



INVESTMENT REFORM MAP

Armenia

Analytical report for the Ministry of Economy

June 30, 2015

Investment Policy and Promotion
Trade and Competitiveness Global Practice
World Bank Group

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Introduction

1. *Despite continuous reform efforts, the global financial crisis has had a significant negative impact on Armenia's economy and important challenges remain in generating sufficient jobs to stem emigration and reduce poverty.*¹ With a population of about 3 million, GDP of about US\$10 billion and GDP per capita of US\$3,830, Armenia is a small lower middle-income country whose economy has undergone a profound transformation since independence in 1991. Sustained growth, ambitious reforms, as well as inflows of capital and remittances, have helped create and sustain a market-oriented environment. More recently these problems have been accentuated by the deterioration of Russia's economy, affecting negatively exports and remittances from migrant workers.

2. *Within this context, the Government of Armenia (GoA) has recognized that foreign direct investment (FDI), as well as non-equity modes (NEMs)² of investment by multinational enterprises, have an important role to play in meeting its development objectives. GoA is interested in undertaking reforms to ensure that its investment policy framework is aligned with these objectives.*

3. *This analytical report provides a framework for Armenia to develop its vision for investment and facilitate its implementation through investment policy reforms.* A result of an interactive process engaging key high-level and technical representatives from GoA and the private sector, the report serves as the starting point for targeted and development-oriented investment policy reforms and offers policy-makers a set of tools to consider when examining investment policy reform options and setting priorities.

4. *The report, as well as the participatory process behind it, have the following three core objectives:*

- (i) Focus the GoA's discussion on identifying relevant investment policy issues and constraints, taking a holistic view of FDI;
- (ii) Assist GoA in setting priorities for reforms, especially as regards efficiency-seeking investment; and
- (iii) Assist GoA in setting an agenda for concrete actions that will support the country's long-term investment vision and bring about measurable impacts within a 2-3 year framework.

5. *Accordingly, the report is organized as follows:*

- The first section outlines Armenia's vision for FDI and its role in the country's economic development. It also explains the methodological framework applied in the report and the key concepts - the Investment Life-cycle and Investment Typology – that can serve GoA in effectively organizing investment policy and promotion reforms to fulfil its vision.

¹ IMF, 2014 Article IV Consultation and First Review Under the Extended Arrangement—Staff Report (March 2015).

² Non-equity modes of investment (NEMs) encompass contractual relationships between foreign and domestic investors in the form of franchising, licensing, contract manufacturing, services outsourcing and other forms. The foreign partner typically provides know-how and the local partner provides the capital to start an investment. NEMs have a high development potential through technology dissemination, enterprise development, and by helping developing countries gain access to global value chains.

- The second section provides an analytical overview of FDI flows and exports to assess whether the type and levels of FDI currently received correspond with Armenia’s vision and its social and economic objectives.
- The third section provides a snapshot of Armenia’s broader competitiveness and investment climate vis-à-vis FDI, in particular efficiency-seeking FDI, which is export-oriented.
- The fourth section extends the previous section and focuses on Armenia’s investment policy framework (*de jure* and *de facto* aspects) to assess whether it is conducive to FDI overall, and efficiency-seeking investment in particular.
- The fifth and final section provides recommendations for reform to Armenia’s investment policy framework in the short and medium term. If implemented, these reforms will address the key policy, legal and institutional constraints to investment in Armenia. The modernization of the Law on Investment (1994) should be undertaken in parallel to ensure synergies between legal and policy reforms.³

6. *In addition to this analytical report and the menu of policy recommendations included in it, it is recommended that GoA adopts a standalone action plan determining specific reform priorities, actions, lead agencies and timelines for implementation.*

I. Armenia’s vision regarding the role of FDI in the economy

7. *Armenia’s objectives and expectations from FDI are captured in two key documents: the Armenia Development Strategy 2014-2025 and the Strategy of Export-Led Industrial Policy of Republic of Armenia:*

- *Armenia Development Strategy (ADS):* Armenia has replaced the former Sustainable Development Program (SDP), adopted in 2008, with the Armenia Development Strategy (ADS), a new strategy covering the period 2014-2025. ADS has four priorities: (i) growth of employment; (ii) development of human capital; (iii) improvement of social protection system; and (iv) institutional modernization of public administration and governance. The continuous improvement of the business environment and investment climate are viewed as a priority for increasing employment by facilitating the establishment of businesses and investments and reducing undue state intervention. Promotion of investments and competitiveness are to be maintained as goals within the framework of ADS. Increasing the effectiveness of investment policy, thus contributing to higher productivity, exports and increased competitiveness is viewed as an important element in accomplishing this goal.⁴

More specifically, ADS spells out the policy reforms needed to improve the business environment and investment climate, namely: (i) significant reduction in direct contacts of businesses and citizens with the state through the introduction of inter-

³ A preliminary review of the Investment law of Armenia by the World Bank Group can be found in annex 3 of the report.

⁴ “...the continuous improvement of business environment and investment climate will remain the main priority of the state framework policy to increase the employment, and will be aimed at facilitating the establishment of businesses and investments and reducing significantly undue state intervention. From the viewpoint of foreign strategic investment attraction steady growth of investors’ protection level is important.” Armenia Development Strategy 2025, p. 33.

agency electronic information exchange systems; (ii) a one-time measure reduction and simplification of state regulations (by about 50%) relating to businesses and citizens; (iii) inspections system reform; (iv) implementation of regulatory impact assessments; and (v) regular study of the business regulation and investment climate best practices and their introduction in Armenia.

ADS also discusses the implementation of policies to support the information technology (IT) sector, including: (i) continuation of establishment of techno parks, incubators and other IT infrastructures; (ii) support to universities in implementation of modern curricula and acquisition of necessary laboratories through promotion of cooperation with the private sector; (iii) implementation of favorable tax policy promoting the export potential in IT; (iv) implementation of state-support programs for SMEs and start-ups in IT; and (v) direct support to IT companies offering innovative products or services.

- *Strategy of Export-Led Industrial Policy of Republic of Armenia (2011)*: The long-term goal of the Export-Led Industrial Policy is to form new driver sectors by expanding currently exporting sectors, as well as those with export potential. Under this strategy, GoA is targeting the expansion of key exportable sectors to develop manufacturing industries and clusters, with the long-term objective of building a knowledge-based economy. The long-term targets set are to expand the exportable sector of the economy to 19 percent by 2020 (exports of goods-to-GDP ratio), diversify the exportable sector of the economy away from metal mining products and diamonds, with a target of US\$1,300-1,500 million by 2020 and increase the competitiveness of Armenian goods, with a target of 4% real increase in productivity of the processing industry (value added per employee). These goals were to be achieved with the participation of foreign investment, as well as through improvements in the business regulatory environment and by ensuring favorable external regimes and elimination of trade barriers, among other policies. Attracting FDI is viewed as an important source of financial resources and new technologies, as well as a way of obtaining management experience and access to markets.

A. Investment Lifecycle and Investment Typology - A framework for organizing investment policy and promotion reforms

8. FDI has the potential to be an important driver of economic growth, diversification and structural transformation. By creating new jobs, enabling a shift from lower to higher value added jobs and by imparting skills and knowledge through transfers and spillovers to the workforce and local firms, FDI has the potential to be an engine of growth for the domestic economy.

9. FDI is also an important vehicle for connecting the domestic economy with the international private sector by fostering a wide range of opportunities for local companies to integrate into global production value chains. In today's world more goods and services reach consumers through sales by foreign affiliates than by trade alone. More than 80,000 foreign affiliates have assets worth US\$97 trillion and sell more than US\$34

trillion worth of goods and services, with a value added of more than US\$7 trillion.⁵ Foreign affiliates directly generate more than 71 million jobs worldwide. FDI and trade are inextricably interrelated through the international production networks in cross-border value chains. This development presents new opportunities for greater integration into global value chains for all countries, including Armenia.

10. **These benefits are not automatic.** First, the growing competition for FDI among developing countries means that host countries need to implement the most effective strategies to attract FDI, while ensuring and maximizing its contribution to the country's development objectives. Second, different kinds of FDI have unique characteristics, and their potential to generate various economic, social, and environmental impacts differs (annex table 1). The FDI policy agenda has to recognize these intricacies and take a comprehensive and tailored approach reflecting their specific contexts.

11. **To maximize countries' attractiveness for FDI as well as benefits from it to local economies, investment policy-makers may want to consider a framework with two key concepts that offers a way of thinking about investment policy issues: the "Investment Lifecycle" and "Investment Typology".**

- *The Investment Lifecycle.* FDI entails an ongoing relationship with many stakeholders, rather than a transaction between the state and the firm. The Investment Lifecycle is a framework that helps to explain how different problems for foreign firms can arise at different stages of their engagement in the host country and with different stakeholders and how investment policy reforms can help address those issues. The Investment Lifecycle begins with the host country's investment vision and policy priorities for FDI and continues with the different stages of the life of an investment, namely, attraction, entry/establishment, retention through protection, linkages and benefits for the national economy (figure 1).

Figure 1. The Investment Lifecycle



⁵ UNCTAD, World Investment Report 2014 (Geneva: UNCTAD).

- *The Investment Typology*. Different types of investment bring different benefits, opportunities and challenges, and different policy approaches are needed to capture the benefits of each type. The Investment Typology is a framework that explains the motives for different types of investment, the impacts, as well as the different risks and benefits for the host country and need for different investment policies. The typology discusses the principal types of investment, the key motives and drivers of each type, as well as implications for investment policy (see Annex Table 1: Investment Typology for a detailed overview).

The types of investment considered in the typology are:

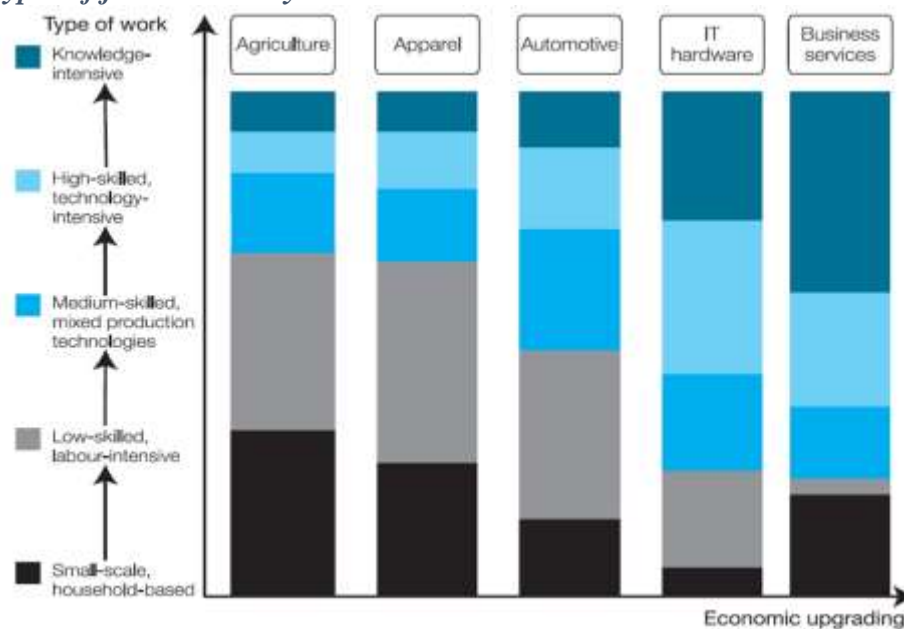
- **Natural resource-seeking investment:** This form of investment occurs when a firm seeks to secure access to certain natural resources that are located in the host country. Investors look for physical resources, such as land, oil, minerals, raw materials or agricultural products.
- **Market-seeking investment:** This form of investment is motivated by the potential to deliver goods and services to customers within the host country and as such it is almost entirely motivated by the size and characteristics of the domestic market. It can be an important source of jobs, including higher-skill, better-paid jobs associated with the services sector. Many small countries around the world have enhanced their market-seeking FDI potential by linking/integrating their economies with larger economies through bilateral or regional preferential trade or economic integration agreements.
- **Efficiency-seeking investment:** This form of investment is generally export-oriented, and occurs where the investor seeks to increase cost efficiency of production by taking advantage of factors that improve the competitiveness of the enterprise. The key determinant for all types of efficiency-seeking investment is a country's "competitiveness". Efficiency-seeking investment has the most transformative potential of all types of foreign investment by not only transferring technology and skills, but also by diversifying the economy rapidly by inserting it into global value chains of goods and/or services.
- **Strategic asset-seeking investment:** This form of investment occurs when a multinational enterprise enters a market to acquire assets, usually of a foreign corporation, but also potentially of the country itself, which will promote the firm's long-term strategic objectives. It is utilized to acquire immobile strategic assets, such as business information, distribution networks, proprietary technologies and brands. Such acquisitions are regarded as a "shortcut" to establishing a new, full-fledged company with a network of sourcing and distribution channels, advanced technologies and brands. Strategic asset seeking investments usually entail acquisitions of companies located in developed countries, which possess the desired strategic assets and own corporate networks of affiliates/value chains.

12. The Investment Typology framework is important because of the different benefits that each type of FDI carries, and importantly, because it helps to tailor a country's value proposition to the types of investment that could help it achieve its objectives. For example, each type of investment can generate different types of jobs. Figure 2 describes how economic upgrading by joining global production networks leads to jobs that can increasingly become higher skilled and knowledge intensive. Natural resource seeking

investment, e.g. in agriculture, tends to generate mostly small-scale household/informal or low-skilled jobs, while efficiency-seeking investment, such as that found in automotive and IT hardware, tends to generate higher-skilled, technology-intensive jobs (figure 2).

In sum, the Investment Lifecycle and Investment Typology offer useful concepts that can be used when designing investment policies by emphasizing that such policies need to be tailored to the types of investment a country seeks to attract and along the different stage(s) in the investment lifecycle.

Figure 2. Types of jobs created by sector



Source: Barrientos, S., G. Gereffi, & A. Rossi (2011) 'Economic and Social Upgrading in Global Production Networks: A New Paradigm for a Changing World', *International Labor Review*, 150(3-4): 319–40.

II. Snapshot of FDI, exports and economic complexity

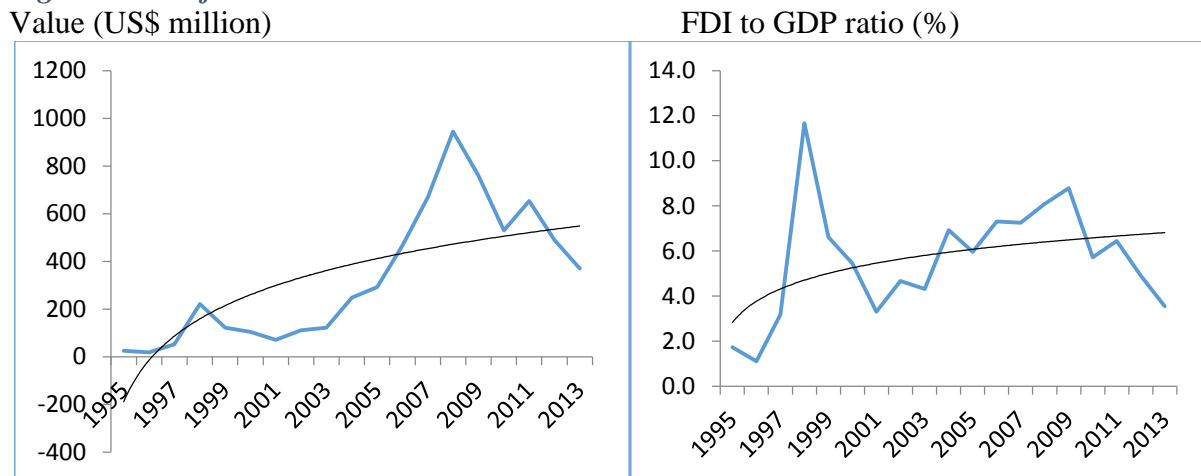
A. Recent FDI trends

13. In relation to comparator countries, Armenia fares well in its FDI performance measured as FDI/GDP ratio: Smaller countries with open economies tend to have relatively high ratios of FDI to GDP and Armenia is not an exception, outperforming several bigger countries that are EU members (e.g. Czech Republic, Slovakia, Slovenia), but lagging behind Estonia and Georgia (figure 4b). FDI flows in Armenia averaged 5.2% of GDP during 2010-2013, compared with 2.2% for lower middle income countries. Armenia also fares well compared with other developing countries in Europe and Central Asia, whose ratio of FDI flows to GDP averaged 2.8% during the same period.

14. However, it is the worsening of Armenia's current FDI flows in relation to earlier times that gives rise to concern. Armenia's FDI flows have been on a declining path following the financial crisis in 2008, both in absolute value and in relation to the size of the domestic economy (figure 3). Over the next five years (2015-2019) FDI flows into Armenia

are projected to plateau and remain in the range of US\$400-500 million annually,⁶ well below the average level of around US\$700 million achieved 2006-2009.

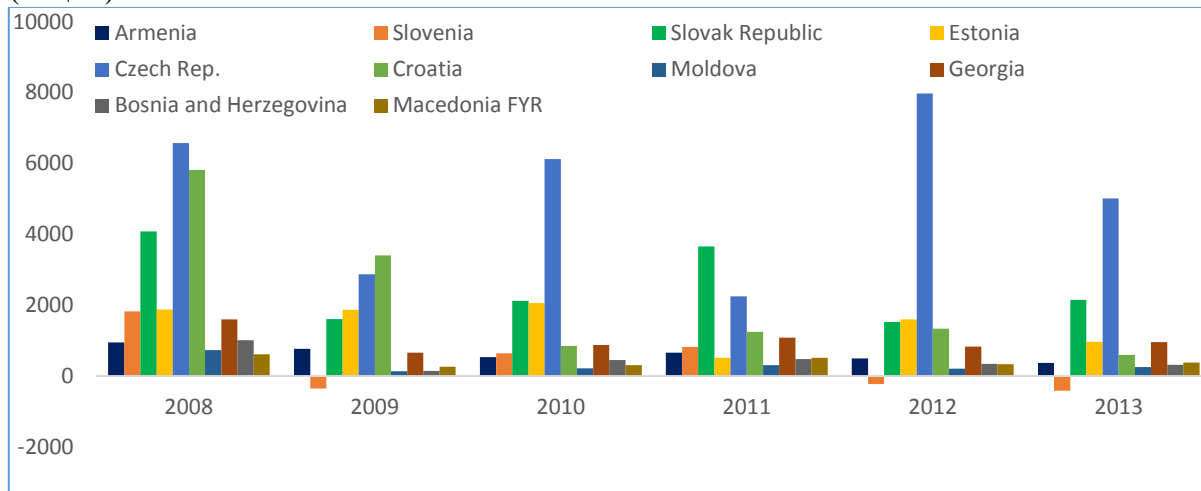
Figure 3. FDI flows in Armenia



Source: World Bank.

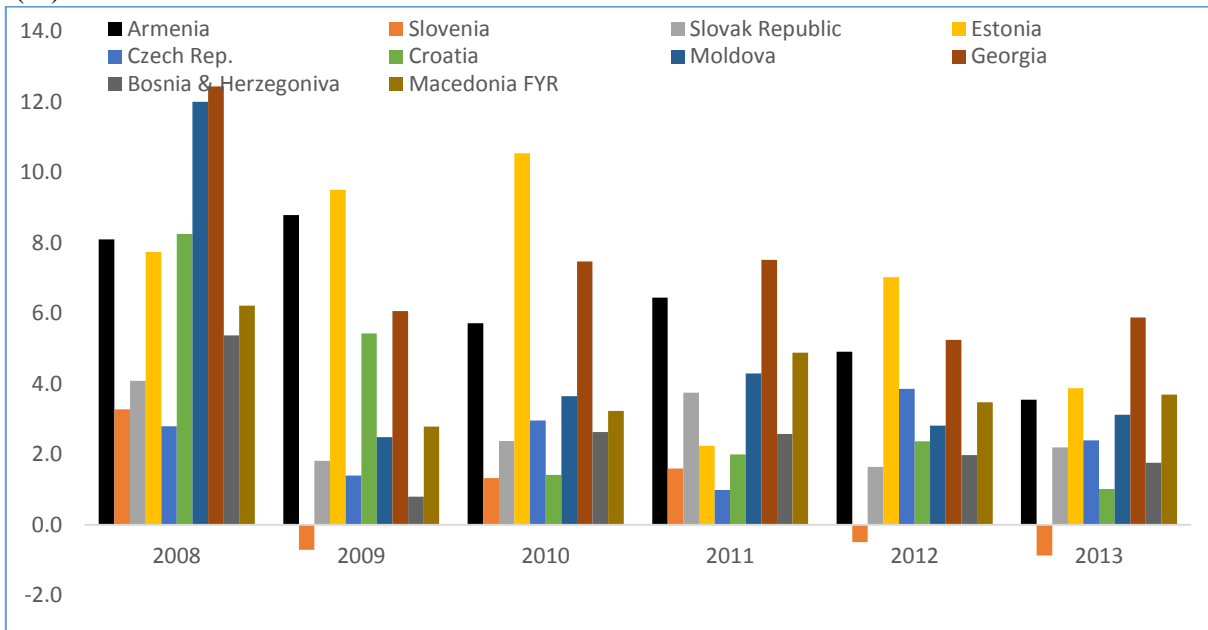
15. The comparison of Armenia’s FDI flows with that of similar countries from within and outside the region reveals a mixed picture (figure 4a). Armenia fares well in terms of value of investment received when compared with other small countries, such as Moldova, Bosnia and Herzegovina and Macedonia FYR and recently Slovenia (a member of the European Union – EU), but lags behind a number of countries that are EU members (Croatia, Estonia, Czech Republic). The larger size of these economies but also their membership in EU can explain this mixed performance as typically EU members are attractive to both intra and inter-regional investment seeking to produce in the most efficient location in terms of the cost-productivity nexus from where they can supply the whole EU market.

Figure 4a: FDI flows – comparator countries (US\$M)



⁶ IMF, 2014 Article IV Consultation and First Review under the Extended Arrangement—Staff Report (March 2015).

Figure 4b: FDI to GDP ratio – comparator countries
(%)



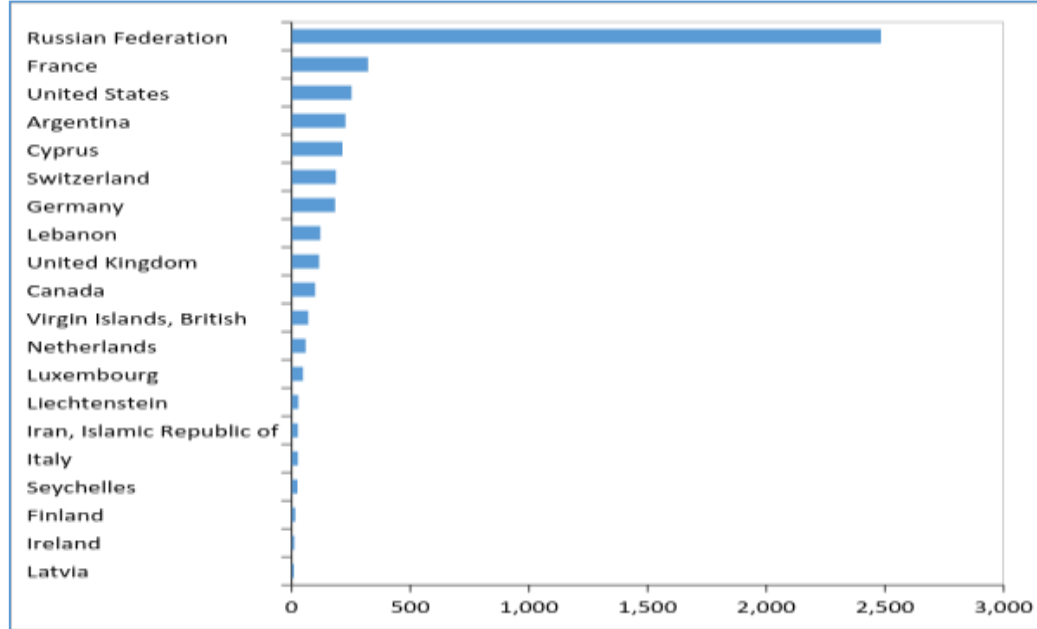
Source: World Bank.

B. Regional composition of FDI

16. **Russia accounts for half of Armenia’s inward FDI stock as of end-2012, underscoring Armenia’s economic links with the country (figure 5).** The EU accounts for another fifth of Armenia’s FDI stock. This picture reflects historical trends and masks a recent shift in the geographical distribution of Armenia’s FDI away from Russia. Depicting recent trends, cumulative FDI flows from EU into Armenia increased significantly during 2010-2013, positioning this group of countries in first place ahead of Russia. France, followed by Germany, have been the biggest investors in Armenia among EU members. In contrast to previous years, FDI flows originating from Russia declined significantly during 2012-2013. EU investments in both 2012 and 2013 were double those of Russia. Apart from EU and Russia, Armenia has received investments from a diverse group of countries worldwide that include Switzerland, Argentina, Lebanon and the United States; countries that might need to be leveraged more as potential sources of FDI going forward.

17. **Stronger relations between Armenia and Russia in the context of Armenia’s accession to the Eurasian Economic Union (EEU) suggests a continuous retention of Russia’s position among the top investors.** As for EU investment, ADS acknowledges a number of risks regarding FDI in the context of not participating in a Deep and Comprehensive Free Trade Area with the EU, which, potentially, can negatively affect interests of some European investors.

Figure 5. Source countries for FDI: Geographical distribution of FDI stock (end-2012)
(US\$ million)

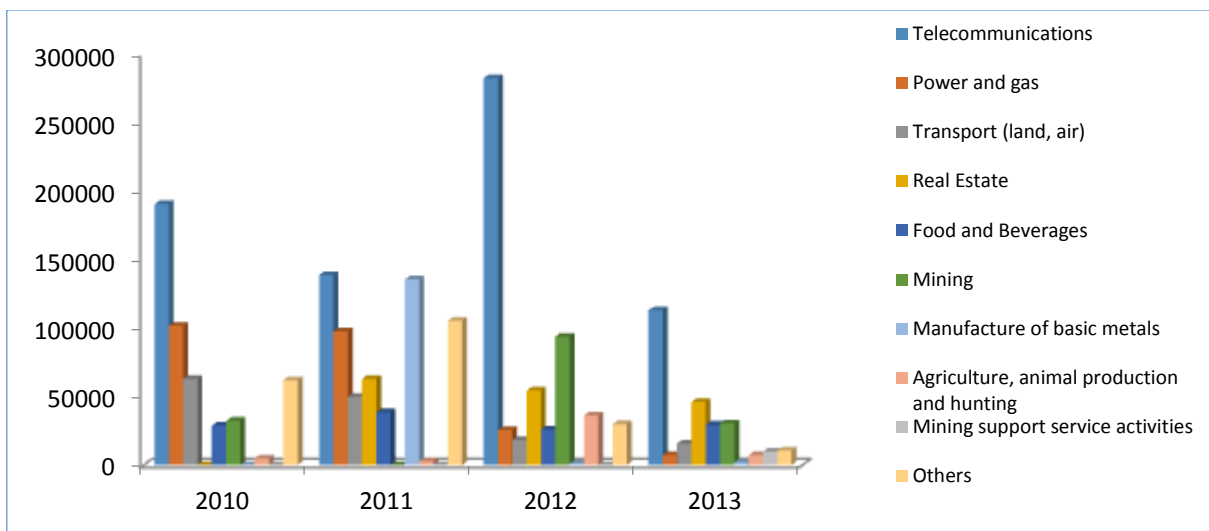
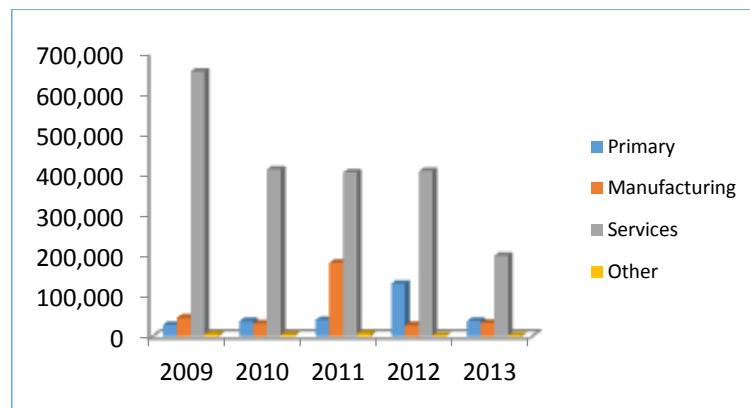


Source: IMF, CDIS and Armenian National Statistics Service.

C. Sector composition of FDI

18. **The services sector has been consistently receiving the lion’s share of FDI flows throughout 2009-2013, although the value of investment in that sector declined sharply in 2013.** That decline - from US\$408 million in 2012 to US\$199 million in 2013 (figure 6) - reflects a more than halving of investments in telecommunications and a decline in real estate. The decline in the former sector is due to completion of foreign investment projects, while the latter sector has been slumping on account of the slowdown in construction. The share of manufacturing and primary sectors has not shown a clear trend, with inflows in some years reflecting a one-time influx of capital likely in relation to individual large projects. This was the case in basic metal manufacturing in 2011 and in mining and agriculture in 2012. Looking more specifically at the industry composition, telecommunications received sizeable FDI flows during 2010-2013, while power and gas received large FDI flows in 2010-2011.

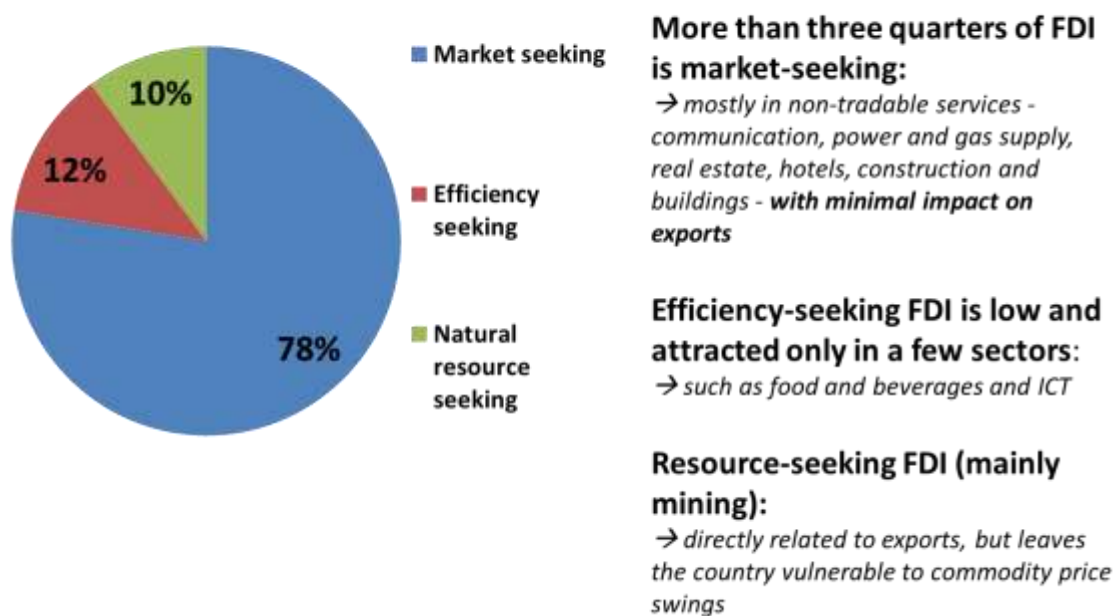
Figure 6. FDI inflows by sector and industry
(US\$ thousand)



Source: Armenian National Statistics Service.

19. Applying the Investment Typology framework to FDI flows into Armenia highlights the dominance of market-seeking investment. It is estimated that up to 78 percent of cumulative investment inflows during 2009-2013 is market seeking (figure 7), mostly comprising non-tradable services for which market presence is the only way of delivering them (e.g. warehousing, professional services, transportation). Natural resource-seeking investment has been small and concentrated in mining and quarrying, reflecting the small contribution of this sector to the domestic economy. The small share of efficiency-seeking investment (e.g. manufacturing goods in e.g. electronics and rubber and plastics) suggests that the country has not fully succeeded in leveraging regional/global value chains and preferential access to international markets and raises questions regarding the country's attractiveness for such investment in terms of its competitiveness (see later section). The small share of efficiency-seeking investment is also not aligned with Armenia's development vision targeting the expansion of higher skilled jobs, exports, technology transfer and with building a knowledge-based economy.

Figure 7. Investment typology applied to Armenia's FDI⁷
(based on cumulative flows, 2009-2013)



Source: World Bank calculations based on Armenian National Statistics Service.

D. Economic complexity of exports

20. Armenia's overall ranking in terms of economic complexity⁸ is 44 (out of 144 countries) with an economic complexity index (ECI) of 0.54 in 2012. Economic complexity reflects the amount of knowledge that is embedded in the productive structure of an economy. Ultimately, the ECI of a country's export basket is closely linked to its global

⁷ Note: Market-seeking investment comprises all services, except computer programming, consultancy and related activities; efficiency-seeking investment comprises all manufacturing and computer programming, consultancy and related activities; natural resource seeking comprises crop and animal production, hunting and related service activities (the latter were not separately available), mining of metal ores and other mining and quarrying. Since there is no clear way to assess the extent of exporting by foreign affiliates in each manufacturing industry, the assumption behind the estimate is that foreign affiliates export at least half of their output in each of these industries and are therefore classified as efficiency-seeking investments.

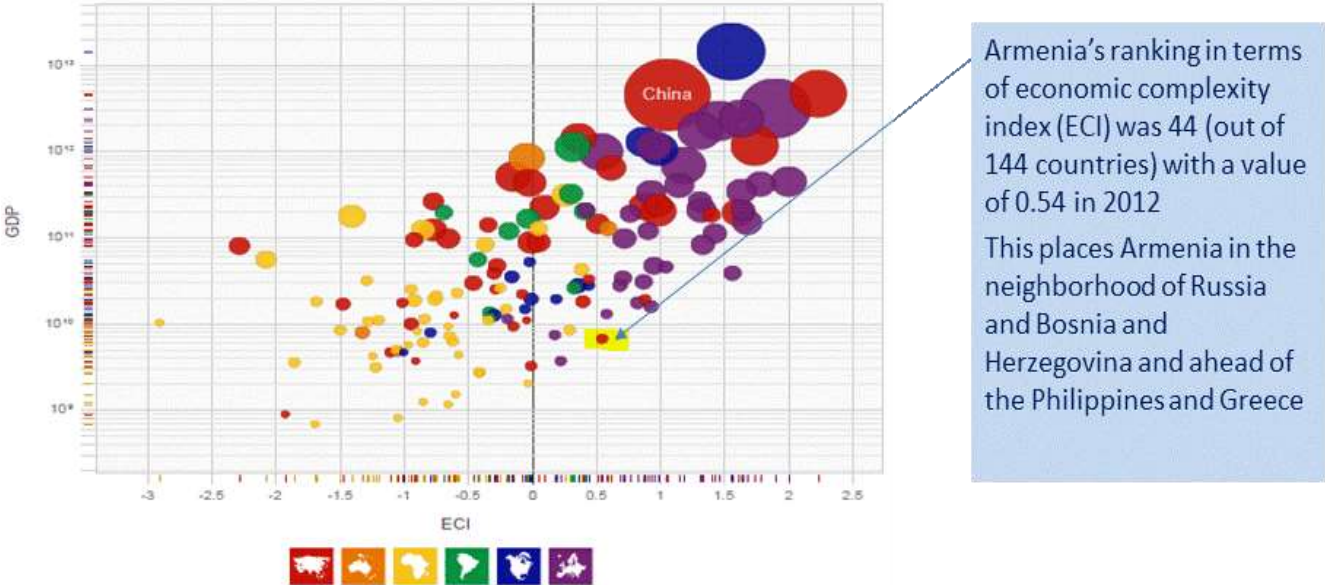
⁸ For more information on the framework underpinning the analysis, see Ricardo Hausmann, Cesar A. Hidalgo et al, The Atlas of Economic Complexity: Mapping Paths to Prosperity, MIT Press, Cambridge, Mass.

ranking in terms of GDP. Apart from those countries with high per capita incomes on account of revenues from natural resource extraction, countries that have high ECI scores are more likely to have higher levels of income. Armenia’s rankings place it in the neighbourhood of Russia and Bosnia and Herzegovina and ahead of the Philippines and Greece (figure 8, highlighted circle). This position represents a drop by seven places from the previous year, the first time Armenia’s ECI was estimated.

The ability of a country to export goods that have a high degree of economic complexity suggests the presence of competitiveness “sparks”. As figure 8 illustrates, there is a strong correlation between ECI and per capita incomes, with countries listed on the upper right hand side quadrant, indicating both high GDP and ECI, being mostly industrialized economies. Exports of products with high ECI scores are those whose industries may need to be investigated further to understand any challenges they face in order to inform the discussion on export-oriented efficiency seeking investment.

21. To improve its ranking, Armenia would need to increase the number and complexity of products it exports (as per the product complexity index, or PCI). Countries that successfully do so focus on productive capabilities that offer opportunities for exporting products with higher PCI. In this regard, there is a role for the right type of efficiency-seeking FDI, which could help promote and diversify exports in favor of those with higher PCI. However, as discussed earlier, such investment is fickle and sensitive to cost factors and policy considerations. To maximize the chance of receiving such investment, Armenia would need to create an environment where investment is attracted and is able to thrive in complex productive activities.

Figure 8. Armenia’s position in the world as per the Economic Complexity Index

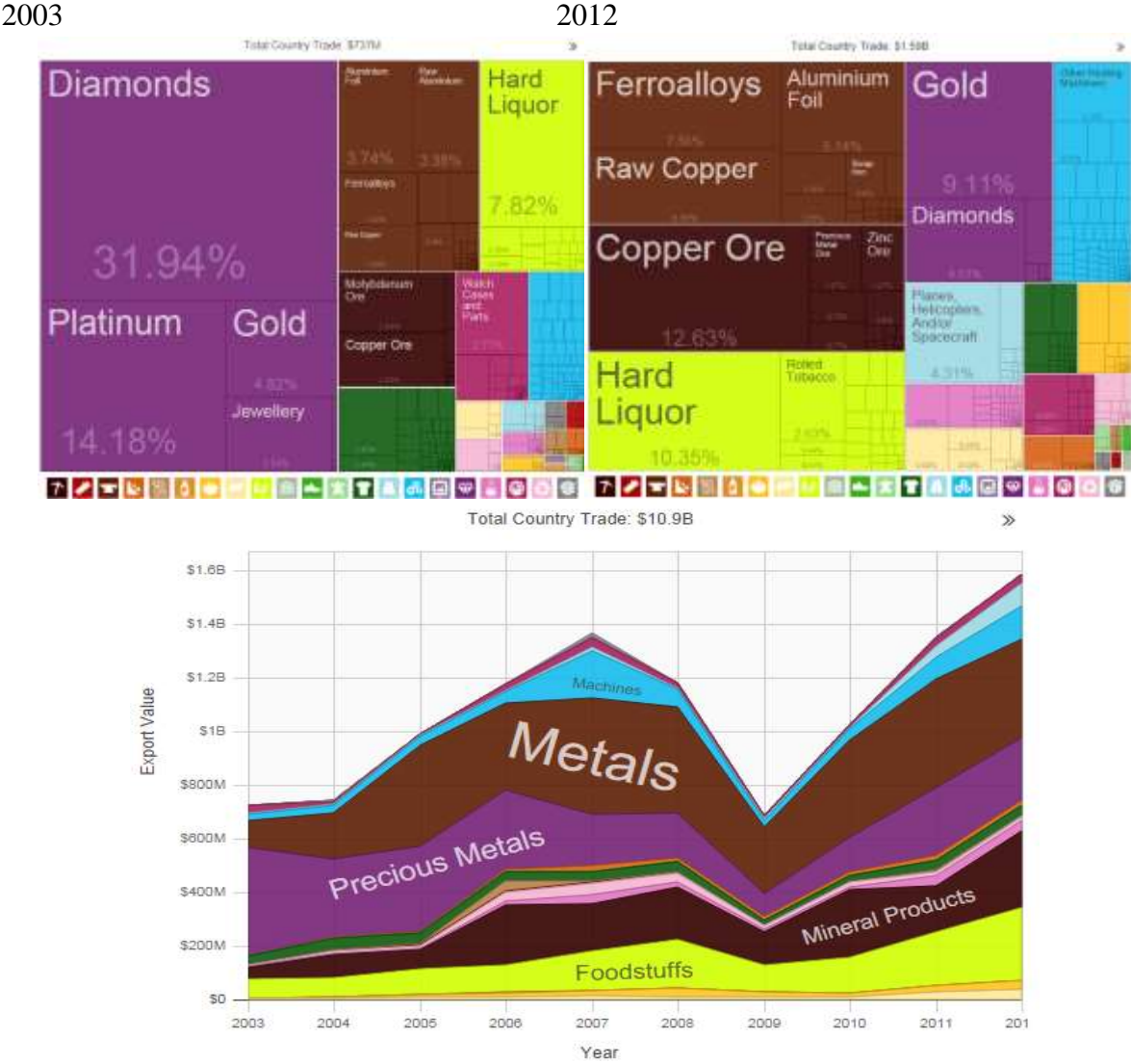


Source: MIT, The Atlas of Economic Complexity. Armenia’s position is the highlighted circle.

22. Armenia’s merchandise export structure is diversified, but has not changed much over the past decade. With the exception of a reduction in the share of diamond exports

(figure 9), Armenia remains dependent on copper exports and thus susceptible to base metal prices, which are likely to continue to decline over the medium term.⁹ Despite the somewhat static character of the export basket, “sparks” appear to have emerged in certain areas, such as aviation goods, which enjoy a high degree of product complexity. The fact that Armenia is already exporting these products, even though in most cases these exports account for a very small share of its total exports, suggests the presence of “sparks” in its export structure. Products with a high degree of product complexity (as denoted by a high score for PCI in table 1) are sophisticated goods that tend to be produced by highly skilled labor. However, minerals (e.g. raw copper, gold), or simple agricultural products, register a low PCI and their production typically embody less sophisticated skills.

Figure 9. Exports by sector, 2003 and 2012



Source: MIT, The Atlas of Economic Complexity.

23. Several products currently exported by Armenia have high scores for both PCI and Revealed Comparative Advantage (RCA). The latter denotes that Armenia currently

⁹ Country Program Snapshot. World Bank – Armenia Partnership. April 2015.

possesses a comparative advantage for such products (an $RCA > 1$ indicates that the product represents a larger share of the country's exports than of world exports). It is such industries that are of interest for efficiency-seeking investment, as their experiences, especially with regard to exporting, can yield important lessons and are relevant for further investigation.

Table 1. Select exports of Armenia - Revealed Comparative Advantage (RCA); Product Complexity Index (PCI) and export share

| Product | RCA | PCI | Export share % (2012) |
|----------------------------------|------|------|-----------------------|
| Ferroalloys | 40 | 0.92 | 7.56 |
| Aluminum foil | 73 | 2.54 | 5.14 |
| Planes, helicopters, spacecraft | 5.22 | 1.78 | 4.31 |
| Other heating machinery | 9.31 | 3.49 | 2.12 |
| Spark-ignition engines | 1.31 | 3.26 | 0.34 |
| Non-mechanical removal machinery | 5.07 | 3.73 | 0.30 |
| Electric soldering equipment | 2.73 | 2.97 | 0.18 |
| Precious metal watches | 1.53 | 1.98 | 0.12 |
| Other clocks and watches | 4.38 | 2.53 | 0.06 |

Source: MIT, The Atlas of Economic Complexity.

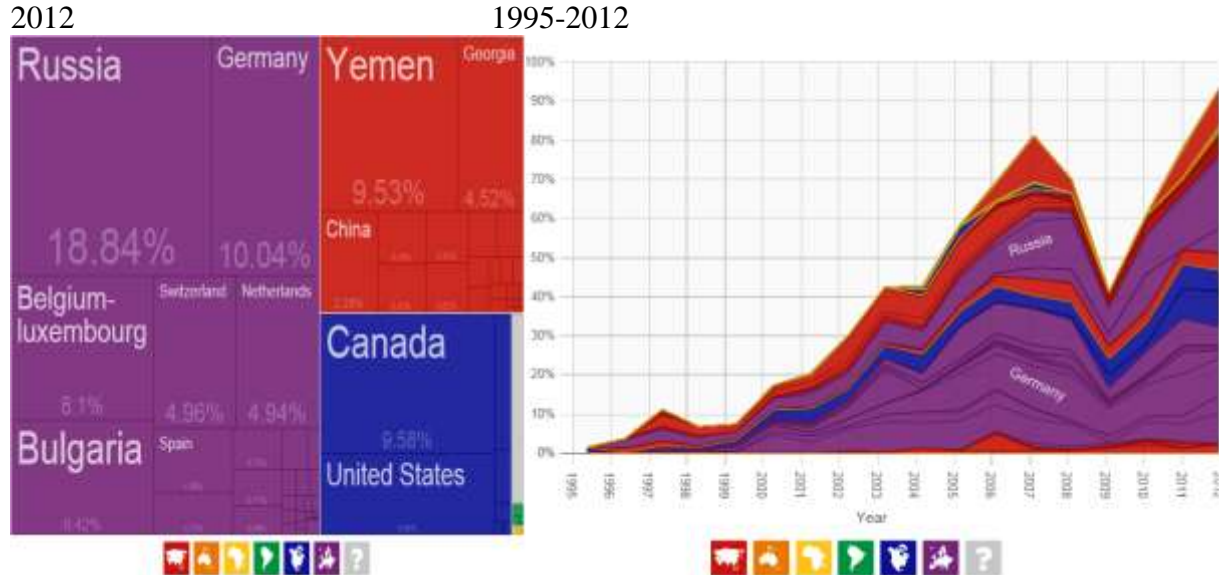
E. Access to international markets

24. Especially important for efficiency-seeking investment is access to international markets. As a small landlocked economy, Armenia needs to look for ways to show to efficiency-seeking investors that it can serve as a base from where they can export goods and services to near or distant markets. The closure of two of its four border of Armenia (with Turkey and Azerbaijan) due to the ongoing conflict in Nagorno-Karabakh does not bode well in this regard. Such limitations manifest themselves in a poor ranking of 126/144 countries in the Global Competitiveness Index 2014-2015 for foreign market size (with a score of 3.2/7) and give rise to high transportation costs, which can diminish Armenia's appeal for efficiency-seeking investment.

25. Since opportunities for efficiency-seeking investment to supply neighbouring markets may be limited, investors would need to view Armenia as a base from where they can export goods and services for markets beyond the immediate region. This is certainly possible: traditionally, Russia and EU have been the dominant destinations of Armenia's merchandise exports (figure 10). Armenia also has the potential to serve as a conduit for trade with new partners in the Middle East (e.g. Iran, especially should sanctions be removed) and channel exports to other parts of the world, including Asia and Europe.

26. An important consideration in Armenia’s investment and export strategy is the potential role for efficiency-seeking investment in higher value added segments and in tradable services. Software development and outsourcing, for example, are important components of production value chains that can be located internationally and for which physical trade obstacles are not as relevant as in the case of goods. There is also potential for moving up the value chain of IT services from outsourcing to higher value added IT-based activities. Armenia’s IT sector is already capitalizing on such opportunities with a reportedly two thirds of Armenian IT output exported to over 20 countries.¹⁰

Figure 10. Armenia’s main export markets, 2000 and 2012



Source: MIT, The Atlas of Economic Complexity.

III. Competitiveness and investment climate considerations

27. The cumulative effect of a number of seemingly small investment climate obstacles (and associated costs) may discourage firms from investing, or from maintaining investment, in Armenia. The mobile character of efficiency-seeking investment requires careful consideration of investment climate obstacles and competitiveness factors (e.g. skills, infrastructure, labor market flexibility to name a few), as well as investment policies for attracting and retaining such investment.

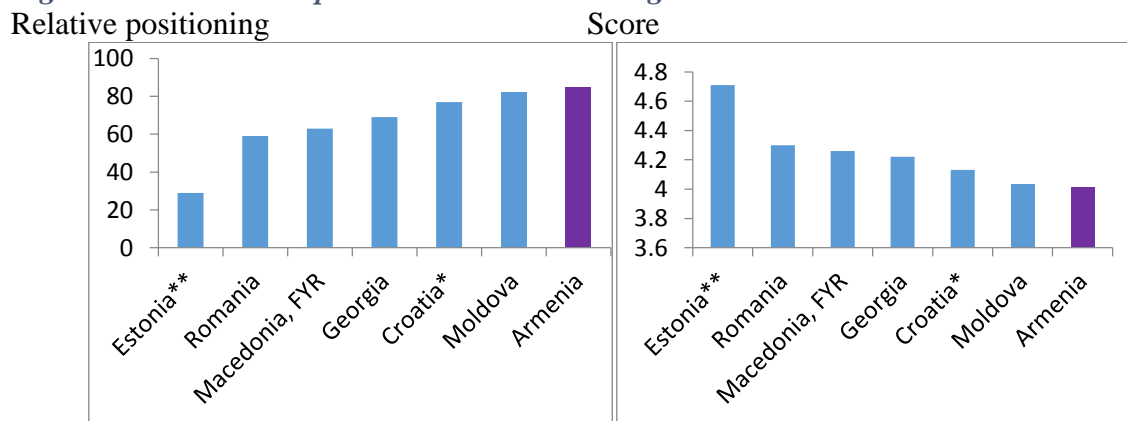
28. Before turning to the policy framework, Armenia’s innate competitiveness for attracting efficiency-seeking investment can be assessed along several determinants. These include availability and cost of raw materials, low-cost unskilled and skilled labor (with costs adjusted for productivity), physical infrastructure (e.g., roads, power,

¹⁰ Armenia is well positioned for investment in IT, with a well-educated workforce possessing IT technical skills, English language proficiency, university programs specializing in IT and related sciences, competitive IT labor cost and government support of the IT sector, combined with links with a sizeable and successful diaspora in Europe and North America. By supporting these joint initiatives, GoA has spearheaded the growth of the IT sector and strengthened linkages between domestic IT firms and global firms.

telecommunications), intermediate products (reliable domestic producers or imports), or access to international markets. Even though some of these factors are more relevant for certain types of efficiency-seeking FDI than for others (e.g. in IT), their examination still provides an overall picture of the systemic competitiveness of Armenia vis-à-vis other potential host countries.

29. According to the World Competitiveness Report 2014-2015, Armenia ranked in 85th place out of 144 countries, with a score of 4.00 (highest score was 5.70 for Switzerland). In relation to other comparator countries, Armenia ranks last in terms of both relative positioning and actual score (figure 11). The capacity of a country to attract and retain talent is important for efficiency-seeking investment, especially for higher value added activities. In both of these areas, Armenia scores particularly low (table 2). The availability of local suppliers is also important; in terms of quality and quantity of local suppliers. Armenia is in 86th and 79th place, respectively, although in terms of availability of scientists and engineers it is in 75th place. Other indicators of the scope for increased value added activities do not bode well. In a number of innovation indicators, e.g.. quality of scientific research institutions and university-industry collaboration in R&D, Armenia scores relatively low, although it ranks in 59th place in terms of enrolment in tertiary education. Rankings for connectivity are mixed – Armenia’s ranking for international internet bandwidth is in 48th place, but in 71st place for individuals using the internet and 67th for mobile broadband subscriptions.

Figure 11. Global Competitiveness Index rankings



Source: World Economic Forum, Global Competitiveness Index 2014-15. *EU member since 2013; **EU member since 2004.

Table 2. Efficiency-seeking investment indicators

| Indicator | Value | Ranking | Source | Website |
|---|-------|---------|--------|---|
| INFRASTRUCTURE | | | | |
| Infrastructure - overall | 3.8 | 78/144 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| Foreign firms identifying transportation as a major constraint (% , 2013) | 8.2 | n/a | WBS | |

| | | | | |
|--|-------|-------------|----------|---|
| Foreign firms identifying electricity as a major constraint (% , 2013) | 7.9 | n/a | WBE S | http://www.enterprisesurveys.org/data/exploreeconomies/2013/armenia#infrastructure |
| ICT use | 3.1/7 | 64 /144 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| The Networked Readiness Index 2014 | 4.03 | 65/14 4 | WEF | http://www.weforum.org/global-information-technology-report-2014-data-platform |
| LABOR | | | | |
| Unemployment rate (% of total labor force, 2014)* | 18 | n/a | IMF | https://www.imf.org/external/pubs/ft/weo/2014/02/weodata/weose1gr.aspx |
| Labor market flexibility | 4.8 | 33/14 4 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| Skilled labor availability** | n/a | n/a | n/a | |
| Foreign firms identifying inadequately educated workforce as a major constraint (% , 2010) | 6.4 | n/a | WBE S | http://www.enterprisesurveys.org/data/exploreeconomies/2013/armenia#workforce |
| Availability of scientists and engineers | 4 | 75/14 4 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| LOCAL SUPPLIERS | | | | |
| Local supplier quantity | 4.5 | 79/14 4 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| Local supplier quality | 4.1 | 86/14 4 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| Value chain breadth*** | 3.6 | 94/14 4 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| TRADE AND LOGISTICS | | | | |
| Merchandise trade (% of GDP, 2013)**** | 57.1 | n/a | WB | http://data.worldbank.org/indicator/TG.VAL.TOTL.GD.ZS |
| Exports (% of GDP, 2013) | 21.9 | 127/1 44 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| Trade in services (% of GDP, 2013)**** | 22.1 | n/a | WB | http://data.worldbank.org/indicator/BG.GSR.NFSV.GD.ZS |

| | | | | |
|--|------|--------|------|---|
| Trade Freedom | 85.4 | n/a | HF | http://www.heritage.org/index/explore |
| Prevalence of trade barriers | 4.3 | 80/144 | WEF | http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/ |
| Foreign firms identifying customs and trade regulations as a major constraint (% , 2013) | 19.8 | n/a | WBES | http://www.enterprisesurveys.org/data/exploreeconomies/2013/armenia#trade |
| Foreign firms identifying labor regulations as a major constraint (% , 2013) | 1.8 | n/a | WBES | http://www.enterprisesurveys.org/data/exploreeconomies/2013/armenia#workforce |
| Logistics Performance Index (2014) | 2.67 | 92/150 | WB | http://lpi.worldbank.org/international/scorecard/radar/128/C/ARM/2014#chartarea |

Source: World Bank (WB); World Economic Forum (WEF), Global Competitiveness Indicators, 2014-15; Heritage Foundation (HF), Index of Economic Freedom; Armenia Enterprise Survey 2013 (WBES). Business owners and top managers in 360 firms were interviewed from November 2012 through July 2013.

*As reported by IMF, October 2014.

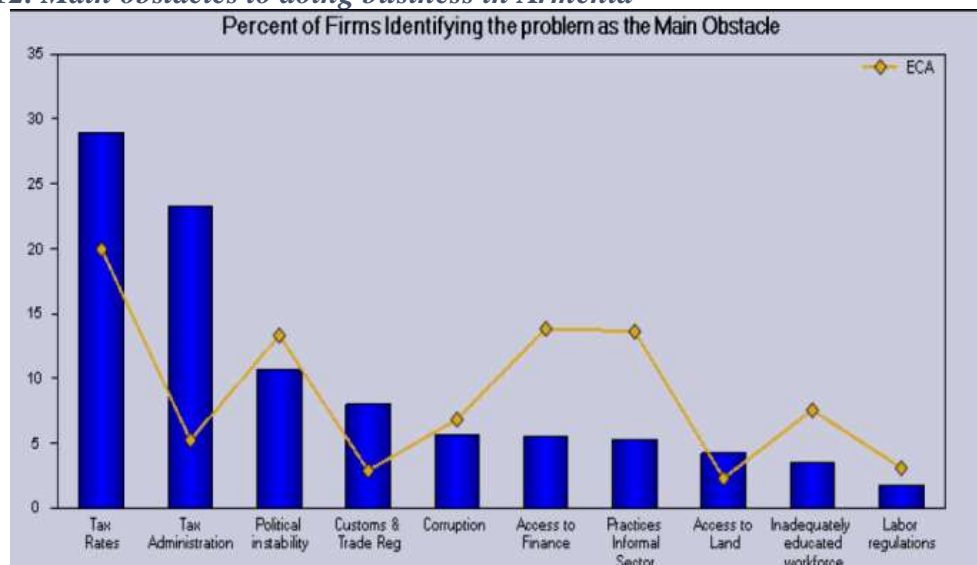
**Labor force with tertiary education as percent of total labor force.

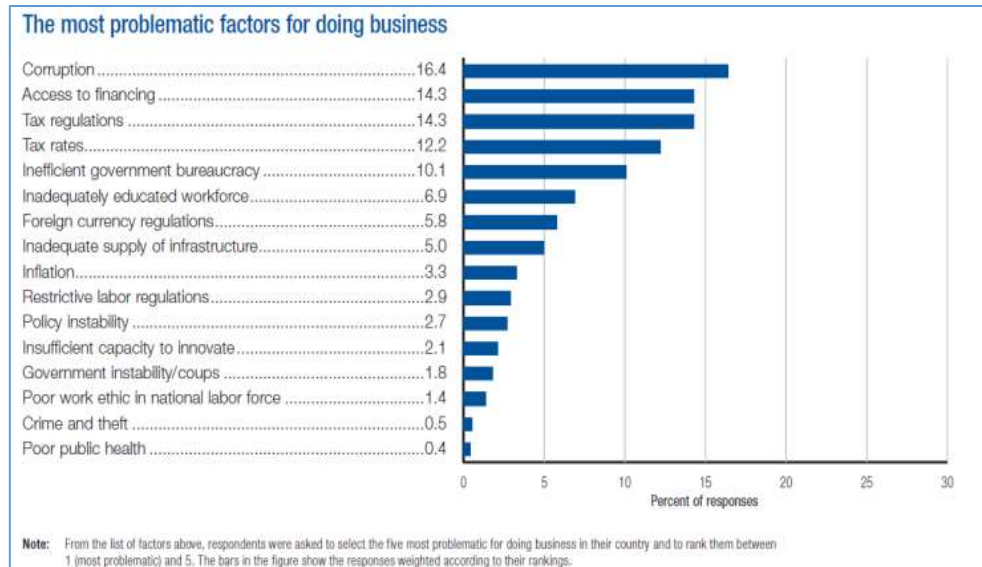
***Narrow or broad presence in a value chain, with 1 = narrow, primarily involved in individual steps of the value chain and 7 = broad, present across the entire value chain (including production and marketing, distribution, design etc.) businesses to enforce contracts.

**** As reported by World Bank.

30. As for broader investment climate considerations, basic conditions to start, operate and grow business are equally important and affect both foreign and domestic investors. There appears to be a consensus by the *Global Competitiveness Report 2014-2015* and the *Armenia Enterprise Survey 2013* that tax-related issues pose a particular challenge for businesses (figures 12 and 13). Tax regulations, tax rates and the tax administration rank high in the list of factors identified by firms as major constraints. Corruption also appears to be a significant obstacle. Tax issues and corruption are important not only for efficiency-seeking investment, but also for all types of FDI.

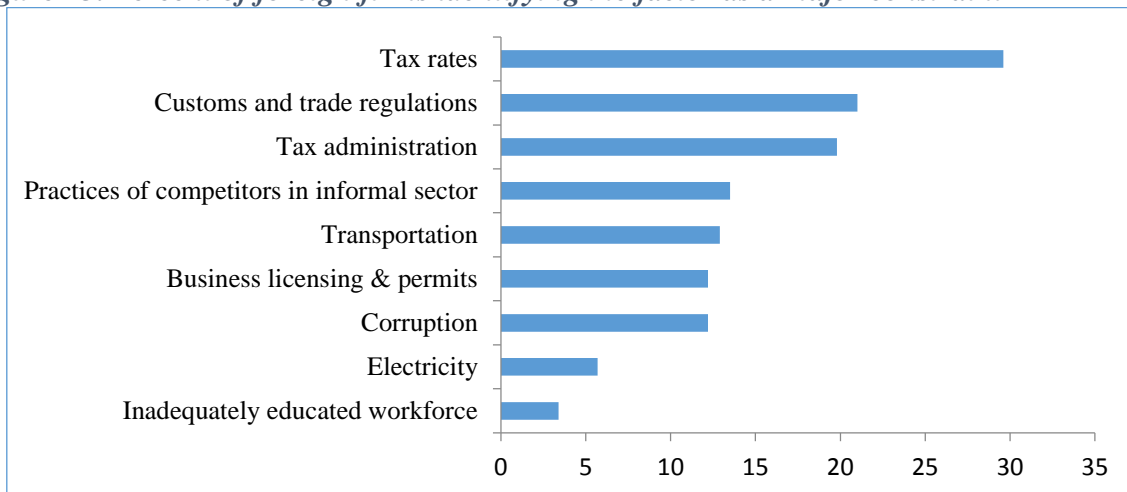
Figure 12. Main obstacles to doing business in Armenia





Source: World Economic Forum, Global Competitiveness Index 2014-15; World Bank, Armenia Enterprise Survey 2013.

Figure 13. Percent of foreign firms identifying the factor as a major constraint



Source: World Bank, Armenia Enterprise Survey 2013. Note: firms with 10% or more foreign ownership.

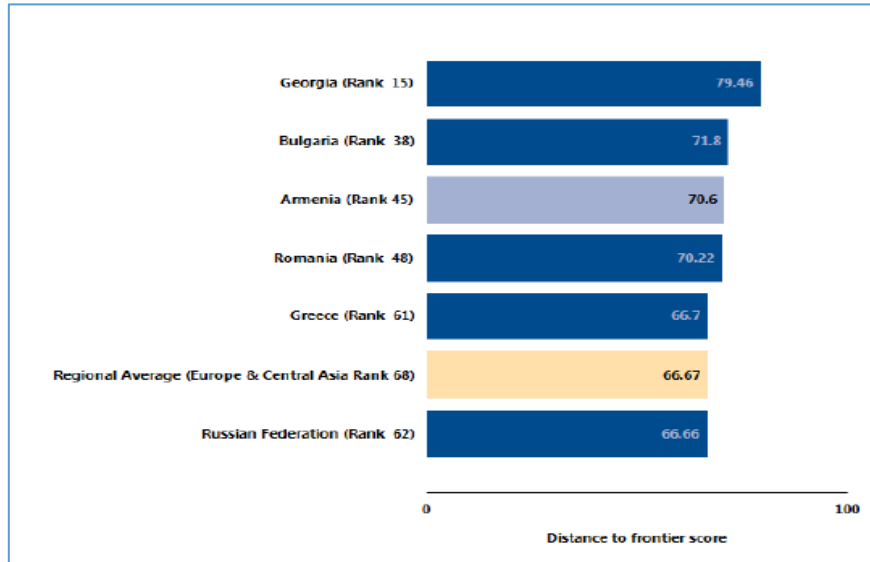
31. **These obstacles to doing business contrast with some of the findings of the *Doing Business 2015* report.** Armenia ranks relatively well in *Doing Business 2015* - 45th out of 189 countries –and up from 49th place in the previous year. On the ease of doing business, Armenia compares favourably with the regional average, but ranks below other countries in the region (figure 14). It performs particularly well in starting a business, with an impressive global rank of 4. Between 2010 and 2015, Armenia implemented a number of reforms as a result of which starting a business requires 2 procedures, takes 3 days and costs 1 percent of income per capita.

32. **Enforcing contracts, trading across borders and getting electricity are Armenia’s weak spots.** In these areas, Armenia ranks in 119th, 110th and 131st place, respectively, out of 189 countries. All these are areas of high importance for both domestic and foreign investors

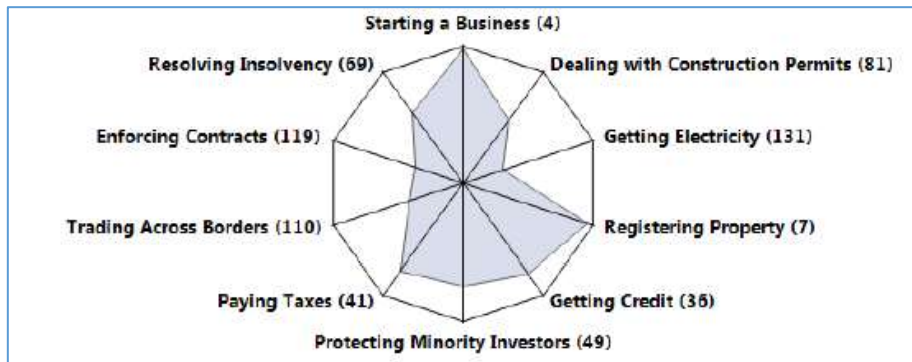
and for all types of investment. Trading across borders is especially important for efficiency-seeking investment, which Armenia needs more of.

Figure 14. Doing business rankings

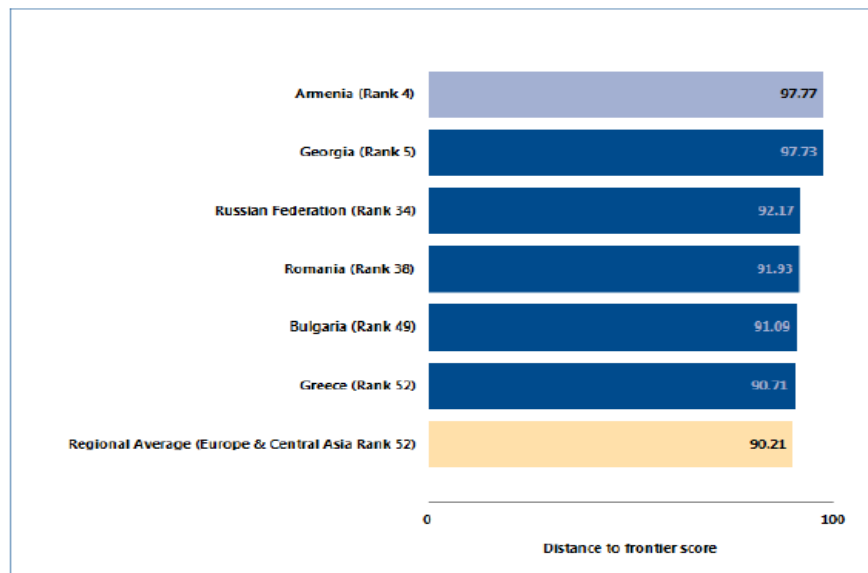
Ease of doing business



Ranks in individual indicators



Starting a business



Source: Doing Business database.

33. Armenia's current position on trading across borders reflects an improvement of twelve places since the previous year, according to *Doing Business 2015*. The *Armenia Enterprise Survey 2013* shows that it takes 8.6 days to clear direct exports through customs, compared with a regional average for Eastern Europe and Central Asia of 4.8 days. Armenia ranked in 92nd place (out of 160 countries) in terms of the Logistics Performance Index 2014, an index that reflects the views of operators on the ground (global freight forwarders and express carriers), on the logistics “friendliness” of the countries in which they operate and those with which they trade. Customs and trade regulations pose challenges, as do burdensome customs procedures. Armenia ranks 108 out of 144 countries (with a score of 3.4 out of 7) as regards this indicator in the Global Competitiveness Index. While Armenia can leverage the zero customs tariffs within EEU when doing business with its members (Russia, Kazakhstan and Belarus, with Kyrgyzstan expected to join soon), international rankings and surveys suggest that more can be done to improve the ability of companies to overcome logistics barriers and trade more freely, thus making Armenia a more promising destination for efficiency-seeking investors, in particular for those from outside EEU.

34. In conclusion, Armenia performs relatively well in a number of areas that are important for efficiency-seeking investment, but is weak in other areas. Strengths include ICT use and the propensity to exploit the opportunities offered by information and communications technology (Network Readiness Index), labor market flexibility, labor cost and labor productivity. However, Armenia's overall infrastructure quality, ability to attract and retain talent, availability and quality of local suppliers and overall business sophistication and innovation levels are relatively low. Tax issues seem to be overwhelmingly regarded as a concern for all types of investors, while trade and custom regulation also raise important concerns.

IV. Investment policy framework

35. Increased flows of FDI, especially of efficiency-seeking investment, can help Armenia meet its key development objectives. As discussed earlier, FDI has an important role to play in helping Armenia integrate in global value chains, diversify its economy in favour of high value added activities, and upgrade the skill set of the domestic labor force. Efficiency-seeking FDI can boost these benefits given its export-orientation. In order to maximize these benefits, sound investment policies that remove legal, regulatory and administrative impediments to attracting and retaining FDI, are required. Such policies are prerequisites for unlocking the potential of individual sectors to contribute to the improvement of the overall competitiveness of the economy.

36. An FDI agenda for all types of investment requires a holistic approach. Efficiency-seeking investment is the most mobile form of investment, and therefore requires certain prerequisites along the following policy areas:

1. *Open, safe and predictable investment regime*, in particular:
 - Simple, streamlined and predictable procedures for entry, including on the movement of labor;

- An adequate network of international investment agreements (IIAs) providing investors and traders with clear rules and disciplines for trade and investment flows and thus offering greater predictability in markets they want to penetrate;
 - Predictability, transparency in the regulatory environment and effective implementation of investment protection guarantees between the State and investors, as set out in IIAs, and
 - A transparent and well-governed regime of incentives.
2. *Efficient export-import flows and operations:* efficient trade logistics and trade facilitation procedures (in case of manufacturing); as efficiency-seeking FDI is inherently trade oriented, an open trade regime can be conducive to attracting and retaining such investment.

A. Regulatory framework

37. This section presents an overview of Armenia’s current legal framework for FDI at the national and international levels, an overview of trade openness, in light of the close link between efficiency-seeking investment and trade, and the institutional set up of government agencies implementing the policies and dealing with FDI.

38. **Armenia’s investment legal framework comprises the Constitution of the Republic of Armenia, the 1994 Law of the Republic of Armenia on Foreign Investment, the Law on Free Economic Zones and tax legislation.** The Constitution protects all forms of property and the right of citizens to own and use property and of foreign individuals to lease it. The Constitution goes as far as to require that the compensation for expropriated property be paid in advance, before the property is taken from the owner. Table 3 summarizes the main elements of Armenia’s investment policies:

Table 3. Investment policy – main elements

| | |
|---|--|
| Conversion & Transfer Policies | Unrestricted foreign exchange regime for FDI. There are no controls on FDI-related capital flows, and no restrictions on repatriating investment income, or making currency payments in foreign exchange. There are no restrictions on export proceeds, and firms may hold bank accounts in foreign currency at home or abroad. Although the Investment Law includes these reasonable guarantees of currency convertibility and transfer, there are some missing elements i.e. the guarantee that such transfers must be timely and prompt; the reference to the applicable exchange rate of conversion; and possible exceptions to the guarantee. |
| Expropriation & Compensation | Foreign investment cannot be nationalized or confiscated except in extreme cases of natural or state emergency, upon a decision by the courts and with due compensation. The Investment Law is, however silent on expropriation and other measures that have an equivalent effect to expropriation (indirect expropriation). |
| Dispute Settlement | According to the 1994 Foreign Investment Law, all disputes that arise between a foreign investor and Armenia must be settled in local courts. |
| Performance requirements & Investment incentives | Performance requirements have been imposed on investors as part of privatization agreements, especially for the privatization of large state-owned enterprises, such as mines or telecommunications network. Armenia offers incentives for exporters (no export duty, VAT refund on goods and services exported) and foreign investors (income tax holidays, the ability to carry forward losses indefinitely, temporary import regimes for raw material |

| | |
|---|---|
| | imports without VAT and customs duties). |
| Right to private ownership & establishment | The Constitution of Armenia protects all forms of property and the right of citizens to own and use property. Foreign individuals who do not hold special residence permits cannot own land, but may lease it. Armenia's Law on Privatization provides that foreign companies have the same right to participate in privatization processes as Armenian firms. |
| Free economic zone (FEZ) | The Law of the Republic of Armenia on "Free Economic Zones" adopted on May 25, 2011 and streamlining regulations and government decrees for individual zones provide for the following: FEZ organizers and operators are exempted from VAT when delivering services and supplying goods in FEZ territory; legal entities are exempted from profit tax and individual entrepreneurs from income tax when being a resident and performing activities in FEZ; public and industrial buildings and structures that belong to or are used by FEZ residents in FEZ territory are exempted from property tax; goods released through "Import to Free Economic Zone" regime, as well as other goods produced on these goods in the territory of the FEZ can be exported from the Republic of Armenia to foreign countries through "export for free circulation" or "re-exportation" regimes without applying customs charges and non-tariff regulation measures; services delivered in the FEZ on behalf of the state bodies are realized on "one stop shop" basis. |

39. The 1994 Law of the Republic of Armenia on Foreign Investment (hereafter the 'Investment Law' or 'the Law') covers a set of rights, which are regarded as important, if not essential, for foreign investors. These are:

- Guarantees equal treatment of foreign and domestic investors.
- Considerably restricts the government's ability to confiscate investors' property.
- Requires full compensation in case of nationalization or confiscation by the government.
- Allows foreign investments in wide sectors of economy and in various forms.
- Protects investments for a period of five years from adverse legislative changes.
- Provides access to Armenian and international courts to resolve commercial disputes.
- Allows for full repatriation of profits and property.
- Protects intellectual property.

40. The Law contain many good provisions and reflects a good degree of openness towards foreign investment and investors. According to a preliminary review of the Investment Law by the World Bank Group (Annex 3.), the Law is not extremely weak or flawed, however, it does present significant room for improvement in specific areas. For example, the Law:

- Supports a general principle of non-discrimination between foreign and domestic investors. However, the Law does not include a clause on the principle of most favored nation as to guarantee no discrimination based on the country of origin of investor or investment.
- Completely omits the principle of Fair and Equitable Treatment (FET). FET is a very important and often misunderstood guarantee, with far-reaching implications. It completes the framework to protect investors against discrimination by providing *due process*, by incorporating principles of good faith, *transparency*, and guarantee against *denials of justice*.

- Provides all investors full disposal of their revenues, opening of bank accounts in Armenia and use of “legally obtained means to acquire foreign currency”. Moreover, Article 11 guarantees foreign investors to “freely export their property, profits and other means legally gained as a result of investments or as payment for labor or as compensation”. These articles taken together could be viewed as providing a reasonable guarantee of currency convertibility and transfer, in spite of some problems with the terminology used and some missing elements.
- Protects investors against nationalization and confiscation. It states that foreign investment will not be subject to nationalization and that confiscation may be allowed only as an extreme means in case of emergency declared in accordance with Armenia’s law and upon the judgment of a court and with full compensation. However, the article is silent on direct and indirect expropriation. It does not include the terms of “prompt, adequate and effective compensation” which have become the golden standards of protection (“Hull formula”).
- Does not explicitly include guaranteed access to alternative mechanisms of dispute resolution, including arbitration, neither for business-to-business disputes, nor for Investor-State disputes. According to Article 24, disputes arising between foreign investors and the State of Armenia shall be considered by domestic courts of Armenia, in a manner established by domestic legislation.

41. The Law on Free Economic Zones (FEZ) provides for the creation and operation of FEZs, aimed at contributing to the creation of a favorable economic climate and the development of export-oriented activities, with active participation from foreign investors. The Law on FEZs sets forth the regulatory framework of a regime of tax and customs preferences for FEZ residents. In accordance with the Law on FEZs, FEZ residents enjoy a number of incentives, including preferential treatment on corporate profit tax, VAT, property tax and customs duties.¹¹

Given the export orientation of efficiency-seeking investment, FEZs may have an important role to play in attracting and retaining investment in the designated sectors. However, further assessments would need to be conducted to assess the effectiveness of existing FEZ regimes. Armenia has two FEZs in operation: “Alliance” based on “RAO Mars” CJSC and “The Yerevan Computer R&D Institute”, and “Meridian”. The “Alliance” FEZ is geared towards the production and export of goods utilizing advanced and innovative technologies in the fields of electronics, precision engineering, pharmaceuticals and biotechnologies, information technologies, alternative energy, industrial design and telecommunications (elaboration and production of technological equipment, systems and materials for data/information transfer), as well as goods not produced elsewhere in Armenia. The “Meridian” FEZ is specialized in jewellery, stone cutting and watch making. The purpose of this FEZ is to stimulate exports, create new jobs and promote sustainable economic development by attracting FDI by international companies specialized in jewellery and watch making.

42. Armenia has bilateral investment treaties (BITs) in force with 37 countries.¹² In addition to providing for national treatment and most favored nation treatment, BITs set out

¹¹ For more information on FEZs, see Ministry of Economy (<http://mineconomy.am/eng/505/free.html>).

¹² Argentina, Austria, United States, Bulgaria, Belgium-Luxemburg, Germany, Iran, Lebanon, Canada, Cyprus, India, Greece, Kyrgyzstan, United Kingdom, China, Romania, Vietnam, Georgia, Ukraine, France, Italy, Switzerland, Israel,

favorable conditions for foreign investors, in particular, the inviolability of investments, the possibility of settlement of emerged disputes in international tribunal courts and the free transfer of returns.

Armenia is actively engaging in negotiations using a model BIT approved by the GoA in 2012. It aims “to promote mutually beneficial economic cooperation by creating favorable conditions with respect to investment by investors of the State of one Contracting Party in the territory of the State of the other Contracting Party”. The Model BIT includes the regular guarantees granted through BITs, i.e. fair and equitable treatment, most favored nation and national treatment, compensation of losses, expropriation only for public purpose and followed by due compensation, free transfers of profits, and the right to access to international investment arbitration. One innovative element of the Model BIT is the inclusion of the provision on performance requirements. Article 2.3 provides that investments shall not be subject to additional performance requirements which may be detrimental to their viability or adversely affect their use, management, conduct, operation, expansion, sale or other disposition. This prohibition will prevent a Contracting Party from enacting protectionist measures for instance by conditioning the operation of a business to the use of domestic produced products.

43. Armenia is a member of key international trade and investment fora. These include the World Trade Organization (WTO) since 2003 and the Commonwealth of Independent States (CIS) Multilateral Convention on the Protection of Investor Rights, the Treaty on Eurasian Economic Union, the Armenia-EC Cooperation Agreement, the Energy Charter Treaty, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the International Centre for the Settlement of Investment Disputes (ICSID). Armenia is also a member of the Hague Convention on Abolishing the Requirement of Legalization for Foreign Public Documents, commonly known as “Hague Apostille Convention” (since 1994), which substantially simplifies bureaucratic formalities that oblige businesses from members states to prove the authenticity of their official public documents.

44. Armenia has had only one known investor-State dispute settlement case under the Armenia-United States BIT. While based on known cases Armenia has not been heavily entangled in investor-state arbitration disputes, commercial arbitration presents some challenges. In the area of commercial arbitration, the duration of arbitration and enforcement proceedings is quite long. The average length of arbitration proceedings is 118 days, while the average length of recognition and enforcement proceedings is 153 days.¹³

B. Trade openness

45. According to the 2010 WTO Trade Policy Review, Armenia maintained a liberal trade regime. Armenia’s average applied MFN tariffs were among the lowest of WTO members. Until recently, Armenia’s trade regime was regulated by the Customs Code of 2001. The Code maintained the following regime:

Qatar, Tajikistan, Russia, Belarus, United Arab Emirates, Uruguay, Finland, Egypt, Netherlands, Latvia, Sweden, Lithuania, Kazakhstan and Syria.

¹³ Pouget, Sophie. "Arbitrating and mediating disputes: benchmarking arbitration and mediation regimes for commercial disputes related to foreign direct investment." World Bank Policy Research Working Paper 6632 (2013).

- All exports from Armenia were duty free.
- The import tariff rates were 0% or 10%. The 10% tariff was levied mainly on consumer and luxury goods.
- Tariffs were in ad valorem terms and levied on CIF values.
- No import customs duties were payable in the following cases:
 - Imported capital goods forming part of an investment in a business (list of goods defined by the GoA);
 - Transit goods transported across the territory of Armenia;
 - The means of transport used to regular interstate transport of freight;
 - Currency and stocks;
 - Goods temporarily imported into Armenia and temporarily exported from Armenia for the purpose of processing or reprocessing.
 - Imported capital goods forming part of an investment in a business (list of goods defined by GoA).

46. **The transition to a unified tariff system as of January 2015 has brought changes to tariff rates, as well as to the method of tariff calculation.** Following accession to EEU, the Customs Code was declared void except for provisions related to duty-free shops, customs warehouses and customs mediators (these will expire after 18 months). The new system introduces a more complex list of tariff rates applicable to different product specifications. While the implications for trade with non-EEU countries and for Armenia's WTO commitments require a review of its own, it is clear that any increases in tariffs potentially noncompliant with existing commitments will be subject to a WTO review.

47. **In the services sector, Armenia undertook sector-specific commitments (guarantees on market access and national treatment)¹⁴ in 11 of 12 sectors, or 97 of the 160 subsectors in the Services Sectoral Classification List.¹⁵** Important exceptions are postal services and transportation of passengers and freight via air and rail. Market access and national treatment were left unbound with respect to the presence of natural persons, except for the temporary entry of persons covered in Armenia's horizontal commitments. Armenia's list of GATS Article II MFN exemptions covers freight and passenger transportation by road, and audio-visual services related to the production and distribution of motion pictures and television programs. All these measures are intended for an indefinite duration, except for audio-visual services which are regulated by bilateral agreements with a pre-determined duration.

48. **Armenia bound some limitations to legal, telecommunications, financial, and transport services in its GATS Schedule of Commitments.** Nonetheless, its legal framework is in most cases (e.g. postal services, telecommunication and financial services)

¹⁴ Obligations contained in the GATS agreement may be categorized as **general obligations**, which apply to all Members and services sectors, and **specific commitments** concerning market access and national treatment in specifically designated sectors. Such commitments are laid down in individual country schedules, which identify the services for which the Member guarantees market access and national treatment and any limitations that may be attached. Most schedules include both a "**Horizontal Section**," which applies across all listed sectors and often refers to a particular "mode of supply" of services, notably commercial presence and the presence of natural persons, and a "**Sector-Specific Section**," which contains entries that apply only to the particular service.

¹⁵ For the list of sector-specific commitments, refer to: WTO document WT/ACC/ARM/23/Add.2, 6 December 2002.

more liberal than its GATS commitments. Armenia was the 15th Party to accede to the WTO's Government Procurement Agreement (GPA). This accession is viewed as a positive move aimed at increasing the openness and transparency of internal markets.

49. Armenia has a fairly open trade regime, but further reforms may be needed to encourage efficiency-seeking investment in the types of industries that lead to exports of complex products, as well as links with global value chains. Such reforms could address existing regulatory environment and administrative obstacles to trade (e.g. customs procedures affecting imports, procedures for obtaining export certificates for agricultural goods), export promotion (e.g. information on potential foreign export markets) and the overall export infrastructure. The latter is particularly important given the small domestic and landlocked market and border closures. Enhanced and streamlined procedures would also reduce the time needed for firms to trade across borders. Such reforms would also be aligned with Armenia's Export-Led Industrial policy, in the context of which sectoral assessments undertaken highlighted a number of sector-specific challenges and regulatory reforms to strengthen industry clusters and improve the export potential of firms.

50. Apart from trade policy reforms, access to international markets through preferential agreements is important for efficiency-seeking investment. As a member of the CIS, Armenia has had free trade agreements in force with CIS partners. Armenia has concluded Free Trade Agreements (FTAs) with Russia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Ukraine. Under these agreements, export and import of goods is free of customs duties or equivalent taxes and fees. Armenia has GSP arrangements with Canada, Japan, Norway, Switzerland, and the United States. Armenia has maintained preferential access to the EU market under the GSP Plus, benefiting from the special incentive arrangement for sustainable development and good governance since July 2005. This arrangement offers Armenian exports advantageous access to the EU market since it provides for a zero duty rate for about 6400 tariff lines.¹⁶ However, the implementation of the Association Agreement and a Deep and Comprehensive Free Trade Area (DCFTA) with the EU, which could have deepened mutual trade relationships, was withheld in September 2013 (following Armenia's decision to join the EEU).

C. Institutional set up

51. Responsibility for the development of investment policy, administration and the improvement of business climate rests on the Ministry of Economy. The Ministry of Economy (MoE) is in charge of the design and implementation of economic development, industrial, and investment policies in Armenia. The tasks of MoE include, among other things, enhancing the international competitiveness of industry; promotion of entrepreneurship; investments and exports; and ensuring a favorable and internationally competitive environment for entrepreneurship.

52. The Development Foundation of Armenia (DFA) is a newly created organization, which merged the National Competitiveness Council and the Industrial Development Foundation. Its predecessor, the Armenian Development Agency, was dissolved. DFA's objectives are multiple, and include promoting economic growth by increasing the ranking

¹⁶ European Commission – Armenia - <http://ec.europa.eu/trade/policy/countries-and-regions/countries/armenia/>.

and competitiveness of the country, attracting investment, developing exports, improving the business environment, implementing regional development programs, and developing tourism. Among other goals, DFA aims at supporting foreign investors based on the “One stop shop” principle and post-investment service provision. In the area of foreign investment promotion, the Ministry of Agriculture has previously also implemented its own promotional activities through foreign embassies and domestic fairs with a focus on agricultural products.

53. A number of fora for private sector dialogue exist on which GoA draws to address specific investor concerns and broader challenges facing Armenia. The Industrial Council, consisting of 50 government and business community representatives and chaired by the Prime Minister, seeks to address problems facing the business community and to accelerate improvements in the business climate. The Chamber of Commerce of Armenia is established to facilitate the development of Armenia's economy and its integration to the global economy and to strengthen commercial, scientific and technical links between domestic and foreign investors. The Chamber of Commerce of Armenia also supports the creation of a market infrastructure for entrepreneurship. The Union of Manufacturers and Businessmen of Armenia is also another important forum representing interests of local manufacturers.

D. Investment constraints

54. To assess constraints with respect to the implementation of laws and regulations, the World Bank Group developed and carried out an investor perception survey. The Armenia Investor Survey (AIS 2014), a confidential investor perception survey of domestic and foreign investors in Armenia, was carried out in May 2014 (see survey sample composition in Annex 2). As per the guidance of the MoE, the survey targeted primarily investors in food and beverage, jewellery, pharmaceuticals and precise engineering. Investors from other sectors were invited to participate, since the survey questions were not specific to any particular sector. The final list of investors was formed based on data compiled by the MoE, investor associations and known companies to the World Bank Group in Yerevan. The online questionnaire was sent to 56 investors by email. 20 responses were collected, representing 36% of the total number of investors. The survey questionnaire consisted of multiple-choice questions and essay questions divided in eight categories mostly following the Investment Lifecycle: motivation for investment in Armenia; entry; protection and confidence; grievances; government incentives; free economic zones; economic impact and outlook. The findings, presented in this section, help to shed light on de facto (implementation) constraints facing investors in Armenia, complementing the regulatory and other investment policy constraints. To complement the findings of the survey, the World Bank Group conducted several missions throughout 2014 and 2015 to assess various bottlenecks for investment to be used as in input in the identification of policy reform priorities.

i. Attraction and promotion

55. There appears to be a lack of a clearly articulated value proposition of Armenia as an investment destination, as well as a value proposition of promising sectors and specific opportunities in these sectors. This articulation would primarily fall within the tasks of the MoE, and of the investment promotion agency, currently, DFA. Ensuring greater

visibility, clarity in the mandate of promoting FDI and measurable effectiveness and impact of DFA compared to its predecessors would be essential.

56. The GoA's involvement in investment promotion so far has been perceived as limited in terms of both, its activities and investor reach. Many investors have not come into contact with specific programs and instead have resorted to other private sources of information on Armenia's investment climate and on specific opportunities for investment. From an institutional viewpoint, DFA needs to ensure partiality in promoting sectors based on their potential. In this regard, synergies in investment attraction activities conducted by different Government agencies (including the Ministry of Agriculture) should be explored to maximize reach as well as to ensure an effective use of available resources for promoting Armenia.

57. In terms of locational incentives for FDI, preliminary findings from AIS 2014 suggest that the availability of information on incentives to foreign investors is lacking. Half of the investors surveyed said they did not have sufficient information about available incentives. There were mixed views as regards the ease of obtaining incentives; on average, it took 28 days to obtain an incentive. These findings beg the questions of whether there is insufficient dissemination of information on the incentives offered and whether there is room for streamlining the process to obtain them. An important caveat of the AIS 2014 incentives findings is that they do not differentiate between different types of investment. Further mapping according to the Investment Typology combined with a cost-benefit analysis is therefore necessary to ascertain where incentives make the most sense in light of Armenia's development objectives and in terms of the benefits they actually yield to investors. The findings of such analysis would help pinpoint the areas which do not require incentives, as well as the areas that can benefit from the provision of effective incentives.

ii. Entry

58. From an investor entry perspective, Armenia's investment regime is relatively open. By law, foreign companies are entitled to the same treatment as Armenian companies (national treatment) and the country fares well when it comes to sector ownership restrictions, imposing virtually no restrictions on foreign investors. Overt statutory ownership restrictions on foreign capital exist in only one of thirty-two sectors (media), according to Investing Across Borders 2012. The Investment Law, however, does not clearly articulate whether restrictions exist and in which sectors. It should do that using a "negative list" approach. Outside foreign ownership restrictions, according to AIS 2014, operational requirements, such as local employment and export requirements may impose a burden on investors, and may constitute an obstacle at the time of entry.

59. Findings on the effectiveness of registration procedures for foreign investors are mixed. On one hand, fast track procedures to accelerate registration processes exist and the average number of procedures to start a foreign subsidiary is 4, while the average number of days is 9.¹⁷ As per AIS 2014, on average two institutions have to be contacted for the process of registration. Co-ordination amongst state bodies involved in the process of registration does not seem to be a problem and was rated satisfactory or good in most cases. On the other hand,

¹⁷ World Bank, Investing Across Borders 2012.

the ease of obtaining licenses and permits was identified as a crucial entry constraint by a third of the respondents in AIS 2014, while another 23 percent mentioned the ease of registration of business in the country as another crucial constraint. This suggests that further investigation may be needed to validate specific obstacles that may arise in practice, and in particular sectors.

iii. Protection and retention

60. Enhanced levels of investor protection can boost investor confidence, leading to new investment and encouraging already existing investors to expand operations. Globally, reinvestments in particular represent an important dimension of FDI as reinvested earnings, comprising between a quarter and a third of FDI flows received by developing countries.¹⁸ Investors around the world facing protection issues - such as unpredictable, arbitrary and inconsistent government action, including inconsistent application of a law by different agencies, adverse regulatory changes or frequent changes in laws without regulatory transparency - are less likely to implement expansion plans and may even cancel existing investments. More than a quarter of global corporate investors surveyed in 2013 said that in the previous year investor protection issues that had given rise to political risks had caused their companies in developing countries to withdraw existing investments or cancel planned ones.¹⁹

61. According to interviews with the private sector, and the AIS 2014, the main obstacle to operating a business in Armenia as regards investor protection is unpredictable, arbitrary and inconsistent government action. This was the view of about 80 percent of respondents in that survey.

Key investor protection issues identified in interviews include:

- a. Lack of access to reliable and updated information on laws and regulations in English.
- b. Duality in legal regime due to the ongoing harmonization of Armenia's laws with EEU frameworks, which is affecting investment, customs and tax regimes. For example, EEU requires that exporters apply for an export license for each individual shipment, while Armenian laws do not require an export license at all.
- c. Arbitrary interpretation of certain laws and regulations (i.e. importation fees based on reference pricing are not clear and can lead to unreasonably priced import duties).
- d. Lack of a level-playing field for investors caused by high levels of corruption and interference of public agencies.
- e. Weak judicial systems and cases that take long and are costly to resolve. The Ministry of Justice established the Judicial Orders Compulsory Enforcement Service to ensure enforcement of judicial orders. However, its effectiveness, as well as the lack of alternative dispute resolution mechanisms for private-private (except for banking cases) cases and state-private grievances and disputes, makes this "safety net" for investors porous.
- f. In some cases, enforceability issues of private contracts governed by foreign laws, as well as of foreign arbitral awards, despite the fact that Armenia is a member of ICSID

¹⁸ World Bank Group data.

¹⁹ MIGA, World Investment and Political Risk 2013.

and of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Key investor protection issues identified in AIS2014 were:

- a. Corruption (73 percent of respondents),
- b. Frequent changes in laws (67 percent), and,
- c. Political risk (67 percent).

Although GoA has introduced a number of reforms over the last few years, corruption clearly remains a problem, especially in critical areas for investors, such as the judiciary. Expropriation ranked as low risk in AIS 2014, but the Investment Law seems to lack full clarity as to the kinds of protection it offers in this area. As discussed earlier, the absence of the Fair and Equitable Treatment (FET) principle from the Investment Law may also send the wrong signal to investors concerned about regulatory transparency. FET protects investors against discrimination by providing due process, by incorporating principles of good faith, transparency and guarantee against denial of justice.

62. Other international rankings related to investor protection paint a mixed picture.

Armenia scores relatively well for transparency in government policymaking, but less so in judicial independence and efficiency of the legal framework in settling disputes (table 4). According to the Index of Economic Freedom, Armenia’s economic freedom score was 67.1 in the 2015 rankings (same as Macedonia FYR and just below Slovakia and Costa Rica), declining by 1.8 points since last year owing to deterioration in property rights, labor freedom, and monetary freedom. It is particularly areas that involve the judiciary which seem to give rise to investor protection concerns.

Table 4. Investor protection indicators for Armenia

| Indicator | Value | Ranking | Source |
|--|----------|---------|--------|
| Efficiency of legal framework in settling disputes | 3.35/7 | 95/144 | WEF |
| Efficiency of legal framework in challenging regulations | 3.24/7 | 84/144 | WEF |
| Judicial independence | 2.91/7 | 107/144 | WEF |
| Transparency in Government policymaking | 4.45/7 | 39/144 | WEF |
| Public institutions | 3.74/7 | 72/144 | WEF |
| Property rights protection | 4.15/7 | 67/144 | WEF |
| Intellectual property protection | 3.45/7 | 84/144 | WEF |
| Investment Freedom | 67.1/100 | 52/165 | HF |

Source: World Economic Forum, Heritage Foundation.

63. **Problems in investor protection often give rise to grievances.** It is important therefore for such grievances to be resolved before they become severe and escalate into formal investor-state disputes (figure 15). According the AIS 2014, 93 percent of investors have not experienced a formal grievance vis-à-vis the state. The problem, however, may lie in lack of clarity in the context of the survey as to what constitutes a formal grievance. Subsequent World Bank Group missions to Armenia found that investors experienced grievances in relation to aggressive and frequent inspections (e.g. tax, environment, energy), which not only consumed substantial time and cost, but often led to unreasonable court proceedings. Tax inspections posed a particular cause of grievances, as did issues involving the tax authority.

Figure 15. Grievances and disputes



64. **Investors who experienced grievances sometimes resorted to informal consultations with government agencies to find a solution.** As per AIS 2014, only 20 percent of the investors surveyed initiated a formal written grievance procedure. Regardless of the grievance resolution route followed by investors, AIS 2014 found poor effectiveness of the State in resolving grievances; State effectiveness was rated mostly between extremely low to fair.

65. **Finally, Armenia needs to ensure economic benefits within and outside EEU integration processes.** This requires a solid and systematic representation of Armenia's positions at the Eurasian Economic Commission. Among other milestones, Armenia will have to re-negotiate some of its WTO commitments, with direct and indirect implications on investors. In this context, several investors deemed important to ensure the allocation of the maximum level of capacity and resources for that task.

V. Investment policy reforms: policy recommendations

66. **The reform of Armenia's investment policy and promotion framework should follow a staged approach.** Such an approach should consider a number of key elements, including:

- An overarching vision and policy tailored to a country's national development objectives;

- A system of laws underpinning the policy;
- Corresponding implementing regulations to the laws ensuring clear rules for implementation; and
- Institutional arrangements aligned with policy to ensure proper de facto implementation.

67. Based on the assessment in this report and international good practices in investment policy and promotion, the following areas should rank high on GoA's investment agenda in the short and medium term for addressing the key policy, legal and institutional constraints to investment:

- A well-defined vision for investment, underpinned by a clearly articulated systemic FDI strategy for investment attraction and retention and delivery framework;
- Visible and impactful policies for investment attraction (including promotion measures and effective incentives) aligned with the FDI strategy;
- Effective investor protection and retention by addressing investor issues;
- Effective inter-agency coordination on investment policy and FDI issues; and
- Sound representation of Armenia on trade and investment policy issues in the Eurasian Economic Commission.

In parallel, the modernization of the Law on Investment (1994) should be undertaken promptly to ensure synergies between policy and legal reforms.

It is also recommended that the GoA adopt a standalone action plan outlining specific reform priorities and actions, lead agencies and timelines for their implementation.

Policy recommendation 1: A well-defined vision for investment, underpinned by a clearly articulated systemic FDI strategy for investment attraction and retention and delivery framework.

An investment vision should explicitly state the specific role that FDI, including efficiency-seeking investment, is expected to play towards achieving the country's development objectives. The FDI strategy should define the roles and responsibilities of the different agencies responsible for investment policy, promotion etc. to ensure an effective delivery, or implementation of the strategy, as well as links with other policy agendas pertinent to efficiency-seeking and other types of FDI (i.e. export promotion, tax and trade policy, skills development, infrastructure development). The strategy should also identify priority sectors for investment, which could help meet the specific policy objectives (e.g. create high-quality jobs and diversify exports). Having a systemic FDI strategy would help articulate the country's value proposition, building on GoA's development vision, to define a compelling national brand. A common and clear vision and strategy would increase the effectiveness of policy-making, but also send positive signals to all investors about the Government's serious commitment to the investment policy agenda.

Suggested government counterparts: MoE and DFA in collaboration with other ministries responsible for FDI-related topics.

Policy recommendation 2: Visible and impactful policies for investment attraction.

In alignment with the investment vision and FDI strategy, GoA should coordinate promotion and facilitation efforts at both strategic and operational levels. As for DFA, with a mandate that is too broad as defined currently by the charter (over 40 functions), there is a need for greater focus and strong capacity in key functions of the agency. Sufficient budget and resources are also critical for proper functioning. As regards human resource management, there is a need to have clear, transparent and competitive staffing procedures. Monitoring and Evaluation (M&E) is critical and should include public disclosures of activities/financial statements and presentations of plans to the Board of DFA, as well as periodic external evaluations of performance.

In the context of incentives for investment attraction, a potential area of immediate assistance is the improvement of investor awareness of the different types of investment incentives offered. Increased awareness and transparency would help “level the playing field” for investors. Furthermore, in the short term it would be necessary to analyze both locational and behavioral investment incentives, especially in sectors receiving efficiency-seeking investment, with a view to assessing their effectiveness in achieving the desired policy objectives, while minimizing distortive effects on competition. This exercise would entail a cost-benefit analysis of incentives, including those granted under FEZs schemes.

Suggested government counterparts: MoE, DFA, other line ministries conducting investment attraction and offering incentives (including Ministry of Finance and Agriculture).

Policy recommendation 3: Effective investor protection and retention.

According to the evidence presented earlier, investors are facing problems regarding a variety of areas during the operation of their businesses, in particular, burdensome tax administration and custom procedures. These investor protection issues stem from insufficiency in regulatory transparency, which carries negative consequences for investment retention. Many of these problems arise from implementation rather than badly drafted laws or regulations.

In order to address investor protection issues, avoid investor-State disputes and foster investor confidence, it would be important to undertake legal/regulatory reforms to: (i) systematically improve substantive investor protection guarantees and related procedures, including the modernization of Investment Law of Armenia (1994) (see policy recommendation 6) and (ii) effectively address investor issues/grievances. In this context, a suitable mechanism for investment retention to register, track and potentially also address investor grievances may be considered (Annex 4).

Suggested government counterparts: MoE, DFA, and Ministry of Justice.

Policy recommendation 4: Effective inter-agency coordination on investment policy and FDI issues.

An improved policy and promotion coordination mechanism will enhance synergies and address overlaps and conflicts in institutional remits and activities. For example, from an

investment promotion perspective, enhanced coordination will strengthen DFA's position by putting in place a coordination mechanism with the Ministry of Economy, Ministry of Agriculture, Ministry of International Economic Integration and Reforms, and any other relevant agencies (i.e. Ministry of Diaspora, Ministry of Education and Science, Ministry of Labor and Social Affairs). From an investor protection perspective, potentially, an effective grievance resolution mechanisms would require systematic collaboration between a "lead agency" for grievance resolution and various ministries and government agencies, including DFA.

Suggested government counterparts: MoE, DFA, other line ministries (to be determined according to the reform topic).

Policy recommendation 5: Sound representation of Armenia on trade and investment policy issues in the Eurasian Economic Commission.

In light of Armenia's WTO commitments and the cross-cutting character of trade and investment policy issues covered in the integration process within EEU, there is a particular need to maximize the capacity required to assess the policy effects of EEU integration in the fields of customs, tax, intellectual property rights and agricultural policies, as well as resources for negotiating and managing various aspects of the integration process with the Commission. Suggested activities include trainings to enhance technical skills on investment policy issues in EEU/WTO, and reinforcing institutional alignment of agencies representing Armenia in EEU/WTO.

Suggested government counterparts: MoE, Ministry of Agriculture, Ministry of International Economic Integration and Reforms, and other ministries representing Armenia in EEU Commission and WTO.

Policy recommendation 6: Modernized Law on Foreign Investment.

A country's investment law is one of the first documents that investors review prior to entering a country. It also often serves as an umbrella legal document setting the principles for the overall investment policy framework. Armenia's Investment Law of 1994, currently in force, constituted progress at the time of its enactment, but investment policy, legislation, and investment practices are not static and evolve over time and would benefit from upgrading. Countries compete to open their economies and modernize their investment frameworks in order to attract FDI and enhance links with the global economy. The implementation of the review already undertaken by the World Bank Group (annex 3) will lead to a timely and appropriate upgrading of Armenia's investment policy.

Although the Investment Law is not a bad law it does present significant room for improvement in a number of areas. One positive change would be the use of a "negative list" to clearly enumerate sector entry restrictions, with a periodic review of that list established in the Law. Other examples include incorporating the FET standard; strengthening provisions for protection against expropriation by covering both direct and indirect expropriation and by providing more detail on compensation; strengthening the currency convertibility and transfer guarantee by adding the types of transactions that are covered by the guarantee and by

incorporating the timeliness element, while also mentioning any exception that may exist; clarifying the dispute settlement clause by providing an explicit and unambiguous right to access international arbitration for Investor-State disputes, and by adding specific references to the ICSID Convention, the New York Convention and UNCITRAL rules in particular.

Suggested government counterparts: MoE, DFA, and other ministries concerned with policy implications from the law review.

Annex table 1. Investment Typology

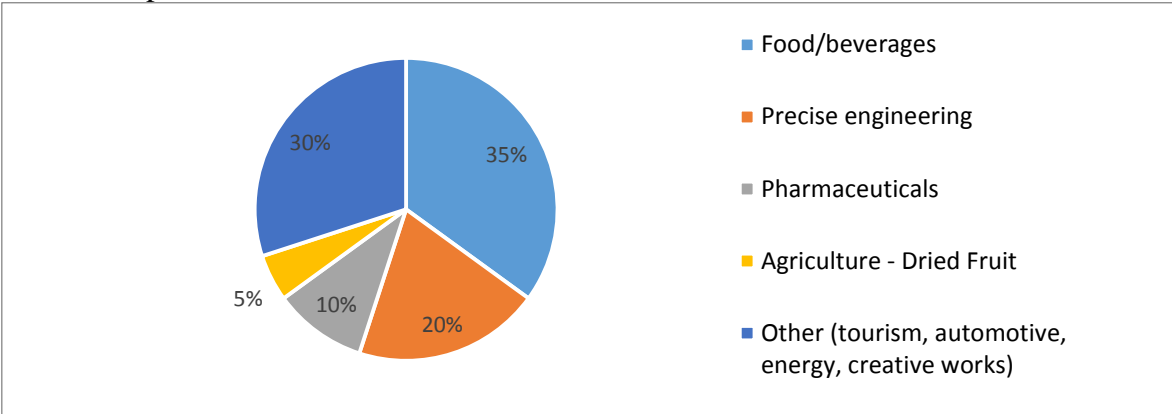
| Type of FDI | Natural Resource-seeking | Market-seeking | Efficiency-seeking | Strategic Asset-Seeking |
|--------------------------|--|---|---|--|
| Fundamental Determinants | Location of natural resources | <ul style="list-style-type: none"> ● Market dimensions and income per capita ● Market growth ● Consumers' specific preferences ● Kind of goods and services to be provided | <ul style="list-style-type: none"> ● International production patterns ● Level of systemic competitiveness of the host country vis-à-vis other potential host countries ● Secure (or preferential) access to key export markets (see link with trade) | Firms sophisticated enough to move into the international market |
| Key Features/Process | <ul style="list-style-type: none"> ● Frequent point of departure for any investment policy program in DC's ● Traditional vehicle for integration into the world economy ● Tends to be North-South, although increasing South-South ● Export efforts start in this sector (and policies tend to mirror this trend) ● As exports increase, FDI tends to increase (also efficiency-seeking FDI in related sectors) | <ul style="list-style-type: none"> ● Tends to occur through M & A ● Traditionally it has been North-North, and then North-South, over the last two decades it is becoming South-South and South-North ● Vehicle for internationalization of SMEs in DCs ● Services FDI tends to concentrate in this type (although increasing in efficiency-seeking through outsourcing) ● Regional integration helps to promote this kind of FDI in smaller DC's (to enlarge markets both for extra-regional and regional businesses). ● See, however, CU vs. FTA debate | <ul style="list-style-type: none"> ● Export oriented ● Potentially, net generator of foreign exchange ● Generator of jobs ● Significant potential gains in terms of expansion and diversification of export supply of host economy and transfer of technology ● Can also lead to non-equity forms of FDI | Generation of Champion Companies in DCs In many DCs, these champions are public investors (SOEs and SWEs) |

| | | | | |
|--|---|---|---|---|
| <p style="text-align: center;">Political Economy/Challenges</p> | <ul style="list-style-type: none"> ● Distribution of rents. Fair distribution of gains derived from exploitation of resources ● Sovereignty over natural resources ● Dutch disease ● Rent-seeking political structures ● Strong pressures for corruption ● Labor rights and other social conditions of workforce (i.e. health) ● Environmental matters | <p>Real or perceived effects over:</p> <ul style="list-style-type: none"> ● Domestic production (crowding-out argument) ● Reaction of domestic suppliers ● Competition policy ● National security | <ul style="list-style-type: none"> ● Systemic competitiveness is difficult to achieve ● Competition among countries (incentives?) ● Importance of signals (vulnerability of smaller countries) ● Increasing controversy in home countries | <ul style="list-style-type: none"> ● Rising economic protectionism ● More common South-North FDI ● Reaction against SOEs and SWFs (Public investors) |
| <p style="text-align: center;">Historical Perspective</p> | <ul style="list-style-type: none"> ● Oldest type of FDI ● Rooted in colonialism ● Origin of North-South divide ● Currently growing because increased demand for raw materials and food supply | <ul style="list-style-type: none"> ● Some initial flows in developing countries in the XIX century ● Originally tended to focus among countries of the North ● Changes with Import-Substitution Industrialization (I.S.I) policies ● Currently growing and become another way to service a market (in particular given the rise in trade in services, and the rise of BRICs) ● Increasing emphasis on pre-establishment issues | <ul style="list-style-type: none"> ● Resulting of GATT's impact on liberalization of trade in manufactures ● Currently in vogue through international value chains | <p>Traditionally limited to North-North FDI, in the last 20 years has started to become increasingly common in developing countries</p> |

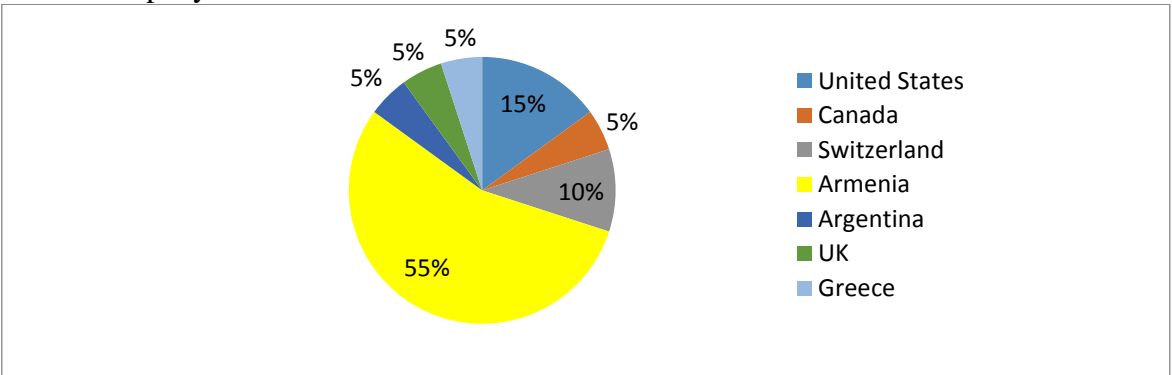
| | | | | |
|---|--|--|---|--|
| <p style="text-align: center;">Relationship with Trade</p> | <ul style="list-style-type: none"> ● Original vehicle for generation of trade ● Generates international division of labor leading to the original North-South divide (that is currently changing) | <ul style="list-style-type: none"> ● Protectionist policies (infant industry argument and currently protectionist stances in some BRICS) ● Original perception that FDI substitutes trade (tariff jumping) ● Currently close links with international patterns of production generated by international competition ● More market-seeking FDI leads to more trade not only of goods but also in services | <ul style="list-style-type: none"> ● Makes trade to grow exponentially ● Fosters intra-firm trade | |
| <p style="text-align: center;">Implications for policy making/How to integrate host country in value chain</p> | <ul style="list-style-type: none"> ● FDI may not necessarily translate in benefits to local economy ● Most difficult FDI to manage in order to minimize drawbacks and maximize potential benefits (Norway vs. Nigeria) ● Constant demand of governments to increase value added of exports ● Need to increase beneficial spillovers and use these sectors to develop others. (Australia, Canada) ● Export promotion diversification (niches) both in goods and in services. | <ul style="list-style-type: none"> ● Often strong resistance from local interest groups has to be overcome ● Typical vehicle for SMEs from DC's to jump into international markets ● Liberalization becomes the core topic around which the policy discussions tend to gravitate ● Competition issues become critical. | <ul style="list-style-type: none"> ● Given clarity of benefits, this is the kind of FDI that is more in demand ● Systemic competitiveness becomes the core topic around which the policy discussions tend to gravitate ● FTAs become critical ● Logistics for integration with the international economy become key | |

Annex table 2. AIS 2014 demographics

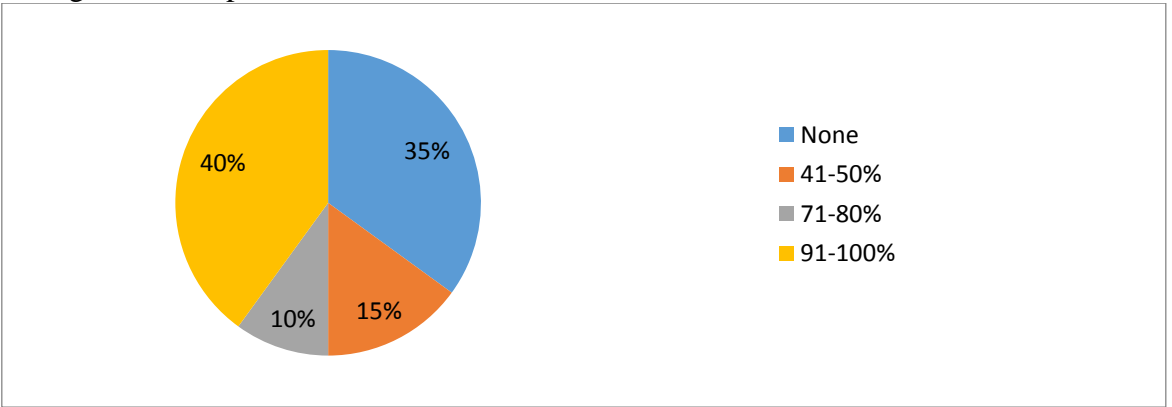
Sector composition



Parent company location



Foreign ownership share



Annex 3. World Bank Group comments on the Law of the Republic of Armenia on Foreign Investments (1994)

Background

Putting in place and fully implementing a policy and legal framework for investment is a long-term and complicated enterprise, especially in countries that went from a centrally planned economy to a market economy as the Republic of Armenia did starting in the late 1980's.

Many countries have taken decades and have gone through several rounds of reform before finding the “right formula”. Armenia is not alone in this process and can benefit from the experience of other countries that underwent the same process of transition, including a number of EU countries.

The Investment Law of 1994 which we are reviewing here and is currently in force constituted progress at the time of its enactment. But investment policy, legislation, and investment practices are not static. They evolve over time. Countries compete to open their economies, to modernize their investment framework, in a robust competition to attract greater foreign investment flows or improve their connectivity to the global economy.

They are also part of a growing network of multilateral and regional trade and investment liberalization and promotion efforts that also tend to lead to greater opening of the economy and higher standards of investor protection. Armenia is precisely in this situation: it needs and wants more investment, including more Foreign Direct Investment (FDI), greater inclusion in global and regional value chains. And it is also an active participant in liberalization efforts notably under the World Trade Organization (WTO). A review and upgrading of its investment policy is therefore timely and appropriate.

The World Bank Group, through its global Trade & Competitiveness (T&C) practice, is supporting the Government of Armenia in this process through the investment Policy component of the Armenia Investment Climate II project.

It is in the context of this project activity that the World Bank was asked to prepare a preliminary review of the current law on investment to identify eventual issues and provisions that could be improved. It primarily serves as a background document to start discussions on the law review with relevant representatives of the Ministry of Economy. It also serves as an input to the ongoing Investment Reform Map process with the Ministry and other investment-related stakeholders, which is aimed at helping the Government of Armenia organize reform priorities in the field of investment policy.

1. Scope, objective, methodology and limitations of the review

1.1. Scope and objective:

This note examines the main legislation governing foreign investment in Armenia, namely “The Law of the Republic of Armenia on Foreign Investments” of July 31, 1994 (hereafter the ‘Investment Law’ or ‘the Law’). The objective is to identify issues that the current law may present and that could deter FDI.

Through a desk review we can identify gaps that may exist between a country’s legislation and international best practice and/or international commitments undertaken by the country (through its international investment agreements, or IIA’s²⁰), with a particular focus on entry of foreign investors and investor protection. When appropriate, we can formulate recommendations of changes that would aim at increasing investor confidence.

Greater investor confidence can help Armenia convince potential investors to invest or existing investors to re-invest, thereby helping the government to achieve its objectives. In this case, the investment law has three stated goals (in summary)²¹:

- Protection of rights and property of foreign investors;
- Creation of necessary conditions for attraction of foreign investment; and
- Effective use of foreign advanced technologies and management and organizing experience.

1.2. Methodology

This note is the result of a desk review of Armenia’s Foreign Investment Law. Findings and recommendations are based on a comparison of Armenia’s Law with global best practices and also on a comparison on investor protection standards in the Investment Law and in some of the IIAs concluded by Armenia.

In this review, rather than commenting the Law article by article, we group issues in two major areas:

- Investment protection and in particular the guarantees extended to investors, and
- Investment entry and in particular any restrictions to entry or procedure to invest.

The note concludes by providing some options in terms of potential areas for further improvements to Armenia’s Foreign Investment Law.

1.3. Limitations:

It is important to understand that this note only reviews one document - the Foreign Investment Law of the Republic of Armenia- to assess to which extent it is in line with or conforming to international best practices and Armenia’s international commitments and how it might be improved.

²⁰ This term includes bilateral investment treaties and other investment related agreements.

²¹ These three goals are established in the preamble of the Law of the Republic of Armenia on Foreign Investments.

Other relevant and important laws and regulations of Armenia that govern or apply to foreign or domestic investment have not been reviewed in preparing this note. Issues of enforcement or practical application of these laws are also not part of our review.

Considering that the present analysis is a legal review, we will not offer specific comments on the type of investment incentive instruments or the duration of the incentives currently in place in Armenia. It is in any case virtually impossible to form an opinion on the incentive regime just by reading the Investment Law, which includes just a few very generic provisions on incentives.

Finally, it should be noted that our comments are solely based on the English version of the Law and some of the issues identified in our review may not exist in the original language version. At the outset, we would like to suggest that a high-quality English translation of the Investment Law be prepared by someone with strong expertise in English legal and investment terminology. Such a document is not only useful to facilitate review by international partners such as ourselves; it will also serve Armenia's promotional efforts toward foreign investors who do not speak and read the national language.

2. Investment Protection

Investment protection is one of the critical issues to consider when reviewing a country's investment policy and legislation. If investors do not feel confident that their investment, their assets, their facilities, workers, and themselves, will receive adequate protection, they will simply not invest or re-invest. Some of the already established investors may leave the host country when they consider that the level of protection of their investment is no longer sufficient (or the level of risk too high which is the same). Therefore, it is critical to ensure that investment protection is provided at a very high standard if the objective is to attract more investment, both domestic and foreign.

Foreign investors look to the country's foreign investment law and the protection of guarantees provided therein as one of the first indicators of a progressive investment climate. Thus, it is important for the Investment Law to reflect key investor protection guarantees. Strong investor protection will ultimately contribute towards increasing investor confidence in Armenia as an investment destination. To ensure implementation of these provisions, Armenia must adequately incorporate them in its domestic laws and policies.

The guarantees that are widely considered as core guarantees or *sine qua non* of a modern and open investment regime (which means that, when one of these guarantees is missing or weak an investment code cannot be considered as best practice) include the following:

- 1. Non-discrimination
 - National Treatment
 - Most Favored Nation
- 2. Fair & Equitable Treatment
- 3. Currency Convertibility/Transfer
- 4. Protection against Expropriation
- 5. Dispute Settlement-Access to Arbitration

The starting point of the following legal analysis on investment protection in Armenia is the Investment Law and Armenia's International Investment Agreements.

The objective of this analysis is to identify any gap in the level of investor protection afforded by the Investment Law *vis-à-vis* higher standards that may be embedded in IIAs concluded by Armenia. The identification of those eventual gaps would constitute a solid basis for reforming and improving the investment legislation with a view to making the country a more attractive destination for investment.

We start our analysis by doing an inventory of the main International Investment Agreements (IIAs) concluded by Armenia or applying to investment in Armenia through its membership in regional organizations. The list also includes trade agreements with a chapter or some provisions pertaining to investment. The agreements are listed in the table below.

| BITs in force | BITs not in force | Other Investment Agreements |
|--|--------------------------|--|
| Argentina, Austria, United States, Bulgaria, Belgium-Luxemburg, Germany, Iran, Lebanon, Canada, Cyprus, India, Greece, Kyrgyzstan, United Kingdom, China, Romania, Vietnam, Georgia, Ukraine, France, Italy, Switzerland, Israel, Qatar, Tajikistan, Russia, Belarus, United Arab Emirates, Uruguay, Finland, Egypt, Netherlands, Latvia, Sweden, Lithuania, Kazakhstan and Syria. | Turkmenistan, Kuwait | Treaty on Eurasian Economic Union, CIS Investor Rights Convention, Armenia-EC Cooperation Agreement, The Energy Charter Treaty |

We then compare the Foreign Investment Law to a sample of three BITs to see on how they fare along the six core guarantees of investor protection which we have pre-identified. The result of this comparison is presented below:

| Core Investor Protection Guarantee | Armenia Investment Law | Armenia-Egypt BIT | Armenia-Netherlands BIT | Armenia-India BIT |
|---|-------------------------------|---|--------------------------------|--------------------------|
| 1. National Treatment (NT) | Yes, with no limitations | Yes, investments and investors only regarding their management, maintenance, use, enjoyment or disposal of their investments. | Yes, with no limitations | Yes, with no limitations |
| 2. Most Favored | Not included | Yes, investments | Yes, with no limitations | Yes, with no limitations |

| | | | | |
|--|---------------------|--|--|-------------------------------------|
| Nation (MFN) | | and investors only regarding their management, maintenance, use, enjoyment or disposal of their investments. | except by virtue of customs unions, economic unions, monetary unions or similar. | |
| 3. Fair and Equitable Treatment | Not included | Not included | Yes | Yes |
| 4. Protection against Expropriation | Not very clear | Yes | Yes | Yes |
| 5. Currency convertibility and transfer | Yes, but incomplete | Yes | Yes | Yes |
| 6. Investor-State Dispute Settlement Provision | Not included | Yes, under UNCITRAL rules | Yes, under ICSID rules | Yes, under UNCITRAL and ICSID rules |

This first level of comparative analysis is useful to show that there are ways to improve the Investment Law to bring it in line with international best practices and with the level of protection provided in the BITs. We can see in the second column that the Foreign Investment Law either does not include some of the core guarantees or includes them but with some limitations or a lack of clarity that can undermine their impact and effectiveness.

We then look in more detail at each of the core guarantees to evaluate how they are incorporated (or not) in the Investment Law.

1) Principles of non-discrimination: NT and MFN

Overall, the Investment Law supports a general principle of non-discrimination between foreign and domestic investors.

Article 6 indicates that guarantees will be provided by the State to foreign and domestic investors by specifying that the legal regime on foreign investment and its implementation cannot be *less favorable* than the regime governing the property, property rights and investment activities of Armenian nationals.

However, the Law does not include a clause on the principle of Most Favored Nation as to guarantee no discrimination based on the country of origin of investor or investment.

Box 1: Example of National Treatment and Most Favored Nation Clause

Article X. National Treatment and Most-Favored Nation Clause

(1) Subject to the provisions of this law, and subject to other laws, international treaties and agreements of [Country X], foreign investors shall have the same rights and obligations as domestic investors.

(2) [Country X], subject to the Constitution, this law and international obligations, shall not discriminate with respect to foreign investors in any form, including but not limited to their citizenship, residency, place of registration or incorporation or the state of origin of investment.

2) Fair and Equitable Treatment

This principle is missing from the Investment Law (and is included in two of the three BITs we reviewed). The Fair and Equitable Treatment (FET) principle is a very important and often misunderstood guarantee, with far-reaching implications. It completes the framework to protect investors against discrimination by providing *due process*, by incorporating principles of good faith, *transparency*, and guarantee against *denials of justice*.

In practical terms, if Armenia were to extend FET to foreign investors, it would mean that, through its domestic legislation, Armenia would provide investors with the following 4 or 5 guarantees:

- a. Transparency on the rules of the game (*i.e.* publication of all laws, regulations, similar instruments),
- b. Right to be notified and consulted before regulatory changes are undertaken,
- c. Guarantee of access to justice; right to bring a claim, right to a fair treatment during the proceedings, and right to enforce the judicial decision, right to appeal,
- d. A guarantee that the government will honor any obligation in writing given to foreign investors,
- e. A guarantee that the government will apply the principle of proportionality in application of decision making.

As one can see, the above guarantees embedded in the FET principle are different from the other investor guarantees and complement them very usefully.

Unlike NT and MFN which are relative provisions (*i.e.*, looking at how a given foreign investor has been treated relative to other investors, domestic or foreign), FET is an absolute standard. Therefore, irrespective of how domestic investors are treated, FET demands a *minimum* standard of treatment of foreign investors. Because of this FET is a very comprehensive and comforting guarantee from an investor's perspective, perhaps even more so than NT or MFN.

On the other hand, considered from the host country's perspective, there are certain risks attached to the FET principle because there is no clear definition in customary international law and arbitral jurisprudence, no clear boundaries on what is included or not. Therefore, when including it in an investment law it is important to clearly define its scope and content to avoid giving excessive room for interpretation to judges or, more likely, arbitrators. When well designed and drafted, the FET standard is a very strong instrument to increase investor confidence and one that we would recommend Armenia to consider adopting.

This change would also bring Armenia closer to best practice. Many of the more recent IIAs, often referred to as ‘next generation IIAs’, have a specific provision requiring States to provide *transparency and due process*, reflecting increasing international consensus around these principles. . Under IIAs, the obligation of transparency includes the requirement of publication, public consultation, notification of specific measures, and review process after application of laws and regulations. These obligations apply with respect to all laws, regulations, decrees, and measures of general application concerning or affecting investment.

Box 2: Example of Transparency Provisions in ‘next generation’ IIAs

Article XX: Publication of Laws and Decisions Respecting Investment

1. Each Party shall ensure that its:

- (a) laws, regulations, procedures, and administrative rulings of general application; and
- (b) Adjudicatory decisions respecting any matter covered by this Treaty are promptly published or otherwise made publicly available.

2. For purposes of this Article, “administrative ruling of general application” means an administrative ruling or interpretation that applies to all persons and fact situations that fall generally within its ambit and that establishes a norm of conduct but does not include:

- (a) a determination or ruling made in an administrative or quasi-judicial proceeding that applies to a particular covered investment or investor of the other Party in a specific case; or
- (b) a ruling that adjudicates with respect to a particular act or practice.

Article XX: Transparency

1. Contact Points

- (a) Each Party shall designate a contact point or points to facilitate communications between the Parties on any matter covered by this Treaty.
- (b) On the request of the other Party, the contact points shall identify the office or official responsible for the matter and assist, as necessary, in facilitating communication with the requesting Party.

2. Publication

To the extent possible, each Party shall:

- (a) publish in advance any measure referred to in Article 10(1)(a) that it proposes to adopt; and
- (b) provide interested persons and the other Party a reasonable opportunity to comment on such proposed measures.

3. Notification and Provision of Information

- (a) To the maximum extent possible, each Party shall notify the other Party of any proposed or actual measure that the Party considers might materially affect the operation of this Treaty or otherwise substantially affect the other Party’s interests under this Treaty.
- (b) On request of the other Party, a Party shall promptly provide information and respond to questions pertaining to any actual or proposed measure referred to in subparagraph (a), whether or not the other Party has been previously notified of that measure.
- (c) Any notification, request, or information under this paragraph shall be provided to the other Party through the relevant contact points.
- (d) Any notification or information provided under this paragraph shall be without prejudice as to whether the measure is consistent with this Treaty.

4. Administrative Proceedings

With a view to administering in a consistent, impartial, and reasonable manner all measures referred to in Article 10(1)(a), each Party shall ensure that in its administrative proceedings applying such measures to particular covered investments or investors of the other Party in specific cases that:

- (a) wherever possible, persons of the other Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is

- initiated, and a general description of any issues in controversy;
- (b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; and
 - (c) its procedures are in accordance with domestic law.

5. Review and Appeal

- (a) Each Party shall establish or maintain judicial, quasi-judicial, or administrative tribunals or procedures for the purpose of the prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Treaty. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.
- (b) Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:
 - (i) a reasonable opportunity to support or defend their respective positions; and
 - (ii) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority.
- (c) Each Party shall ensure, subject to appeal or further review as provided in its domestic law, that such decisions shall be implemented by, and shall govern the practice of, the offices or authorities responsible for the administrative action at issue.

Source: Article 10 and 11 of US-Uruguay Bilateral Investment Treaty

3) Guarantee of Currency Convertibility/Transfer

Article 10 of the Investment Law allows foreign investors full disposal of their revenues, to open bank accounts in Armenia and to use their “legally obtained means to acquire foreign currency”. Moreover, Article 11 guarantees foreign investors to “freely export their property, profits and other means legally gained as a result of investments or as payment for labor or as compensation”. These two articles taken together could be viewed as providing a reasonable guarantee of currency convertibility and transfer, in spite of some problems with the terminology used (for instance, “export their property”) and some missing elements.

An important element of best practice concerning the transfer guarantee is that transfer must be timely and prompt. Best practice legislation even provide that interests will be due if such prompt transfer is impeded by actions of the government (except for reasons that should be defined in advance, e.g., a balance of payment crisis). Here, the Investment Law does not include any reference to the ‘timely or prompt transfer’. A review of the legal and administrative requirements entailed in making such a transfer would give us a more precise assessment of how easy or difficult making a dividend transfer out of Armenia is for an average foreign investor, how much time it takes in practice.

We further note that, in most of the BITs we have reviewed, Armenia has committed to providing timely transfer. Therefore, we would recommend to revise the related provisions to include an obligation to ensure ‘timely transfer’, improve and clarify some of the terminology used, and specific if there are any exceptions to the guarantee (e.g., temporary restriction for balance of payment crisis). Finally, it is also good practice to use the market rate of exchange on the date of transfer as the rate of conversion.

4) Protection against Expropriation

Article 8 of the Investment Law protects investors against nationalization and confiscation. It states that foreign investment will not be subject to nationalization. And that confiscation may be allowed only as an extreme means in case of emergency declared in accordance with Armenia's law and upon the judgment of a court and through full compensation. The article is silent on expropriation.

First, it is important to clarify that nationalization, confiscation and expropriation are different concepts. Nationalization in broad sense is the process of taking an industry or assets into the public ownership of a national government or state. Confiscation is the act of seizing property and submitting it to the public treasury. Most common confiscation is used regarding illegal items such as narcotics or firearms, or profits from sale of illegal goods, and most of the cases is not followed by compensation. Expropriation is the act of a government taking private property; eminent domain is the legal term describing the government's right to do so. So if the typology is to be complete the three terms (nationalization, confiscation, and expropriation) should be used. Or if only one term is to be used, then it should probably be expropriation.

Second, no one is expecting a government to promise to never expropriate or never appropriate. What is expected is protection against illegal, abusive expropriation, expropriation without due process, without valid reason, with discrimination, and/or without compensation. Therefore, the point of this provision is not to prohibit governments from nationalizing or expropriating but providing some safeguards and guarantees (only for public purpose, with due process, without discrimination, and against prompt, adequate and effective compensation).

Third, best practice is to protect investors not only against direct expropriation but also against measures that have an equivalent effect (indirect expropriation), that is measures that deprive investors of their property or control over an investment without necessarily entailing a formal confiscation or seizure of title. Rather than direct seizure of property, a bigger threat to foreign investors nowadays are measures (including regulatory measures) which have "effects equivalent to direct expropriation". The scope of the protection should therefore be wider and include both forms of expropriation.

Fourth, the current provision prescribes that confiscation should be accompanied with payment of 'prompt compensation at current market prices determined by independent auditors'. The meaning of 'prompt compensation at current market prices determined by independent auditors' is unclear. It should be kept in mind that there is near universal consensus internationally that "prompt, adequate and effective" are the standard parameters for compensation for a lawful expropriation. Some variations still exist at country level but generally, investment commitments of countries reflect the "prompt, adequate and effective" standard. Any specific commitment beyond this is for individual States to decide, so long as it reflects the reality of the required domestic procedures for actual payment of compensation.

The "prompt, adequate and effective" standard requires that the compensation must be paid in a timely manner/without delay and in freely convertible currency. Further, it requires that the compensation is adequate, that is, the valuation should be based on fair market value. The World Bank Guidelines on the Treatment of Foreign Direct Investment define fair market value as "an amount that a willing buyer would normally pay to a willing seller after taking

into account the nature of the investment, the circumstances in which it would operate in the future and its specific characteristics, including the period in which it has been in existence, the proportion of tangible assets in the total investment and other relevant factors pertinent to the specific circumstances of each case.” Generally, it is suggested that the valuation include the going concern value, asset value including declared tax value of tangible property. It must be noted, that both the timeliness of the payment of compensation and an appropriate amount of compensation are very important for investors and thus must be suitably provided in the Investment Law.

All of the above-mentioned best practice standards are also provided in the BITs which have been reviewed and that form part of Armenia’s legal framework. As a matter of compliance and consistency with these agreements and to give the right signal to foreign investors and increase certainty and clarity, it is critical for Armenia to ensure incorporation of these principles into its domestic legislation as well as its effective implementation.

Box 3: Example of Expropriation Clause (Armenia-US BIT)

Article X. Expropriation and Nationalization

Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except: for public purpose; in a nondiscriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be calculated in a freely usable currency on the basis of the prevailing market rate of exchange at that time; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable.

5) Settlement of Disputes

According to Article 24 of the Investment Law, disputes arising between foreign investors and the State of Armenia shall be considered by domestic courts of Armenia, in a manner established by domestic legislation.

The Investment Law falls seriously short of best practice standard for foreign investment legislation. It is common practice nowadays to explicitly include guaranteed access to alternative mechanisms of dispute resolution, principally international arbitration, not only for business-to-business disputes but also for Investor-State disputes.

References to ICSID (which Armenia is a full member of –the Convention having entered into force for Armenia on October 16, 1992) and UNCITRAL are very common and not finding them in foreign investment legislation will give concern to many foreign investors. Similarly, Armenia also acceded to the New York Convention in 1998 and mentioning the NY Convention would reassure investors that, should they obtain an arbitral decision overseas, they will be able to invoke and have it recognized and enforced in Armenia.

Such elements of best practice for dispute settlement provisions are also included in most of the BITs which have been reviewed and thus, in any case, form a part of Armenia’s legal framework. As a matter of compliance with these agreements and more importantly to give the right signal to foreign investors and increase certainty and clarity, it is critical for Armenia

to ensure incorporation of this clause into its domestic laws as well as their effective implementation.

6) Other guarantees and obligations

The foreign investment law also includes other guarantees on foreign investors:

| | |
|--|---|
| <i>Article 2. Recognition of International Agreements</i> | The rules of international treaties shall apply in case of contradiction with the Foreign Investment Law. |
| <i>Article 7. Stabilization of the legal framework</i> | In the event of amendments to the investment law, the legislation which was effective at the moment of implementation of investments shall be applied, during a five year period. |
| <i>Article 9. Compensation for material and moral damages</i> | Foreign investors shall be entitled to compensation, through a court order, for those material and moral damages, including lost profits, which damages are caused as a result of illegal actions or improper performance by government bodies. |
| <i>Article 19. Property Rights over Land and Other Natural Resources</i> | The acquisition by foreign investors of property rights over land and other natural resources shall be regulated by the relevant domestic legislation. |
| <i>Article 20. Leasing of Property</i> | Property may be leased to foreign investors and enterprises with foreign investment on the basis of lease contracts in accordance with domestic legislation. |
| <i>Article 21. Concession of Contracts</i> | Any foreign investor shall be entitled to exploit renewable and non-renewable natural resources on the basis of concession contracts in accordance with domestic legislation. |
| <i>Article 22. Intellectual Property Rights</i> | The exercise and protection of foreign investor's intellectual property rights shall be guaranteed in accordance with domestic legislation. |
| <i>Article 23. Insurance of Property and Risks</i> | Foreign investors may insure their property and risks at their discretion, unless stipulated by domestic legislation. |
| <i>Article 25. Responsibility and Obligations of Foreign Investors</i> | Foreign investors shall bear responsibility for any violation of domestic legislation. Property of a foreign investor, including working capital and property rights may be used by that investor to guarantee any type of obligation. |

These guarantees do not call for major observations. They tend to refer to other laws of the land. Their inclusion is positive but not necessarily essential in the sense that investors would still be able to lease property or they will still have protected property rights in Armenia even if the Investment Law was silent on these issues (because these rights are covered by other laws of the land and probably even the Constitution). On the other hand, unless the Investment

Law specifically protects investors against indirect expropriation or specifically extends Fair and Equitable Treatment, there is a risk that these guarantees will not be recognized and enforceable (except for investors from countries that have BITs with Armenia that recognize these guarantees). Similarly, unless access to international arbitration was expressly recognized in the Investment Law, it would not necessarily be a valid option for these investors, again with the exception of investors from BIT countries or investors who have an agreement or contract with the State of Armenia allowing them to submit an eventual or actual dispute to international arbitration. This is also why we draw a line between guarantees that are considered “core” elements of investor protection and others that are “non-core”.

3. Investment Entry: Market Access and Investment Procedures

3.1. Market Access:

In many (if not most) economies around the world, including OECD economies, there are certain restrictions or prohibitions to invest that apply to foreign direct investment. When in a given economy such restrictions exist, the foreign investment law should mention these restrictions, in the spirit of transparency, predictability, and fairness.

In some cases the restrictions can be enumerated directly into the law but in others (such as, for instance, ceilings or prohibitions to invest in certain sectors/industries), it may be wiser to include the principle in the Law but enumerate the sectors themselves in a “negative list” attached to the law and having lower legal value (for instance a decree or regulation). This system is considered best practice for two reasons:

- It allows investors to know immediately where they can invest, or not invest, or whether an equity limit exists.
- Having the sectors listed in a decree allows the government to further liberalize the economy over time without having to change the main Investment Law (given the fact that it is usually easier to revise a decree than a law).

In the case of Armenia, the Law of 1994 is silent or at least not clear on whether such restrictions to invest exist and where there might be.

Does the silence of the Investment Law on this question mean that the economy is fully open to FDI, without any restriction of any type? Or does it mean that an important piece of information that should be provided by the Law is missing?

Should the latter hypothesis be the correct one, a revision of the Law should rectify this. Through our IRM exercise, we can identify these eventual restrictions, we can assess them based on international trends and best practices; we can help rationalize them if they appear to be excessive; and we can then help incorporate them into the Law with a proper negative list system. This would resolve the current uncertainty over which restrictions may exist.

In addition, a periodic review of the negative list could also be established in the Investment Law, along with the principle of “revising the negative list only in the direction of further liberalization” (that is, the government can pledge to make the list shorter over time and to not renege on commitments once certain sectors have been liberalized). These concepts would go

a long way in establishing Armenia among the countries with the most modern and open investment policies.

3.2. Investment Procedure: Registration of foreign investment

According to Article 12 enterprises with foreign investment, their divisions, branches, representative offices and economic associations of enterprises, shall be registered in compliance with the Law of The Republic of Armenia on Enterprises and Commercial Activities and any other legislation of Armenia.

In addition, Article 14 provides that an enterprise with foreign investment may conduct any economic activity which complies with the goals and objectives stated in its charter and which is not prohibited by Armenian legislation. Important to mention that certain economic activity, that the law does not specify, may be conducted by enterprises with foreign investment only after obtaining a license in the manner established under domestic law.

We observe that the Investment Law does not provide for a screening and approval requirement which is very positive, requiring only registration unless provided otherwise under Armenian's law.

It could be useful to review the laws and regulations that impose licensing requirements for specific economic activities in order to assess their degree of conformity with best practices and determine if any clarification or simplification of the said licensing requirements might be in order. This is one issue that goes well beyond this review of the Investment Law.

Conclusion

In conclusion, our assessment is that the Investment Law of 1994 was a good effort at the time of its enactment. It does contain many good provisions and reflects a good degree of openness of the government and of the national policy towards foreign investment and investors. Although it is not extremely weak or flawed, and not among the least appealing laws which we have reviewed, our analysis also shows that the Law does present significant room for improvement in specific areas which we have identified through this desk review.

In particular the core guarantees that are part of Investor Protection could be solidified by:

- Incorporating the fair and equitable treatment standard;
- Strengthening the protection against expropriation, by incorporating the elements of best practice, by covering both direct and indirect expropriation, and by providing more detail on compensation;
- Strengthening the currency convertibility and transfer guarantee by adding to the types of transactions that are covered by the guarantee and by incorporating the timeliness element, while also mentioning any exception that may exist;
- Clarifying the dispute settlement clause by providing an explicit and unambiguous right to access international arbitration for Investor-State disputes, and by adding specific references to the ICSID Convention, the NY Convention, and to UNCITRAL rules in particular.

With regard to investment entry, the Law should clarify whether any restrictions to FDI entry exist and ideally use a system of “negative list” to enumerate these restrictions very clearly. A periodic review of the negative list could also be institutionalized. And the principle of “only adjusting the negative list in the direction of further liberalization” (only making the list shorter over time and not renegeing on commitments to open certain sectors) should also be considered as elements that best practice countries have adopted.

The Trade & Competitiveness team of the World Bank Group remains fully available to discuss the above findings and recommendations with the authorities, and explore the technical assistance that could be provided to revise the Investment Law based on these recommendations.

Annex 4. Model Mechanism for Investor Retention and Confidence

