation of the first securities market in the region, the lack of relevant legislation to ensure reliable and efficient management of investments will likely result in Armenia losing the leading role in the regional capital market.[138] This is especially true given the Parliament's recent rejection of a draft law on Securities Market Regulation.[139] Some goals of the bill were: to ensure protection of investor rights, including prevention of fraud; that issuers of securities and other market participants fully disclose information; and to create transparent market processes.[140] Further, the fairly stable

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133. *Id.* Another significant commercial bank linked with the EBRD is the International Commercial Black Sea Bank, a joint venture of the International Bank of Greece and EBRD. *See Banking in Armenia, supra* note 123. In an effort to promote intra-regional trade, the International Finance Corporation (IFC), a World Bank affiliate, and Austria's Raiffeisen Zentralbank (RZB) established a $60 million guarantee facility, available to all former Soviet republics, including Armenia. *International Finance: IFC, Austrian Bank to Create Facility to Promote Trade in Former Soviet Bloc*, 13 INT'L TRADE REP. (BNA) No. 21, at 848 (May 22, 1996). The objective of creating the guarantee facility is to increase trade by "expand[ing] the capacity of local banks to offer proper credit and settlement devices for trade transactions . . . ." *Id.* at 849.

134. *Armenia: Review 2000, supra* note 19, at 4.

135. ARMENIA: FOREIGN INVESTMENT GUIDE, *supra* note 8, at 18.

136. *Id.*

137. *International Accounting Standards to be Implemented in Armenia in 2000–2001*, DAILY MEDIA DIGEST OF USAID/ARM. ECON. REFORMS, Jan. 21, 2000 (on file with the Loyola of Los Angeles International and Comparative Law Review). Levon Barkhudaryan, Minister of Finance of Armenia, reported that twenty-six of the thirty-five accounting standards have already been confirmed. *Id.*

138. *Absence of Capital Market Hampers Economic Progress, SMMA States*, NOYAN TAPAN NEWS AGENCY, Feb. 29, 2000 (on file with author).

139. *See id.*

140. *Draft Law on Securities Market Not Approved*, DAILY MEDIA DIGEST OF USAID/ARM. ECON. REFORMS, Feb. 24, 2000 (on file with the Loyola of Los Angeles International and Comparative Law Review). The draft bill also provided for the

currency and single-digit inflation has spurred interest rate hikes.[141] Consequently, the Central Bank's benchmark refinancing rate is above 40%, which impedes business growth.[142] A strong securities market and low interest rates will boost foreign investor confidence, raise the capitalization of the existing commercial banks, and promote the establishment of foreign affiliate banks in Armenia.

Another important element that attracts more foreign direct investment is the effectuation of foreign investment treaties.[143] Armenia's investment treaties with the United States, France, and the European Union have established the groundwork for future direct investment and joint ventures.

C. Investment Treaties

After the collapse of the former Soviet Union, the United States negotiated the Bilateral Investment Treaty (BIT) with Armenia.[144] Relatively little information is available about the BIT because it has been in effect for less than four years.[145] It is important, however, to examine how the treaty impacts foreign investment.[146] Given its implementation of market reforms, the BIT aims to promote and facilitate private investment in Armenia.[147] A fundamental element of the BIT is its guarantee of

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appointment of an independent securities market regulator. *Id.*

141. Danielyan, *supra* note 21.

142. *Id.*

143. *See* discussion *infra* Part III.C.

144. Treaty Between the United States of America and the Republic of Armenia Concerning the Reciprocal Encouragement and Protection of Investment, Sept. 23, 1992, U.S.-Arm., S. TREATY DOC. No. 103-11 [hereinafter Armenia BIT]. The Treaty was signed on Sept. 23, 1992. *Id.* It remains in effect for ten years. *Id.* art. XIII.

145. *See* Kenneth J. Vandevelde, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH J. INT'L L. 621, 632–33 (1993) [hereinafter Vandevelde, *U.S. Bilateral Investment Treaties*] (stating that in 1993, no BIT had been in force for more than four years). The Armenia BIT has only been in force since March 29, 1996, and has remained in effect throughout the recent political crises that have plagued Armenia. Extensive research by the author uncovered no evidence to either confirm or deny the success of the Treaty. Therefore one can reasonably conclude that it is a success because it has remained in effect for over five years, despite the recent political crises and continued economic stagnancy.

146. *See id.* at 633–42.

147. *See id.* at 634; *see also* Armenia BIT, *supra* note 144, art. III. Armenia also entered into a bilateral investment treaty with France, *L'Accord entre le Gouvernement de la République française et le Gouvernement de la République d'Arménie sur l'encouragement et la protection réciproques des investissements* [Treaty on the

national and most favored nation (MFN) treatment.[148] Both U.S. and Armenian investors are afforded the same access and legal right to acquire and establish investments in Armenia and the United States, respectively.[149] This equal treatment aims to minimize risk and maximize returns.[150] Upon adoption, the BIT also locked-in pro-market policies that prevent the state from retreating to anti-market policies in times of economic adversity.[151] For Armenia, the BIT represents a status symbol, a reward for the market reforms already adopted, and a means to procure more investment from the United States and other investors.[152]

Several measures of the Armenia BIT protect U.S. investments: (1) a requirement that compensation be paid in the event of expropriation of covered investment;[153] (2) a prohibition on currency exchange controls;[154] (3) a requirement that the state

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Reciprocal Promotion and Protection of Investments], which mirrors its bilateral investment treaty with the United States with the exception that there are no sector-related exceptions to the MFN treatment. Law No. 97-779 of Nov. 4, 1995, J.O., Aug. 6, 1997, p. 11696; 1997 Recueil des traités, No. 97-779.

148. Armenia BIT, *supra* note 144, art. II(9).

149. Vandevelde, *U.S. Bilateral Investment Treaties*, *supra* note 145, at 634; *see also* Armenia BIT, *supra* note 144, art. II(1). It is important to note that BITs effectuated in the late 1980s, as well as the Armenia BIT in 1992, have included sector-related exceptions to the general MFN obligation in the annexes of the treaties, which seems diametrically opposed to promoting investment. *See* Vandevelde, *U.S. Bilateral Investment Treaties*, *supra* note 145, at 641–42. Each side includes exceptions to national treatment, with the U.S. listing, *inter alia*, custom house brokers, banking, insurance, and government grants, while Armenia included, *inter alia*, government grants, government insurance and loan programs, customs house brokers, and extraction of natural resources. Armenia BIT, *supra* note 144, annex (1), (3). Additionally, the guarantees of MFN treatment "do not aid the investor in establishing the investment, but do prohibit discrimination once the host state has allowed the investment to be established." Kenneth J. Vandevelde, *Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties*, 36 COLUM. J. TRANSNAT'L L. 501, 512 (1998) [hereinafter Vandevelde, *Investment Liberalization*].

150. *See* Vandevelde, *U.S. Bilateral Investment Treaties*, *supra* note 145, at 634.

151. *See id.* at 638.

152. *See id.* at 634. Kenneth Vandevelde warns that it is difficult to establish a positive correlation between the implementation of the BIT and increased foreign investment and that it is important to look to other factors, such as highly skilled workers (especially present in Armenia) and tax incentives, to assess the growth of foreign investment. *See* Vandevelde, *Investment Liberalization*, *supra* note 149, at 524–25; U.N. CTR. ON TRANSNAT'L CORPS., THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT—A SURVEY OF THE EVIDENCE at 9, 60, U.N. Doc. ST/CTC/121, U.N. Sales No. E.92.II.A.2 (1992).

153. *See* Armenia BIT, *supra* note 144, art. III.

154. *Id.* art. IV(2).

afford covered investment both national and MFN treatment, even in the event of war;[155] (4) a general obligation of due care towards covered investment (specifically "fair and equitable" treatment in accordance with international law);[156] and (5) a requirement that the host state honor any previous investment commitments.[157]

Compensation for expropriation must be "prompt, adequate and effective" and equivalent to the "fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier."[158] As a result, the compensation amount prevents loss to the investor because of a change in the exchange rate: "[t]he investor receives the amount of freely useable currency that [he or she] would have received had transfer occurred on the date of expropriation, even though the transfer will be carried out at the rate of exchange on the date of transfer."[159] In case of dispute, resolution occurs through arbitration or a procedure agreed to by the United States and Armenia.[160] Further, the investor chooses the mode of binding arbitration, which is conducted either through the International Centre for the Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL).[161]

Despite the BIT's lack of tangible success, it has encouraged the implementation of market reforms in Armenia by emphasizing various levels of investment protection, including nondiscrimination, security, and dispute resolution.[162] The BIT also provides Armenia with the tools to implement more far-reaching market-based reforms.[163]

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155. *Id.* art. III(3). The author notes that most BITs grant a right of U.S. investment, but the right is always limited by local law. *See* Vandevelde, *Investment Liberalization*, *supra* note 149, at 511. Armenia, as discussed earlier, has implemented many laws, notably banking and privatization laws, that have permitted increased foreign investment. *See supra* Part III.A–B.

156. *See* Armenia BIT, *supra* note 144, art. II(2)(a). The treatment article prohibits performance requirements such as conditioning investment on the export of goods produced or the local purchase of goods or services. *Id.* art. II(5).

157. *See* Vandevelde, *Investment Liberalization*, *supra* note 149, at 504–05.

158. Armenia BIT, *supra* note 144, art. III(1).

159. Vandevelde, *U.S. Bilateral Investment Treaties*, *supra* note 145, at 654.

160. Armenia BIT, *supra* note 144, art. VI(2).

161. *Id.* art. VI(3)(i), (iii).

162. *Id.* arts. III, VI, X.

163. *See* Vandevelde, *Investment Liberalization*, *supra* note 149, at 514. The author

Multilateral agreements, however, are more effective than the BIT in promoting a sustainable liberal investment regime in Armenia.[164] Multilateral agreements reflect international consensus. They embody political legitimacy because the host-state agrees to conform to a universal legal framework of liberal investment.[165] One such example is Armenia's partnership and cooperation agreement with the European Union (Treaty).[166] The E.U. Treaty aims to promote trade and investment in Armenia by encouraging market-based reforms and fostering cooperation in the areas of investment, mining, education, and training.[167] The Treaty also provides the European Union with external energy sources.[168] The Treaty helps Armenia harmonize

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stresses that BITs are primarily instruments of investment protection, and while this argument is sound considering Armenia's economic and political problems, it is also arguable that the Armenia BIT has laid the foundation for increased investment in the future, especially considering that five years have elapsed from the signing of the Treaty and its implementation, investment has grown, though unevenly, and the Treaty remains in effect. This indicates a conscious effort on the part of the United States to monitor the progress of political and economic reform before allowing the Treaty to go into effect and in fact, much of the reform took place years before the implementation of the treaty. Thus, the author's insistence on the limited value of BITs in the case of Armenia is not applicable.

164. *See* Kenneth J. Vandevelde, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373, 396 (1998) [hereinafter Vandevelde, *Sustainable Liberalism*].

165. *See id.*

166. The treaty was signed on April 22, 1996, and stays in effect for ten years. *International Agreements: European Parliament Endorses Accords with Georgia, Armenia, Azerbaijan, Kazakstan*, 14 INT'L TRADE REP. (BNA) No. 12, at 534 (March 19, 1997); *International Agreements: EU Signs Accords with Three Former Soviet Countries, supra* note 51, at 692. Armenia also entered into a partnership and cooperation treaty with France, seeking to establish regular meetings among the foreign affairs ministers of each country to discuss topics of common interest and harmonize certain policies, such as conflict prevention and defense as well as some cultural and educational exchanges. Friendship and Cooperation Treaty, Mar. 12, 1993, J.O., May 18, 1994, arts. 7, 13(1)(2).

167. *See International Agreements: European Parliament Endorses Accords with Georgia, Armenia, Azerbaijan, Kazakstan, supra* note 166, at 534; *International Agreements: EU Signs Accords with Three Former Soviet Countries, supra* note 51, at 692; *see also* Partnership and Cooperation Agreement Between the European Communities and their Member States, of the one part, and the Republic of Armenia, of the other part, 1999 O.J. (L 239) 42, arts. 1, 47, 50, 52 [hereinafter Partnership and Cooperation Between the E.C. and Armenia]. With respect to the energy sector, the agreement seeks to modernize the infrastructure and alternative energy resources, especially important for the European Union, which is increasingly dependent on external energy sources. *See id.* art. 54(1)(2); *International Agreements: European Parliament Endorses Accords with Georgia, Armenia, Azerbaijan, Kazakstan, supra* note 166, at 534.

168. *See International Agreements: European Parliament Endorses Accords with*

its laws to conform to those of the European Union, especially in the areas of customs law, banking law, intellectual property, and financial services.[169]

The E.U. Treaty is also designed to aid Armenia in becoming a member of the World Trade Organization (WTO).[170] In addition, the Treaty grants MFN status for the trading of goods.[171] Nevertheless, MFN treatment does not prevent the parties from adopting measures prohibiting, *inter alia*, double taxation.[172] Neither party may offer MFN treatment to the others' financial services other than what is outlined in the General Agreement on Trade in Services (GATS), particularly in Articles 2–5.[173]

Furthermore, the Treaty addresses corruption by providing that the European Union must assist Armenia in monitoring corrupt business and trade practices. For example, the Treaty calls for the establishment of research centers to disseminate trade information.[174]

This Treaty signifies a turning pointing in Armenia's position in global trade and investment. It demonstrates the European Union's confidence in Armenia's political and economic reforms. Most notably, the European Union is Armenia's leading trading partner, accounting for approximately one-third of Armenia's external trade.[175] In the words of Hans van de Broek, the commissioner who oversees E.U. relations with eastern and central European nations:

Georgia, Armenia, Azerbaijan, Kazakstan, *supra* note 166, at 534.

169. Partnership and Cooperation Between the E.C. and Armenia, *supra* note 167, art. 43(1)(2); *International Agreements: E.U. Signs Accords with Three Former Soviet Countries*, *supra* note 51, at 692. Armenia, along with Azerbaijan, has been admitted into the Council of Europe, the European Union's network of European and non-European heads of state, which addresses issues of foreign policy at regularly-held summit meetings, furthering deeper cooperation with its European trading partners. *See* THE EUROPEAN COMMUNITY AND THE CHALLENGE OF THE FUTURE 21 (Juliet Lodge ed., 2d ed. 1993); *see also* Armen Zakarian & Emil Danielian, *Council of Europe Admits Armenia & Azerbaijan*, RADIO FREE EUR./RADIO LIBERTY (ARM. REP.), Nov. 8, 2000, http://www.rferl.org/bd/ar/reports/archives/2000/11/081100.html.

170. *International Agreements: E.U. Signs Accords with Three Former Soviet Countries*, *supra* note 51, at 692.

171. *Id.*

172. Partnership and Cooperation Between the E.C. and Armenia, *supra* note 167, arts. 9, 39.

173. *Id.* arts 2–5.

174. *Id.* art. 69.

175. Danielyan, *supra* note 21.

> Political stability has allowed the implementation of economic reforms. Now we feel we have taken significant steps to ensure the respect for the rule of law, human rights, and the principles of a market economy. The further development of these are essential in the relationship between the E.U. and [Armenia].[176]

IV. CONCLUSION

Armenia is one of the leading countries in the CIS because of its reformation of laws, allowing privatization and foreign direct investment. It has become more politically and economically stable, thereby permitting extensive privatization, numerous joint ventures, and investment treaties.[177] This stability demonstrates Armenia's commitment to a market-based economy and its willingness to standardize its goods and services in conformity with international norms. Alain Duran, Vice-President of the Association of France Norms (AFNOR), declared that "Armenia is one of the leading countries in the CIS by bringing the standardization of goods and services up to international norms."[178] A survey conducted jointly by the Armenian Ministry of Trade and Industry and the U.S. Agency for International Development (USAID) found that most of the sixty randomly interviewed foreign investors regard "Armenia as an important production base to reach markets of the former Soviet Union and Middle East."[179] Foreign investors also listed Armenia's inexpensive, highly-skilled labor force and reliable local trade partners as advantages to investment.[180]

By implementing broad economic reforms, Armenia is better prepared to engage in regional cooperation. For example, the "Synergy Program" coalesces 170 organizations from Armenia, Azerbaijan, and Georgia to pursue cross-border projects such as

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176. *International Agreements: E.U. Signs Accords with Three Former Soviet Countries*, *supra* note 51, at 692.

177. *See supra* Part III.

178. *Armenia Shows Lead in Standardization in CIS*, NOYAN TAPAN NEWS AGENCY, Oct. 19, 1998 (on file with author).

179. Atom Markarian, *Foreign Investors See Opportunities in Armenia Despite Chronic Problems*, NOYAN TAPAN NEWS AGENCY, Oct. 24, 1998 (on file with author) [hereinafter *Foreign Investors*].

180. *Id.*

"regional business development, tourism, regional media cooperation, and integrated electronic communications."[181]

Armenia still has many challenges to face. According to the IMF, Armenia is a "country in transition"—it has embraced macroeconomic ideology and implemented economic reforms to advance its goal of becoming a market economy, yet despite its pro-Western orientation, Armenia fails to rid itself entirely of totalitarian influences.[182] Armenia historically identifies its interests with Russia; Russia perceives itself as Armenia's guardian against its Muslim neighbors.[183] This relationship strengthened in the years following the collapse of the Soviet Union.[184] Armenia depends heavily upon Russian economic and military support.[185] Armenia also supports Russia "on issues concerning relations among the former Soviet republics."[186] Russia, however, has failed to sustain market reforms and combat rampant corruption and bribery in its own government.[187] Therefore, Armenia's firm ties to Russia call into question its commitment to market reform and whether it has shed its totalitarian past.

Armenia's failure to strengthen its securities market and enforce existing investment law, in addition to reports of bribery and corruption, hinders foreign investment.[188] Investors are

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181. *170 Organizations from Armenia, Azerbaijan and Georgia Pursue New Avenues of Cooperation*, 32 ARMENIAN REP. INT'L, Dec. 12, 1998, at 29. The program is organized by the Eurasia Foundation, a privately managed, U.S. non-profit grant-making organization funded by USAID. *Id.* Eurasia has made numerous contributions to public and private sector development in Armenia since 1995 (totaling $2,970,000) and has provided 122 loans to businesses through its Small Business Loan Program (totaling $3,430,000). *Id.* The EBRD is also assisting local business owners—one of the EBRD's six approved projects for 2000 is to promote local small and medium-sized enterprises (SMEs) through specialized credit lines and direct capital investments utilizing suitable intermediaries, including venture capital funds. *EBRD Had Approved Six Investments in Armenia Totally* [sic] *EUR 145.30 [Million]*, *supra* note 94.

182. United Nations Development Programme (UNDP), *Armenia: National Human Deveolopment Report 1999*, ch. 1, *at* http://www.undp.am/archive/Nhdr/nhdr99/eng/1.html (last visited Feb. 14, 2001).

183. SAMUEL P. HUNTINGTON, THE CLASH OF CIVILIZATIONS AND THE REMAKING OF WORLD ORDER 164 (1996). The author argues that "[t]he Orthodox countries of the former Soviet Union [(Armenia, Belarus, Georgia, Ukraine, and Moldova)] are central to the development of a coherent Russian bloc in Eurasian and world affairs." *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.* at 163–68.

188. *See Foreign Investors*, *supra* note 179.

reluctant to invest in a politically unstable country and are not certain that they will receive financial incentives offered them.[189] Varoujan Kouzoukian, head of Foreign Investors Assembly, a consulting firm based in Yerevan, laments that many economic laws differ in practice from how they appear on paper.[190] Kouzoukian adds that frequent tax inspections of firms contribute to the reluctance of investors to expand their involvement in Armenia.[191]

In addition, the political unrest caused by the recent assassinations of the Prime Minister and the Chairman of the National Assembly, as well as the ongoing Nagorno-Karabakh dispute, caused a major decline in foreign direct investment.[192] Foreign investment in Armenia, however, has increased steadily with $107 million invested in the first half of 2000, a 122% increase compared to the same period in 1999; an additional $400 million is expected to be invested in 2001.[193] The realization of foreign investment projections for 2001 are inextricably linked to the political stability and the resolution of the Nagorno-Karabakh dispute.[194]

Armenia faces significant economic and social challenges, notwithstanding macroeconomic reforms.[195] Unemployment has increased steadily since 1992, while government subsidies have decreased.[196] About 80% of the population is classified as poor or very poor.[197] The social reforms following the 1991 coup (i.e., free education, public health care, the right to paid work, and leisure achievements) are no longer in existence.[198] Further, despite the

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189. *See id.*; Atom Markarian, *Obstacles to Foreign Investment in Armenia*, RADIO FREE EUR./RADIO LIBERTY (CAUCASUS REP., vol. 1, No. 33), Oct. 16, 1998, http://www.rferl.org/caucasus-report/1998/10/33-161098.html [hereinafter *Obstacles*].

190. *Obstacles*, *supra* note 189.

191. *Id.*

192. *See supra* Part II.A.

193. *Volume of Foreign Investments into Economy of Armenia May Amount to $400 Million*, SNARK BUS. BULL., Oct. 10, 2000 (on file with author).

194. *See* United Nations Development Programme (UNDP), *supra* note 182, ch. 1.4, http://www.undp.am/archive/Nhdr/nhdr99/eng/1-4.html (last visited Feb. 14, 2001).

195. United Nations High Commission on Refugees (UNHCR), *Country Profiles—Armenia*, *at* http://www.unhcr.ch/world/euro/armenia.htm (Sept. 1999).

196. *See id.*

197. United Nations High Commission on Refugees (UNHCR), *Country Profiles—Armenia*, *supra* note 195.

198. *See* United Nations Development Programme (UNDP), *supra* note 182, ch. 2, http://www.undp.am/archive/Nhdr/nhdr99/eng/2.html (last visited Feb. 14, 2001).

formal involvement of the population in the privatization process, only 10% of the population retained and accumulated privatization certificates and exercised their rights to privatization.[199] The remainder sold the certificates on the black market at extremely low prices, remaining alienated from property.[200]

Foreign investment in Armenia will sustain its transition from a central to market economy. The government reforms previously enacted must be enforced and new ones must be created. The transition to democracy and a market economy will take time. As Armen Yeghiazarian, former Minister of the Economy, noted: "Armenia is a country which is trying to become democratic, and that's not something you can do in four years."[201] A firm commitment to adhere to market principles and active engagement in resolving the Nagorno-Karabakh dispute are essential to restore investor confidence in Armenia.[202] Any wavering in such commitment jeopardizes all privatizations as well as prospects for continued foreign investment.

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199. *Id.*

200. *Id.*

201. Freeland, *supra* note 18, at 35.

202. *See* United Nations Development Programme (UNDP), *supra* note 182, ch. 1.4, http://www.undp.am/archive/Nhdr/nhdr99/eng/1-4.html (last visited Feb. 14, 2001).