



Armenia and Its Diaspora Is There Scope for a Stronger Economic Link?

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With the breakup of the Soviet Union in 1991, the newly emerging independent countries faced an enormous dual challenge: to cope with the loss of subsidies and markets, and to build a new economic system in place of the failed Soviet model.* Different countries adopted different approaches. It was understood that the new economic systems would be market oriented, but no one knew whether the optimal path would require breaking the old system entirely and building anew, or maintaining and building on potentially useful remains of that system. There was very little theory and simply no historical evidence of this scale to use as a benchmark.

Seventy-odd years after the establishment of the first Armenian republic in 1918, Armenia became independent again in 1991. It was a dream come true not only for some in Armenia, but also for many Armenians living outside Armenia, in the vast Armenian diaspora.¹ And now Armenians around the world are faced

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¹ *Webster's American Dictionary* (College Edition, 1997) defines diaspora as a group that has been dispersed outside its traditional homeland. It is this broad definition of diaspora that we employ in our paper: the term Armenian diaspora (hereafter, the diaspora) would refer to ethnic Armenians living outside the borders of the present-day Republic of Armenia and Gharabagh. As diverse as various Armenian communities around the world are (a difference that is largely dictated by host-country social, religious, and economic peculiarities), for the purposes of our study these differences are either assumed away in full or assumed to be of secondary importance relative to individuals' ethnicity and culture. Thus, we regard the diaspora as a uniform entity with the same ethnic origin and certain cultural ties to the native population of the Republic of Armenia. Furthermore, here we will not touch upon the incentives behind diaspora individuals' involvement in Armenia. Since the reasons could be numerous—ranging from knowledge of the language and the environment to cultural ties, altruism, and patriotic

with the same challenge of building a strong homeland, capable of weathering external political and economic shocks and unifying the nation. Even those diaspora Armenians for whom the economic development of the Republic of Armenia may not have been a core objective have been coming to realize that nationwide aspirations of any kind can only succeed through an economically powerful homeland—one that is also heard and respected outside its borders.

From the very beginning, the new republic enjoyed the active and expanding participation of diaspora groups in various reconstruction and humanitarian projects. To the young state, the diaspora brought optimism and hope for a stable recovery, rapid development, and successful integration into the world economy. The general public in Armenia viewed the diaspora as the primary push factor for economic reforms and democratic change in Armenia. The much-vaunted economic power of the diaspora was expected to turn Armenia into a transition success story within a short period of time.

Under the circumstances, a great deal has been accomplished in the eleven years of independence. The economy is on a path not much different from, and at times even more successful than that taken by other, more fortunate former Soviet republics. Basic institutions were created from scratch, while the economy as a whole was facing collapsing trade links, the consequences of a devastating earthquake, and an all-inclusive economic blockade by Turkey and Azerbaijan. Despite these severe adverse shocks, Armenia's achievements on the macroeconomic front since 1994 have been remarkable. These are reflected in the relative stability of prices and exchange rates. The economy has grown by about 7 percent per year, on average, since 1994—albeit from a low base. The country has adopted a series of measures to liberalize trade and reduce the tax burden on enterprises. These processes have been accompanied by some improvement in living standards.

Yet, much more remains to be done before Armenia can even catch up to its 1989 level of indicators of aggregate economic performance and social development.² Whereas Armenia was one of the most technologically advanced republics of the former Soviet Union, most of its factories and underlying technologies are gradually becoming obsolete, owing to inadequate maintenance and lack of new investments. Very few pretransition enterprises can produce goods that are

feelings—for the purpose of this study we will assume that some incentives exist for a diaspora individual—a businessperson or volunteer—to get involved in Armenia's affairs either through providing humanitarian assistance or through more active engagement in business and social life. We also believe these incentives to be dynamic and to change over time in response to factors such as the need for such involvement (however defined), the "returns" on individuals' previous experiences in Armenia (if any), the political will of and subsequent steps taken by the Armenian government to welcome this involvement, etc.

² Presently, Armenia's GDP stands at around three-quarters of its 1989 level.

competitive in international markets, unless they import or find ways to develop new technologies.

A cross-country comparison leaves even more to be desired: as Armenia moves closer to its pretransition level of GDP, fast-growing developing countries in Asia, Latin America, and Eastern Europe are moving further beyond their 1989 levels. Despite the progress Armenia has made, it is becoming exceedingly difficult for it to break the vicious circle that can be presented schematically as

low income >> low savings >> low investment >> low output >> low income

In a very simplified way, this circle shows that unless external resources are called upon, an economy that produces less and, therefore, saves less, is bound to remain poor because it has few resources to invest to grow further.³ The real bad news is that the economy's ability to attract foreign resources to finance its growth also depends on how well it functions. So once it is (or is perceived to be) in the trap described above, the economy is doomed to a slow growth (and, therefore, poor prospects of poverty reduction), the vicious nature of which would require a strong effort to break. There is good news, however: at least at the theoretical level, each individual link mentioned above is breakable—some with more difficulty, some with less. This paper is about breaking the second and third links above: it is about attracting more investments (both public and private) and making them count for more in terms of the output they generate. This paper is about concrete channels of reaching these objectives in the Armenian context.

Throughout the paper we will be guided implicitly by the model of a neo-classical macroeconomic production function, which essentially states that there are three ways to achieve higher output and production levels: (1) by improving technology and productivity, (2) by expanding the capital stock, and (3) by employing more labor with more human capital. We will be talking about each of these three channels separately, sometimes going down to the details of project implementation, but more often simply opening avenues for further research. We will not be dwelling upon what went wrong or what else could have been done to make things better. Instead, our focus is on the future and on the diaspora's pivotal role in making that future happen.

Modalities of Current Diaspora Involvement in Armenia: A Case for More Active Economic Involvement

The current wave of diaspora involvement in Armenia goes back to the late

³ Availability of investment is only a *necessary* condition for growth to take place. For an excellent discussion on the *sufficient* conditions (the presence of developed institutions and enforcement mechanisms, properly functioning markets, etc.), see William Easterly, *The Elusive Quest for Growth* (Cambridge, Mass.: MIT Press, 2001).

1980s. After the devastating earthquake of 1988, a number of diaspora organizations were formed and some reactivated their work in the communities abroad and Armenia. Since the earthquake and independence in 1991, the diaspora has provided massive humanitarian aid to Armenia. According to one estimate, fourteen major organizations provided some 630 million United States dollars in assistance to Armenia in the decade following the earthquake.⁴ The diaspora has also assisted the newborn republic through its lobbying efforts in the United States, France, Russia, Canada, and other countries. Thanks to this lobbying, Armenia has been one of the top recipients of official United States foreign aid: in 2001 alone, the United States provided Armenia with an estimated \$110 million in various assistance programs; only Israel received more foreign aid from the United States, per capita, than Armenia.⁵ Meanwhile, strong Armenian links in the Kremlin have helped pass into law several pro-Armenia legal acts, granting citizens of Armenia a status similar to that of Russian citizens, simplifying trade transactions between the two states, and allowing citizens of Armenia and Russia to travel visa-free between the two states.

We do not intend to provide an exhaustive review of the activities of the diaspora in Armenia. The reason is simple: many organizations have done a great deal—most of which is unique in nature and generous in the desire to help—that goes beyond the scope of the current study (see box 1). We will instead review the dynamics of the diaspora-Armenia link, the modalities it now has, and those it could have in the future. It seems particularly important to define the objectives for diaspora involvement in the homeland up front. This definition has important implications for the scale and scope of efforts put in on both sides and for the forms that the relationship between the two may eventually take.

To demonstrate the point, let us look at two extreme examples. If, for instance, the objective of the diaspora individual or entity is merely to establish conditions for tourism, so that Armenians and others might visit Armenia, become acquainted with its cultural riches, and leave, then the development of tourism infrastructure may be enough. As challenging as this could be, the available international evidence from low-income countries in the Middle East and Latin America suggests that it would require relatively little effort. What if, on the other hand, the objective were to create a viable modern Armenian state, able to provide security and an environment where most diaspora Armenians were willing to settle? This would require the development of an economic environment based on the rule of law, capable of providing incentives for those

⁴ See Hrach Tchilingirian's report, "Diaspora Humanitarian Assistance to Armenia in the Last Decade," presented at the first Armenia-Diaspora conference in September 1999, available at <<http://groong.usc.edu/ADconf/199909/reports/humanitarian.html>>.

⁵ Armenian Assembly of America, "U.S. Assistance to Armenia" (fact sheet), 2002.

Box 1. Instances of Diaspora Aid to Armenia

The **Fund for Armenian Relief** (FAR) was founded after the devastating earthquake in northwestern Armenia in December 1988. Headquartered in New York City, FAR has branch offices in Yerevan, Gyumri, and Stepanakert. It has channeled over \$200 million in humanitarian assistance to Armenia since its establishment. The fund's projects predominantly focus on medical assistance, agriculture, construction, education, and cultural heritage, and include assistance to earthquake victims, various food programs, children's summer camps, training programs (including English-language courses and vocational training for older orphans), and restoration of schools and churches. An education project to provide grants for research in Armenia is one of the FAR's recent undertakings. The Fund for Armenian Relief carries out humanitarian operations in Gharabagh and recently originated projects in the Armenian-populated regions of neighboring Georgia.

The **Hayastan All-Armenian Fund** was founded six months after the declaration of independence of Armenia. The primary purpose of the fund is to consolidate support for the newborn state and Gharabagh. During the past ten years, the fund has implemented more than one hundred projects totaling \$75 million. The fund has built or renovated 210 residential buildings and houses for 960 families, thirty-six schools and other educational establishments, and twelve health establishments. It has built 220 kilometers of roads, 131 kilometers of water pipelines, and 60 kilometers of power-transmission lines. Through campaigns across the world, the fund has been able to collect significant donations from Armenian communities and international organizations in over thirty countries. The members of the board are high-level officials of the Republic of Armenia and Gharabagh, representatives of churches, diaspora parties, public and charitable organizations, and well-known individuals. The fund has created several endowments for sponsoring educational and social assistance programs.

Established shortly after the 1988 earthquake, the **United Armenian Fund** (UAF) is a product of a coalition of the Armenian Assembly of America, the Armenian General Benevolent Union, the Armenian Missionary Association of America, the Armenian Relief Society, the Diocese of the Armenian Church of America, the Prelacy of the Armenian Apostolic Church of America, and the Lincy Foundation (see below). Since its establishment, the UAF has collected and transported nearly \$350 million worth of humanitarian assistance to Armenia to help the country weather the consequences of the earthquake and subsequent shocks. The donations collected by the UAF from across the United States (mostly in the form of medicine and medical equipment) have averaged approximately \$30 million per year. The fund's objective is to provide immediate assistance to low-income families in Armenia.

Finally, the **Lincy Foundation** offers targeted economic as well as humanitarian and cultural development assistance to Armenia. In 2000 the foundation announced plans to funnel \$165 million in the form of grants earmarked for capital expenditure, including renovation projects in Yerevan; restoration of several historical and cultural institutions; design and construction of a network of roads within Armenia; and reconstruction of housing in the earthquake zone. The amount allocated represents

about 7 percent of Armenia's GDP and is to be disbursed before November 2003. Founded by Armenian-American philanthropist Kirk Kerkorian, the foundation is financing projects that are part of the government's public investment program. The foundation's investment projects include a \$20 million loan program to small and medium businesses in Armenia.

Sources: <<http://www.farusa.org>>, <<http://www.amaainc.org>>, <<http://www.armeniadiaspora.com>>. For more information on the activities of nongovernmental organizations in Armenia, see <<http://www.ngoc.am>>.

patriotically inclined or economically challenged, to live and succeed. This task is much greater in scope and a very difficult one to achieve, at least from where Armenia stands at the moment.

We believe that at present the objectives of individuals and entities in the diaspora as a whole vis-à-vis Armenia lie somewhere between the two goals outlined above. This is primarily a reflection of the short-term difficulty of attaining the second goal, a prosperous economy based on the rule of law. It is, however, likely to shift closer to the second goal if encouraged by the pace of the reform process in Armenia. To put it another way, the diaspora-Armenia link is not a static concept; one should not assume a certain predetermined level of support or interest from the diaspora. Instead, the relationship is a dynamic one, which could be influenced by policy makers in Armenia by steps they take toward the elimination of problems related to economic management, public-sector governance, and the rule of law. These are essential to building trust and signaling the seriousness and credibility of reforms. They cannot go unnoticed by the diaspora and non-Armenian investors alike. By the same token, the opposite is also true: lack of action in this regard would push the diaspora toward less ambitious objectives in its relations with Armenia.

But is this a one-way street? Should the diaspora really wait and see whether it is satisfied with the reform process in Armenia before making its assistance and links to the homeland more efficient, in line with its potential, which some argue is not fully realized?⁶ Throughout this paper we advocate more active diaspora involvement. The diaspora has by now gone a long way in terms of humanitarian and cultural activities; it is about time for it to direct its activity toward economic policy and business life, aiming for longer-term economic growth and development. It is important for diaspora communities everywhere to realize that without their active participation in the underlying economic processes in Armenia, the process of development has fewer chances to succeed. Indeed, a lack of active participation may effectively undermine any chances

⁶ See Lev Freinkman, "Role of the Diasporas in Transition Economies: Lessons from Armenia" (paper presented at the eleventh annual meeting of the Association for the Study of the Cuban Economy, Coral Gables, Florida, 2-4 August 2001).

for further diaspora-Armenia rapprochement, and lead to faster assimilation of Armenians in the diaspora.

As has been noted elsewhere, constant reliance on soft (that is, unconditional) financing—originating either from the diaspora or through foreign aid—creates a moral hazard, especially if the monitoring of the projects for which the financing is intended is not done properly. This is particularly true in the case of the Armenian diaspora, where at times “the act of giving seems to be more important than the actual effect.”⁷ The soft assistance that the diaspora tends to provide is not the best channel for strengthening Armenia’s overall growth prospects. Although there are a few instances of direct economic initiatives on the part of the diaspora, most activities of diaspora organizations are still philanthropic. Missing are the economic-development-oriented channels, which could lead the way for faster development of the Armenian economy and a stronger diaspora-Armenia link (in the sense of the second goal described above).⁸ Does the diaspora, with its human and physical capital, have ways to meet this challenge? The answer is an undoubted “yes.”

To date, however, the underlying character of the relationship (with a few exceptions) remains largely humanitarian and cultural, and it is not, strictly speaking, broadly based. The economic and business agendas of the diaspora are weak or nonexistent, as evident from the conclusions of the second Armenia-diaspora conference (see box 2). And, as Razmik Panossian has noted, the established relationship is concentrated and typically includes large-scale influential business persons and groups, usually those with proven commitment of non-involvement in local politics and economic power-sharing.⁹ This approach has left out a wide array of small and midlevel business owners and activists who have no party or group affiliations, but comparable enthusiasm about being involved in Armenia.

In the rest of this paper we will discuss some tangible programs to broaden the base of diaspora participation in Armenia’s business and economic life.

⁷ Ibid.

⁸ Being graded high on the social and economic impact scale is also likely to gather stronger popular support and reduce any resistance stemming from local interest groups. As utilitarian as this might sound, given the poverty level and severity of social issues in Armenia, projects are likely to be judged by their immediate impact on the well-being of the population. A perfect example of this is the recent popular outcry against the idea put forth by the Cafesjian Foundation to build a \$20 million cultural exhibit in downtown Yerevan and move a world-famous glass collection worth \$110 million into it. This said, projects that may not necessarily be viewed by the public as having high economic and social impact, might benefit from active public-relations campaigns describing their short- and long-run impacts and benefits.

⁹ Razmik Panossian, “Courting a Diaspora: Armenia-Diaspora Relations since 1998” (Department of Government, London School of Economics, 2002). Because the treatment extended to diaspora business owners and philanthropists was typically based on individual/private contact of the Armenian elite, it was only natural to expect that this attention would be limited to a few wealthiest and the most influential, as opposed to being all-inclusive and institutional.

Box 2. The Armenia Diaspora Conference, 2002

The second Armenia-Diaspora Conference took place in Yerevan on May 27–28, 2002. Over two thousand delegates from around the world went to Armenia to discuss the prospects of future cooperation between the diaspora and the Republic of Armenia. As a result of two-day-long discussions, a number of specific projects were adopted and goals were set, in an effort to enrich the partnership. Below is a short description of projects agreed upon during the conference:

Computerization of Schools: The objective is to computerize all 1,500 schools in Armenia and another two hundred in Nagorno-Karabakh. Of this total, three hundred will be completed by 2003 through the resources of existing programs. The target is the completion of the remainder by 2005. The objective of the program is to prepare students for the challenges and techniques of the information age.

Center for Genocide Studies: The intention is to set up a research center for the study of the Armenian Genocide. Although there has been significant amount of research done on the subject, the conference participants felt that it is necessary to augment this effort, systematize it, and encourage a new generation of scholars. A center will be staffed and developed by joint Armenia-diaspora effort

Virtual Armenian Studies University: By taking advantage of information technology, this project will establish an Internet-based university to provide resources and courses in Armenian studies. A database and online classes will provide teachers, scholars, and students an opportunity to exchange ideas, study the past, and analyze current and future issues. A curriculum devised by practitioners will provide a model for Armenian studies at the high school and college levels.

Committee on Curriculum: What Armenians learn about themselves—their heritage and their legacy—is critical to their self-image and the way in which they determine how to build their future. This committee will provide a forum for Armenian educators to meet and discuss various approaches for teaching Armenian language, culture, and history. Aspects of such a curriculum may be adopted by schools and educators in Armenia and the diaspora.

Identifying and Supporting Armenian University Students: In order to consolidate the potential of Armenian students in universities in Armenia and abroad, a joint committee of university students and professors will devise a program to identify, track, and support college students. A network of students will be the launching pad for finding scholarship sources, encouraging civic involvement, and promoting higher education.

Regional Health Center: The purpose of this project is to bring together resources from the diaspora to establish a world-class health-care center in Yerevan. The center will develop and provide medical services anchored by a hospital and equipped with new technologies, specialized institutes, clinics, and short- and medium-term convalescent facilities. The project will make it possible to raise the level of health care in Armenia and to provide opportunities for diaspora medical professionals and trainees to participate in health-care provision in Armenia.

Diaspora Museum: The purpose of the Diaspora Museum is to create a repository of artifacts, archival evidence, and a narrative of the life of diaspora communities. By collecting materials from areas where Armenians have lived, this museum will document the unity through diversity of all Armenian homes away from home.

Source: <<http://www.armeniadiaspora.com>>

Having high developmental content, these programs would require organized and institutional diaspora participation as well as unambiguous and orderly steps by the government if they are to take off and be effective. In addition to revisiting the idea of organized repatriation as a channel for the transfer of human capital and market-oriented mentality and incentives, we will discuss the merits of direct versus indirect (that is, institutional) financial investments, and a sovereign diaspora bonds program.

Repatriation and Volunteerism as Sources of New Skills, Technology, and Incentives

Repatriation—the organized and assisted migration of a population to its ancestral homeland—can be a powerful tool for transferring new skills, technology, and market-oriented mentality to Armenia and, thereby, for breaking the cycle of substandard performance and underdevelopment discussed above.¹⁰

In addition to addressing the challenge of persuading diaspora Armenians to move to Armenia, we must confront the domestic politics of such a program. The idea of repatriation (regardless of scale) can be politically unpopular in any country, in view of its potential short-term impact on the domestic labor market, and it may never become popular unless its long-run benefits are understood and properly disseminated.

In the Armenian context, the idea surfaced publicly at a recent conference in Yerevan as a way to guarantee sustained economic development.¹¹ The proposed approach was rather bold and ambitious, but not new. Armenia itself has experience with organized repatriation. Panossian writes,

Between the early 1920s and 1970s, around a quarter of a million Armenians made this journey, including over 100,000 in the largest and most significant “repatriation” drive launched by the Soviet authorities in 1945. Ostensibly, this was to populate the historic Armenian regions

¹⁰ At least in terms of incentives and transfer of knowledge and skills, everything said in this section also refers to volunteer activities. This is especially true in cases that involve volunteer activities for extended periods of time (see box 3).

¹¹ Armen Aivazian, “Organized Repatriation as the Path for the Development of the Armenian State and Nation” (paper presented at American Chamber of Commerce in Armenia conference, “Diaspora as a Factor of Country Competitiveness,” 2002).

of Kars and Ardahan, which the USSR was to acquire from Turkey. The land claims, made in the context of postwar superpower geopolitical maneuvering, came to naught, but between 1946 and 1948, some 100,000 Armenians immigrated to “their” Soviet “homeland.” This sudden influx of diasporan immigrants represented 9 percent of the 1946 [Soviet] Armenian population of 1.2 million.¹²

We believe that the idea of repatriation in the context of current-day Armenia merits some research as it carries significant potential in terms of its economic implications, at least in the long run. For the purpose of assessing the potential impact of repatriation, box 3 below reviews the literature on immigration, which is fairly extensive.¹³ Not surprisingly, most of the research has been concentrated on the effects of migration in countries such as Israel, Germany, Hong Kong, Canada, Australia, and the United States, some of which have played significant roles as major magnets for migrant populations from every corner of the world. It is largely the experience of these countries that shows that—notwithstanding short-term labor market frictions—the long-run effects of immigration are favorable for both the employment outcomes and economic growth of recipient countries (see box 3).

The Political Economic Aspects of Repatriation

What type of diaspora group would repatriate to Armenia under the current economic conditions? Why would well-to-do Armenians from western countries—a highly desirable cluster for Armenia to attract—ever relocate to Armenia? Is this whole idea of repatriation anything more than wishful thinking? Without going into the incentives and motives of each diaspora group—from the East or the West—it suffices to say that the process has already started.

According to unofficial data from the Ministry of Foreign Affairs obtained by one of the authors, hundreds of citizenship applications from diaspora Armenians are currently under review.¹⁴ Most of the applicants for now are from Arab countries, Iran, and Georgia. The process is already taking place and policy makers in Armenia and the diaspora have two choices:¹⁵ to close their eyes and

¹² Razmik Panossian, “Between Ambivalence and Intrusion: Politics and Identity in Armenia-Diaspora Relations,” *Diaspora: A Journal of Transnational Studies* 7, no. 2 (1998).

¹³ Both processes are quite similar in nature, except for the differences in incentives which induce individuals to move, a difference which we will assume to be insignificant for the purpose of reviewing the impact on labor movements on domestic labor market outcomes.

¹⁴ Note that before an individual (of Armenian origin) can apply for citizenship of the Republic of Armenia, proof of three years’ residency is required. Thus, individuals currently applying for citizenship have resided in Armenia since 1999 at the latest.

¹⁵ Indirect evidence of inflow (or at least of reduced net outflow) of population can be found through surveys of real estate transactions in Yerevan within the past 12–24 months. Real estate prices in Yerevan have been mushrooming, and anecdotal evidence suggests that transactions by diaspora Armenians (including, of course, Armenians from former Soviet republics) are at least partially responsible.

Box 3. Empirical Evidence on the Impact of Immigration

A popular belief associated with immigration is that migrants have a large adverse impact on the wages and employment opportunities of the native population. In his discussion of a need for Hong Kong to admit more professionals from the mainland, Richard Wong calls this a “misguided criticism that stems from a faulty application of economic analysis.”¹ A quick overview of the sizable literature on the subject leads one to agree with this statement.² Contrary to the popular belief, research today consistently shows a very small effect of migration on the native labor market in terms of reduced native employment and wages. The studies based on different countries show that a 10 percent increase in the fraction of immigrants in the population reduces native wages by at most 1 percent.³

In their study of labor-market outcomes in the United States, George Borjas, Richard Freeman, and Lawrence Katz report that the estimated effects of immigration “depend critically on the empirical experiment used to assess immigration.”⁴ The authors go on to summarize that the results are neither conclusive nor supportive of the negative effects of immigration, due to variations in education levels of the migrants in different regions and internal migration of the native labor force. In an earlier study, using United States Census data from 1980, Borjas concludes that immigrants tend to be substitutes for some labor market groups and complements for others.⁵ The major conclusion is that the effect of shifts of foreign-born labor supply on the earnings of the native born are numerically very small. If anything, increases in immigrant labor supply have a sizable impact on immigrants’ own earnings. The analysis yields a 10 percent reduction of immigrants’ wages for every 10 percent increase in immigrant labor supply in less skilled occupations. Thus, according to this study, immigrants actually compete with each other.

Looking at labor market outcomes in Hong Kong, Wong notes that the fundamental problem with the criticism of migration is the assumption of unchanged demand for labor once labor supply increases as a result of immigration.⁶ The author criticizes this static view and argues that capital is more likely to flow where human resources are available. As a consequence, an increase in labor supply would attract greater capital inflows that would, in turn, generate greater demand for labor and restore the premigration equilibrium wage level.

To support such findings, researchers often cite the Israeli experience with repatriation in the country’s early years and in the years right after the collapse of the Soviet Union. Israel was able to capitalize on the waves of migration, thanks in part to great support from international donors and an investment boom largely financed by external borrowing,⁷ the flexibility of the Israeli labor market, and the entrepreneurial spirit and determination of the population. In her analysis of the Israeli labor market, Rachel Friedberg shows that, indeed, as a result of the mass influx of new workers, there was some displacement of native workers in the short run, which is however, soon restored to premigration levels.⁸ The results of her study support the view that immigrants do not adversely affect the earnings of native workers.

Finally, within the framework of the relationship of migration and long-run

economic growth, researchers focus on the role of human capital (typically measured as average years of schooling) and mobility of physical capital. Employing a neoclassical production function and allowing for perfect long-run capital mobility, Juan Braun as well as Elise Brezis and Paul Krugman show that in the long run output will increase more than proportionately in response to immigration, implying a rise in the rate of return on capital as well as an increase in wages.⁹ Elsewhere, Robert Barro and Xavier Sala-i-Martin as well as Olivier Blanchard and Lawrence Katz mention intercountry migration in response to an increased level of immigration as the only downside of immigration's positive effect on growth.¹⁰

To sum up, the discussion above affirms our position concerning the benefits of repatriation for Armenia. The consensus seems to be that if the repatriates represent greater human capital than the natives, the impact of immigration on growth would be positive, even if the capital is assumed to be fixed (or immobile) in the short run.¹¹ If, in addition, repatriation is coupled with the inflow of physical capital (either in the form of the private savings of immigrants or in the form of directed diaspora or international assistance), the benefits would be even greater. It may well be possible that, if it takes place, an inflow of settlers from the diaspora would cause some adjustments in Armenia's labor market (for example crossregional labor movements, changes in skill mix of natives to retain competitiveness, and the like). But the research above suggests that the long-run effects would be favorable for both the employment outcomes and economic growth.

¹ Richard Y. C. Wong, "Why Hong Kong Needs the Admission of Mainland Professionals Scheme" (The University of Hong Kong, 2001).

² See, for example, Joseph Altonji and David Card, "The Effects of Immigration on the Labor Market Outcomes of Less-skilled Natives," in *Immigration, Trade, and the Labor Market*, ed. J. Abowd and R. Freeman (Chicago: Univ. of Chicago Press, 1991), pp. 201–34; George Borjas, "Immigrants, Minorities, and Labor Market Competition," *Industrial and Labor Relations Review* 40, no. 3 (1987), pp. 382–92; Rachel Friedberg, "The Impact of Mass Migration on the Israeli Labor Market," *Quarterly Journal of Economics* 116, no. 4 (2001), pp. 1373–408; Rachel Friedberg and Jennifer Hunt, "The Impact of Immigrants on Host Country Wages, Employment and Growth," *Journal of Economic Perspectives* 9, no. 2 (1995), pp. 23–44; Yoram Weiss and Menachem Gotlibovski, "Immigration, Search and Loss of Skill" (Foerder Institute Working Paper 34-95, 1995).

³ Friedberg and Hunt, "The Impact of Immigrants."

⁴ George Borjas, Richard Freeman, and Lawrence Katz, "Searching for the Effect of Immigration on the Labor Market," *American Economic Review*, May 1996.

⁵ Borjas, "Immigrants, Minorities, and Labor Market Competition."

⁶ Wong, "Why Hong Kong Needs the Admission of Mainland Professionals Scheme."

⁷ See, for example, Sarit Cohen and Chang-Tai Hsieh, *Macroeconomic and Labor Market Impact of Russian Immigration in Israel* (Tel Aviv University and Princeton University, 2000).

⁸ Friedberg, "The Impact of Mass Migration."

⁹ Juan Braun, "Migration and Economic Growth" (Harvard University working paper, 1992); Elise Brezis and Paul Krugman, "Immigration, Investment, and Real Wages," *Journal of Population Economics* 9, no. 1 (1996), pp. 83–93.

¹⁰ Robert Barro and Xavier Sala-i-Martin, "Regional Growth and Migration: A Japan-United States Comparison," *Journal of the International and Japanese Economies* 6 (1992), pp. 312–46; Olivier Blanchard and Lawrence Katz, "Regional Evolutions" (Brookings Papers on Economic Activity, 1), pp. 1–61.

¹¹ The last part of this statement is guaranteed by the positive (albeit declining) returns to one input (in this case, the human capital) in a neoclassical production function discussed earlier, even if all other inputs are held constant (in this case, capital).

pretend that repatriation is not happening (or is trivial in size and importance), or to acknowledge its existence and benefits, and encourage more repatriation. From the developmental point of view, one thing is clear: those determined to settle in Armenia will either be ideological migrants (much like those in the early years of Israeli independence) or purely economic migrants from low-income countries of the Middle East and Central Asia. Either way, because of the mere fact that they *chose to relocate*, they are likely to have more incentives to survive and be successful in Armenia—thus helping Armenia succeed economically—than those among natives who are willing to leave Armenia no matter what. Incentives are essential to the future economic rebirth of Armenia; after all, they are the main reason for western economic success and Soviet economic failure.¹⁶

Finally, in addition to acting as a channel for technology and skills transfer and a source of stronger incentives, repatriation is likely to boost the demand for reforms (through bottom-to-top pressures to improve governance and public service provision and the general business climate) and expand the domestic market, which has been subject to continuing shrinkage due to emigration. The first of these two channels is of particular importance because of its impact on public-sector governance, even if the individuals in question are not directly employed in the civil service. This impact, we believe, will be greater, the bigger the inflow of repatriates from countries where corruption and public sector mismanagement are not part of everyday life and culture. Countering the impact of immigration and restoring the purchasing power of the local market is likely to have an impact on domestic demand and, through that, on aggregate production.

The Short Run

Does repatriation have to be painful in the short run? The answer is definitely “no.” Repatriation can be targeted and carefully planned to avoid the possible short-term implications of the expansion of the labor supply. Moreover, programs

¹⁶ It should be noted that the phenomena of repatriation and the use of diaspora professionals at home are not Armenia-specific. Other countries too have tried to tap the potential on their diasporas and turn them into key players in domestic politics and civil service. While going through the worst economic crisis in its recent history, Turkey invited Kemal Dervish, an ethnic Turk, then a vice president at the World Bank, to orchestrate its economic recovery. According to *The Economist*, “since becoming independent in 1991, Estonia has recruited from the diaspora two foreign ministers and a defense minister, plus lots of civil servants, especially in the foreign ministry. Latvia’s popular president was brought back from Canada. It has also had the services of an American-Latvian defence minister, a bunch of members of parliament, and a handful of diplomats, all mustered from the ranks of its émigrés. Lithuania’s huge diaspora has supplied it with a president, the current chief of general staff (both Lithuanian-Americans) and several historians, novelists and poets” (“A World of Exiles,” *The Economist*, 2 Jan. 2003). Armenia’s experience in absolute terms remains similar, with at least two foreign ministers and two deputy ministers recruited from the diaspora. But compared with the overall potential of the Armenian diaspora and Armenian intellectuals abroad, what has been utilized in Armenia to date is a negligible proportion, not reflecting the true needs of the civil service and the Armenian economy as a whole.

could be implemented—such as retirement in Armenia—that have virtually no impact on the labor supply, and instead are capable of raising the demand for labor. Repatriation does not have to be done on a large scale. It could start off as small as a plan to attract a few hundred skilled diaspora individuals with experience in priority areas of development (particularly those where the demand is more pronounced, such as law, information technologies, and finance), and then spread to other sectors once sufficiently healthy labor demand is being experienced. These programs to attract highly skilled professionals could also copy the design of “Development Associates,” which relocates entrepreneurs and businesspeople from developed countries for pay to developing countries (within the framework of developmental assistance programs, such as those run by the United States Agency for International Development) for extended periods of time (typically one to two years) to assist local enterprises through transferring knowledge and also making equity investments in those companies.¹⁷

The repatriation programs could also have a purely ideological component. Drawing upon the experience of Israel and Jewish groups around the world, a mechanism could be developed to attract young Armenians to Armenia for a limited period of time, perhaps initially through voluntary programs and activities. (For some examples of this already taking place in Armenia, see box 4.) Building a bond between young Armenians and the homeland in such a way would be critical for the transfer of a new mentality and skills, along with the desire and incentives to help.

Overall, repatriation should be well thought out and carefully orchestrated, and should draw on the experience of other countries to be successful. Because repatriation, unlike plain immigration, is an organized and planned process—and therefore has less of a downside risk of being massive (that is, uncontrolled) in nature—if well implemented, it may generate significant gains.

The Basic Preconditions for Repatriation

The following are the main prerequisites for the successful implementation of any repatriation program in Armenia.

1. Clarifying the legal status of immigrants: residency, dual citizenship, issues related to land and real estate ownership and transfer, and the like. Box 5 provides a quick overview of property and land ownership issues. Developments in this area are quite encouraging, though diaspora communities are barely aware of them. The issue of dual nationality—the last hurdle on the way to legal equality between members of the diaspora and citizens of Armenia—is controversial;

¹⁷ Richard Beilock and David Grigorian, “An Alternative Approach for Small and Medium Size Business Development Assistance to Developing Countries,” mimeo, Armenian International Policy Research Group, 2003.

Box 4. The Impact of Volunteerism in the World

The year 2001 was officially named the International Year of Volunteers by the United Nations. The year was devoted to the promotion, recognition, networking, and facilitation of volunteers and volunteerism worldwide. Because volunteerism touches upon all segments of the society, including the elderly, people with disabilities, and youth, its social impact could be sizable. It turns out that the economic impact of volunteer activities too is quite large as well.

A number of recent United Nations studies, including the report of the Secretary-General, *Support for Volunteering*, dedicate sections on the economic impact of volunteer work around the world. According to *Support for Volunteering*, “available empirical data points to the sizeable economic contribution of volunteering. Surveys in the United States of America suggest that volunteering equals 9 million full-time jobs with a value of US\$ 225 billion a year; in Canada, the figures are 1.11 billion hours a year or 578,000 full-time jobs with an estimated value of US\$ 11 billion; and in the Netherlands, 802 million hours a year are spent in volunteering, or 455,000 full-time jobs equivalent to \$13.65 billion. In the United Kingdom, volunteering is valued at the equivalent of \$57 billion a year and in South Korea 3,898,564 people volunteered over 451 million hours in 1999 with a value exceeding \$2 billion.” (p. 3) While the report recognizes that methodologies for calculation vary from country to country, making comparisons unreliable, where data does exist, volunteering is believed to account for between 8 and 14 percent of the economy’s gross domestic product.

Following the collapse of the Soviet Union, and the subsequent abolition of *subotniks* (Russian; *shabatoriaks* in Armenian),¹ little has been done to maintain the tradition of volunteerism across the former Soviet Union. This de facto forced volunteer tradition was largely believed to be an element of socialism, and was to be forgotten, or almost so.² Fortunately, volunteer groups of diaspora Armenians from western countries—where the act of helping is neither forced nor associated with an unpopular ideology—are slowly breaking the ground in Armenia. As small as these efforts are at present, coupled with support from a local Armenian population wishing to see a change, they are bound to make a difference. The Armenian Volunteer Corps, the Land and Culture Organization, and Habitat for Humanity Armenia are some examples of volunteer activities set up by diaspora Armenians and assisted by local Armenians in Armenia.

The **Armenian Volunteer Corps** (AVC) provides Armenians in the diaspora an opportunity to serve for one year in Armenia. Through this program, volunteers have the opportunity to discover themselves and their culture; they also bridge the gap between Armenian communities in the diaspora and the homeland. Through the personal, professional, and spiritual relationships they form, volunteers provide invaluable service to the homeland and help build the communities within which they work. The AVC has developed its programs jointly with other organizations in the following sectors: agriculture and farming, teaching, public health, construction, computer training, community and business development, language courses, law, social work, youth work, arts and culture, environment, and so on.

For over two decades the **Land and Culture Organization** (LCO) has organized summer programs in Armenia. Volunteers from Europe, Canada, and the United States have been involved in a variety of tasks in architectural preservation, land cultivation, and community development in Armenia. Having started as a modest grassroots experiment, the LCO over the years has evolved into a multinational effort that focuses on the preservation and restoration of Armenia's historic monuments. In addition to helping preserve Armenia's heritage, the LCO helps diaspora Armenians learn about Armenia and, through this combination, strengthen the link between themselves and the homeland.

Habitat For Humanity Armenia, part of a global volunteering effort, was formed in March 2000 in Yerevan to provide assistance to the needy households in Armenia. Habitat uses a combination of two approaches to help families solve their housing problems: (1) completing half-built homes, and (2) purchasing apartments, hence making use of Armenia's existing housing stock. By the end of 2002, HFH has completed the reconstruction or renovation of 28 houses, for 154 individuals, with the cost of each new house or renovation around \$5,000. Habitat currently has 77 volunteers working on various projects.

Sources: <<http://www.volunteerabroad.com>>, <<http://www.worldvolunteerweb.org>>, <<http://www.lcousa.org>>, and <<http://www.armenianhabitat.am>>.

¹ A tradition of doing volunteer work on preannounced Saturdays (usually tied with some holidays and celebrations), which was widely believed to have been established by Lenin in early years of Soviet Union.

² Scattered attempts were made to restore *shapatoriaks* in Armenia by the Yerevan municipality in recent years, but unfortunately the attempts did not succeed in reintroducing voluntarism on a large scale.

its benefits should, however, be objectively weighed against any alleged political risks which voting by individuals living abroad are said to carry. If Armenia were to go forward with this, it would not, after all, be the first country to allow dual citizenship with voting right to its diaspora members.¹⁸

2. External financing of repatriation efforts through
 - issuing of sovereign diaspora bonds (see below)
 - redirecting existing official financial assistance from foreign governments
 - attracting new international assistance¹⁹

¹⁸ "Twelve out of the 120 seats were allotted to diaspora Croats, who cast their votes in consulates abroad, or in community centers, clubs and churches designated by the authorities in Zagreb. By contrast, only seven seats were set aside for Croatia's ethnic minorities. Since 1996, Mexicans abroad have also had the right to vote in national elections, although the legislation to allow them to do so without coming home has yet to be passed." ("A world of exiles," *The Economist*). Even though the size of the Armenian diaspora relative to the local Armenian population could make Armenia a serious outlier within any sample of countries (making the above parallel irrelevant), we believe granting dual citizenship to diaspora Armenians who resided in Armenia for a set period could be a good starting point.

¹⁹ An example of this could be a recent episode with the Norwegian Refugee Council providing funding to Armenian immigrants residing in Turkmenistan to return to Armenia.

Box 5. Property and Land Ownership Rights Issues

The laws of the Republic of Armenia currently distinguish between the following three categories of potential owners:

1. Citizens of the republic
2. holders of 10-year residency permits (visa/passport)
3. noncitizens (including legal entities registered outside of Armenia)

Group 3 can own real estate and rent land, but cannot own land.¹ Groups 1 and 2 have equal rights regarding ownership of buildings and land: even though the land code bars noncitizens from owning land, it creates an exception for people with special status (for example, 10-year passport holders). In addition, the law provides for an expedited procedure for diaspora Armenians willing to obtain 10-year residence permits. In short, diaspora Armenians do get preferential treatment regarding land ownership when compared with other noncitizens.² The main obstacles for non-resident diaspora Armenians (those holding 10-year visas) in dealing with real estate and land are administrative (for example, notarizations and registrations) which generally require presence in person or powers of attorney.

The trend over the past decade has been to liberalize real estate and land ownership: until recently, the 10-year resident visa/passport holders did not have the right to own land. This practice has been reversed only recently.

¹ They can, however, set up an Armenian legal entity to hold the land and own the shares.

² Although the Armenian Constitution does not allow dual citizenship, many de facto exceptions exist (for example, Armenians in the United States, Russia, the United Kingdom, and other jurisdictions that permit dual citizenship, but do not require renunciation of foreign citizenship as a prerequisite to naturalization).

3. Powerful public-relations campaigns in Armenia (to explain the long-run benefits of repatriation to reduce potential resistance from local labor groups, etc.) and in the diaspora (to promote the idea of repatriation). The experiences of current repatriates to Armenia should be a part of these campaigns, as these may serve as precedents for the success of the process.

In sum, the approach on both sides should be active, with the diaspora defining the basic requirements for repatriation (for example legal status, financial and logistical assistance) and the government defining the scale and the scope of its repatriation needs, as well as the financing assistance needed to achieve maximum returns on the repatriation program.

Do Diaspora Armenians Really Want to Do Business with Armenia?

In the previous sections, we discussed certain aspects of the Armenian diaspora's involvement in Armenia. We noted that this involvement—purely charitable in

the beginning—has evolved into an engagement that encompasses culture, humanitarian assistance, and at times also business. We also noted that the business component of the diaspora's involvement originates from a limited number of wealthy individuals, as a result of which aggregate diaspora investment levels are modest. As we will see below, this outcome cannot be explained simply by the presence of perceived administrative barriers to doing business in Armenia. However, before we argue for measures to broaden the investor base as a means of attracting more investments, let us try to get a basic idea of where diaspora Armenians stand in terms of their interest in doing business in Armenia.

An interesting study attempting to measure diasporas' interest in investing in their homelands was reported by Kate Gillespie and others in 1999.²⁰ The researchers analyzed responses from four large ethnic communities in the United States—Armenians, Cubans, Iranians, and Palestinians.²¹ We should start off by mentioning that the response rates for the Armenian group—which included Armenians from the second generation and beyond—was the highest in the sample: 41 percent of those to whom the questionnaires were sent, against the response rates of 17 percent, 17 percent, and 19 percent for Cubans, Iranians, and Palestinians respectively.²² Before going any further, and bearing in mind that there is an apparent sample selection bias imbedded in this kind of survey (see below), we would like to speculate, based on the response rate alone, that more Armenians care about the issue on hand than members of other interviewed groups. Nevertheless, the results are not as encouraging once one goes further.

It appears that as many as 45 percent of the total respondents of Armenian origin indicated no interest in investment activity in Armenia. The corresponding percentage was 18, 23, and 22 percent for Cubans, Iranians, and Palestinians respectively. Investment activity—the dependent variable for the study—was defined as at least one of the following: producing products at home for sale at home; producing products at home for export; and developing any type of services at home. The authors then used three independent variables to explain any differences in the dependent variable: (1) frequency of visits to the homeland; (2) whether the respondent read periodicals in the native language; and

²⁰ Kate Gillespie, Liesl Riddle, Edward Sayre, and David Sturges, "Diaspora Interest in Homeland Investment," *Journal of International Business Studies* 30, no. 3 (1999), pp. 623–34.

²¹ The original list of over two thousand Armenians comprised the charitable contributors of the Diocese of the Armenian Church. The lists for Cubans, Iranians, and Palestinians were much smaller and comprised 803, 800, and 297 individuals respectively.

²² The overall numbers of respondents accepted for the study (after completed questionnaires were received and further sampled) were 166, 111, 78, and 40 for Armenians, Cubans, Iranian, and Palestinians respectively. It is important to note that only 21 percent of Armenians considered themselves "first generation," while the number for Cubans, Iranians, and Palestinians was 92, 100, and 93 percent. Only 60 percent of Armenians reported to have college degrees, while the same number for Cubans, Iranians, and Palestinians were 70, 90, and 81 percent. And finally, only 50 percent of Armenians spoke Armenian, while at least 97 percent of all Cubans, Iranians, and Palestinians spoke their native language.

(3) whether the respondent kept any contact with anyone in the homeland. The following hypotheses were tested: (1) there is a positive relationship between cultural similarities and investment; (2) there is a direct relation between altruism and investment at home; (3) there is a positive correlation between education levels and self-employment and the investment level; (4) there is a negative correlation between business obstacles as well as age and interest in investing. The results yielded support across all four communities for the hypothesis that altruism and cultural similarities have a positive effect on the investment interest. The hypothesis on business impediments was not supported by the results: the business impediments in homelands did not appear to affect the respondents' interest in investing. Finally, age and self-employment were only significant for Armenia, suggesting a stronger interest to invest in the homeland among young or self-employed diaspora Armenians.

Despite the sample selection bias (which occurs because people who care more about the issue are more likely to respond to the questionnaire) and the choice of a hypothetical (as opposed to an observable and quantifiable) indicator as the dependent variable, the study offers important insights for our work.²³ The results suggest that in addition to being subject to the usual set of stimuli determining interest in investing, diaspora Armenians care more about Armenia (if proxied by the high proportion of prospects who replied to the questionnaire) but are less likely to invest in Armenia. This finding is consistent with the mostly humanitarian nature of the diaspora's involvement in Armenia observed until recently. If coupled with the finding that perceived business impediments in Armenia do not reduce the desire of diasporans to invest in Armenia, one might interpret the overall outcome as either plain unwillingness (for whatever reason) to do business in Armenia or a lack of knowledge about investment opportunities available to the average diaspora Armenian. Either way, the challenge for policy makers would be to turn this care for Armenia into a willingness to invest and contribute to the growth and development of their ancestral homeland. How does one do that?

The Need for More Investments

Armenia's need for investment is strongly manifested in its large negative current account balance:²⁴ despite improvements since 1998, it is expected to be around

²³ Another point of criticism of this study is that it does not control for the fact that because most diaspora Armenians have not been born in Armenia (as partially reflected in the fewer number of respondents who considered themselves "first generation Armenians"), and therefore, other things equal, would feel less attached to their ancestral homeland than Cubans, Iranians, and Palestinians, most of whom were born in their homeland.

²⁴ The current account balance is a measure of a country's dependence on outside borrowing. It is the sum of (1) net exports (exports minus imports) of goods and services, (2) net factor income (interest payments from abroad minus interest payments on Armenia's debt, plus wages of Armenian workers working abroad minus wages of foreign workers employed in Armenia), and (3) net transfers from abroad.

negative 9.0 percent of gross domestic product (GDP) in 2002. A quick reference to introductory macroeconomics reveals that the current account balance is equal to the difference between gross national savings and total investment.²⁵ This implies that in 2002 the combined savings of Armenian private and public sectors were by almost one tenth of the GDP less than their combined investment. In other words, to sustain its current levels of consumption and already very low level of investment in 2002, Armenia had to either (1) draw down on its holdings of foreign currency reserves, (2) rely on net foreign official borrowing (borrow from international financial institutions and foreign governments, or reschedule debt repayments owed to them) or (3) attract foreign private investments, to the tune of \$200 million.²⁶ The implications for the economy are that until the level of savings increases to bridge this gap (which would be possible by either higher GDP or lower government spending—both unlikely to change drastically in the short run), the country will be dependent on foreign borrowing and inflow of investments in substantial amounts compared to the size of its economy.

This macroeconomic story is further confirmed at the microeconomic level. A recent feasibility study commissioned by the International Finance Corporation indicated that despite numerous lending programs by local banks (even those sponsored by international donors and other organizations), many Armenian enterprises were unable to meet their financing needs. Indeed, the banking sector's total loans are about 10 percent of GDP (a low ratio even by transition-country standards), and fall short of satisfying the growing need of the private sector for credit. In addition to shortages of loanable funds, the current lending environment (with a prohibitively high cost of borrowing) creates very few incentives for private banks to lend for long-term projects—the lion's share of loans are of short-term maturity and require substantial collateral coverage.

So how does one ideally try to bridge this savings-and-investment gap and break the second link mentioned in the introductory section of this paper? It turns out that there are ways to achieve this objective. The rest of the paper will be devoted to conventional and unconventional means of attracting foreign (in this case also diaspora) savings to complement domestic savings. We will discuss the benefits associated with each proposed channel and the institutional arrangements and intensity required to make them work.

²⁵ Gross national savings is essentially what is left at the economy's disposal after subtracting private consumption and government expenditures from gross national disposable income (which itself is defined as GDP plus net factor income and net transfers from abroad).

²⁶ This number was \$278 million in 2000 and \$201 million in 2001 (see p. 34 of the IMF Country Report No. 02/228, obtainable from <<http://www.imf.org/external/pubs/ft/scr/2002/cr02228.pdf>>).

Foreign Direct Investments

It is hard to overstate the importance of foreign direct investment (FDI) as a source of non-debt-generating capital flows to developing countries. The common arguments brought forward in favor of foreign ownership in a transition environment are the ability to guarantee external project financing and facilitate transfer of commercial know-how. *Financial benefits* of foreign involvement for domestic companies may include, among other things, access to cheap (usually low-interest) funds (made available because of parent companies' guarantees or better credit ratings), tax holidays and exemptions, and the ability to economize through various transfer pricing arrangements with parent companies abroad. Enterprises can also benefit greatly from *commercial know-how* which includes access to better technologies and business practices, use of distribution networks of their parent companies abroad, and presence of better training opportunities for local personnel. In addition, as Peter Farkas has argued, technology transfers from parent companies may contribute to reduced research-and-development expenditures for local companies.²⁷ Finally, the public and private benefits derived from imposing western-style *corporate governance* in a transition environment could also be sizable.²⁸ They can include improved job discipline, accountability and a more professional work ethic, introduction of more aggressive and clear developmental strategies, knowledge of accounting standards and financial planning, elimination of widespread tax-evasion practices, and the like. In addition, it has been argued that there is a potential benefit from foreign investment through spillovers of technology and training to other domestic (non-foreign-owned) companies.²⁹

This said, it is not surprising that many developed countries seek FDI flows to complement financial and humanitarian aid. But because FDI flows are known to be attracted by domestic market size, quality of infrastructure, and structural characteristics,³⁰ it seems that countries like Armenia have very little or no chance of attracting any serious volume of FDI until they are perceived as good opportunities to generate high risk-adjusted returns.

²⁷ Peter Farkas, "The Effect of Foreign Direct Investment on Research, Development, and Innovation in Hungary," (Hungarian Academy of Sciences, Budapest Institute of World Economics, Working Paper No. 81, 1997).

²⁸ As ironic as the phrase "western standards of financial reporting and corporate governance" may seem in the light of the recent Enron and Arthur Anderson scandals, the authors are referring to adherence to international accounting standards and transparent manager-owner relationships otherwise practiced in developed countries and almost completely missing (at least in the early stages of transition process) in former socialist-block countries.

²⁹ Saul Estrin, Kristy Hughes, and Sarah Todd, *Foreign Direct Investment in Central and Eastern Europe: Multinationals in Transition*, (London: Royal Institute of International Affairs, 1997).

³⁰ See William H. Davidson, "The Location of Foreign Direct Investment Activity: Country Characteristics and Experience Effects," *Journal of International Business Studies* 11, no. 2 (1980), pp. 9–22; Nagesh Kumar, "Determinants of Export Orientation of Foreign Production by U.S. Multinationals: An Inter-country Analysis." *Journal of International Business Studies* 25, no. 1 (1994), pp. 141–56.

The Reality at Work

And this is where the diaspora has a role to play: to invest in the homeland when others are still reluctant to do so, hence playing a *catalytic role* for nondiaspora investments to start flowing to Armenia. The international evidence demonstrates that, besides playing this role, the diaspora alone can move things around.

Many argue that a diaspora playing an active role in a country's economy can be a real force for prosperity and strong, long-term economic growth, especially in the case of transition economies.³¹ Numerous studies of countries with a large national diaspora indicate a strong and direct relationship between closer, targeted diaspora involvement and economic changes in the native country, leading to economic growth. The empirical evidence from countries such as Greece, Israel, China, and Mexico suggests that the diaspora can have a significant impact on the development of the native country.³² Most of these economies have received and continue to receive considerable economic assistance in various forms from their respective diasporas. Capital inflows come not only in the forms of private transfers, but more importantly, in the form of targeted investments and other arrangements.³³

Despite certain trend improvements in the relationship between the diaspora and Armenia, and improvements in the friendliness of the investment climate and trade openness, the results have not been very encouraging.³⁴ The barriers are apparently still perceived to be too high for FDI to flow to Armenia in larger quantities. In addition to issues related to imperfect contract enforcement and the legal and regulatory regime, this perception may have something to do with unwillingness of some circles in Armenia to go a step further than just giving promises to diaspora business people. The ruling elite is perhaps still

³¹ See, for example, Lev Freinkman, "Role of the Diasporas in Transition Economies: Lessons from Armenia" (2001); David M. Gould, "Immigrant Links to the Home Country: Empirical Implications for US Bilateral Flows," *Review of Economics and Statistics*, Vol. 76 (1994); and James E. Rauch, "Ethnic Chinese Networks in International Trade," NBER Working Paper Series No. 7189 (1999).

³² See the following reports from The Economist Intelligence Unit: "Greece: Acquisition of Real Estate" (1997); "Armenia: Off the Beaten Track" (2002); "Armenia: Business Climate Overview" (2002); "Business Outlook: Armenia: Left Out" (2002); "Israel: Foreign Trade Overview" (2002).

³³ For instance, Israel is nearly unique in having free-trade agreements with the United States, Mexico, and Canada (under the North American Free Trade Agreement) and the European Union. Another country with a large diaspora, Greece, has dedicated special areas near its frontiers for sale to diaspora Greeks. This measure serves the purpose of reenergizing economic activity in the area: the land is available only for establishing a business or a primary residence. The Chinese diaspora plays an active role in the country's economic processes by generating FDI, setting up joint ventures, developing trade links, promoting export of domestic companies, and so on.

³⁴ A recently published 2003 Index of Economic Freedom—a joint *Wall Street Journal* and Heritage Foundation publication—named Armenia the most open and free economy in the Commonwealth of Independent States, and together with Estonia, Hong Kong SAR, and Singapore, the country with the most open trade regime in the world (<<http://www.heritage.org/research/features/index/>>).

reluctant to allow some power sharing even in the business sphere, let alone in politics. Providing a true level playing field for diaspora (and other foreign) investments and generally giving the diaspora a true welcome is perhaps still seen as a threat to the monopolistic structures indirectly controlled by the ruling elite. As Panossian observes, “Almost all of the progress has been made in the symbolic realm, while discussions of more lasting or established structures bringing the two parts of the nation [together] have not been materialized.”³⁵

This attitude cannot go unnoticed and is clearly having its impact on the diaspora’s involvement (and also nondiaspora FDI), if judged by the volume of investments in Armenia. The economy is currently experiencing severe and chronic shortages of foreign investments to substitute for the low level of domestic savings: the level of FDI is estimated to be under 80 million dollars a year, including privatization revenues, in both 2001 and 2002. Reliance on privatization revenues as a source of FDI cannot be sustained as fewer state assets remain to be privatized. For whatever reason (those mentioned in either this or the previous section), the direct business component of the diaspora-Armenia link is not flourishing. Perhaps it is time to rethink the strategy by looking at ways to involve small- to medium-scale investors by offering them new and institutional mechanisms to invest in Armenia—mechanisms that would not have the drawbacks of running one’s own private business on a full-time basis in Armenia.

Indirect Investment Vehicles

So what is the way around this shallow and concentrated structure of diaspora business involvement in Armenia? One of the most feasible ways of addressing this issue is the institutional investment channel, and more specifically, investment funds. Such funds will broaden the investment base to include medium-scale diaspora investors otherwise not engaged because of the disproportionately high institutional barriers they face compared to larger investors.

How do these funds work and what makes them so special? Managed by diaspora professionals with experience in western-style financial management, these funds will be designed to issue shares to medium- and large-scale investors and use the proceeds to make equity investments in private (existing and possibly even start-up) companies in Armenia.³⁶ By also attracting the savings of medium-scale diaspora investors, the funds will not only address the issues of the liability side of the balance sheet, but also those on the asset side typically faced by smaller individual investors: what individual investors may not be able

³⁵ Panossian, “Courting a Diaspora.”

³⁶ Because these funds would be privately owned and operated, we do not think the risks associated with holding the shares of such funds would be within the range typically tolerated by risk-averse small (retail) investors.

to achieve on their own—not only in terms of overcoming imperfections of local laws and law enforcement, but also from the point of view of attaining *economies of scale*—could be achievable for larger institutional players such as these investment funds.

Economic Benefits of Institutional Investment

Indeed, the financing made available through investment funds and other institutional means of investing may have important implications for the economy of Armenia. The long-term implications of institutional diaspora involvement in Armenia may go well beyond the first-order effects of equity or loan financing, however, and be sizable.

Corporate governance channel: One of the most common problems observed in its severe forms in countries in transition in central and eastern Europe and the former Soviet Union is the conflict of interest between the owners and the managers of enterprises. Lack of effective control by owners over management, either because the owners are too small and dispersed or too far away to act, have led to self-enrichment by management, and as a consequence, to suboptimal levels of performance and output generation by enterprises.³⁷

There is yet another dimension to this issue. As mentioned earlier, the anecdotal evidence from Armenia suggests that large individual diaspora investors may be more successful in overcoming administrative and legal barriers of investing than their smaller counterparts. The involvement of smaller (individual) investors has often been less successful because of the costs of dealing with less-than-perfect laws and judicial enforcement, and various administrative obstacles in Armenia, which could prove to be too high to warrant a reasonable rate of return.

So how could institutional investment vehicles, such as investment funds, address these issues? The investment funds, if set up as holding companies, would have the ability to exert effective control over management of enterprises they invest in by the virtue of the size of its ownership stake (large relative to the enterprises' equity) and its physical presence in Armenia. Second, they should not only be able to overcome the common transaction costs associated with the underdeveloped institutional framework in Armenia, but also in due course may shape and develop those institutions through their impact on the relationship between local companies and all their shareholders and creditors.

³⁷ For an overview of corporate governance issues in a transition economy context, see Simeon Djankov and Peter Murrell, "Enterprise Restructuring in Transition: A Quantitative Survey" (2000), <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=238716>, and David Grigorian, *Ownership and Corporate Performance in a Transition Context: The Case of Lithuania* (Ph.D. diss., Department of Economics, University of Maryland at College Park, 2001).

Capacity Building and Knowledge Channel: In addition to the economic impact of project financing and an improved corporate governance landscape in Armenia, the investment funds will facilitate skills transfer and capacity building in Armenia. If managed by qualified diaspora professionals, the funds may provide training opportunities for local Armenians to get hands-on investment banking experience without leaving their homeland. Finally, investment funds will be able to offer new range of financial products to companies in Armenia.

Technology Channel: The introduction of new and advanced technologies too is an area where the investment funds may have an important role to play. The risk sharing offered by investment funds through their equity investments in foreign joint ventures would make it more attractive for foreign companies to seek Armenia as a regional center. In addition to a highly skilled and inexpensive Armenian labor force, the funds will be able to attract foreign companies by offering them equity financing at lower required rates of return, making it all the more attractive for large multinationals—with their new and advanced technological capabilities—to invest in Armenia.

The Need to Build Confidence and Trust

The less-than-perfect perceptions of the risk of investing in Armenia may well be overstated, especially if weighed against the benefits offered by the availability of a highly skilled labor force and macroeconomic stability. But any asymmetry in perception about doing business in Armenia will persist unless proven wrong by those who dare to try. A recent World Bank study on Armenia calls such people “first movers.”³⁸ The role of the first movers is to create a much-needed success story by “going out there and trying.” Establishing a track record now is extremely important for solidifying the diaspora-Armenia link. This will provide diaspora investors with a certain level of comfort to supplement their desire to help their homeland. By virtue of its design, and the immunity it has against most commonly observed problems as described above, an investment fund can play that role of first movers. By enjoying the collective backing of diaspora investors, it has more chances to succeed and lead the way for other investors to get involved in Armenia.

In sum, it is relatively straightforward to see that these features grade the investment funds favorably on the *institutional intensiveness* scale (see table 2 at the end of this article): these funds are more likely to overcome common institutional barriers and are even capable of reducing institutional imperfections they may encounter. From the diaspora’s point of view, investment funds, therefore,

³⁸ Lev Freinkman, “Growth Challenges and Government Policies in Armenia” (World Bank Country Study No. 22854-AM, 2001).

offer more security than individual involvement in Armenia. In terms of the transaction costs, too, the funds are hard to beat: holding shares of investment funds requires little personal involvement, since well-trained diaspora professionals and management would be there to oversee the use of funds.

Again, as in the case of repatriation, the process of setting up institutional investment vehicles in Armenia has started. A good example, about to happen on the ground, is the Armenia Small and Medium Enterprise Fund, supported by the International Finance Corporation. With highly professional diaspora management and a highly reputable international investor on board, this is an undertaking that, we believe, offers all the benefits discussed above, and, therefore, deserves all the attention it can get from policy makers on both sides.

Pan-Armenian (Development) Bank

The discussion in the previous sections indicated that the direct investment mode is perhaps the best option for large-scale investors who are able and ready to spend time and secure a physical presence in Armenia. It was also argued that investment funds are suited the best to cater to medium-scale investors. How does one then address the issue of involvement of smaller (retail) diaspora investors in Armenia? We believe the ultimate vehicle to have to attract the typically risk-averse small investors is a full-fledged development bank.

Since deposit holding in conventional commercial banks would (at least on average) offer more modest returns than holdings of investment bank shares,³⁹ the deposit rates that any prudent commercial bank would be able to offer too would be lower. To make diaspora investors interested in depositing funds in an Armenia-based bank would, therefore, require bringing those deposit rates in line with the returns required by diaspora investors. The required rates of return could be low if and when the credibility of the bank is high enough to virtually eliminate the underlying institutional (and perhaps even country) risks and allow for low-cost and broader-based financing of the bank and the economy. Eliminating, or at least seriously limiting, the bank-specific risk could be achieved by a deposit insurance scheme, which Armenian monetary authorities are planning to introduce in Armenia in 2005.

If sufficiently low cost of financing is achieved (by lowering the perceived bank-specific and country-specific risks), the bank will be able to undertake projects in agriculture, education, and health sectors typically not financed by conventional commercial banks, thus starting to perform the functions of a

³⁹ Holdings of investment bank shares by individuals/companies are viewed as a substitute for their holdings of commercial bank deposits. The difference in risk profile of these assets arises because of the fixed nature of deposit-based income, as opposed to returns to equity holdings by investment funds, which can be limitless, at least in theory, in both directions.

development bank. This would enable the bank to focus on priority areas of development by, among other channels, consolidating the experience of Armenians worldwide in agriculture, education, and health, and getting them involved in the relevant departments of the bank. Following the design of regional development banks (such as the African Development Bank and the Asian Development Bank), these clusters of specialists could help gather the best international experience and direct the bank's policy in their respective areas, thus multiplying the overall economic impact of the bank.

In sum, if successful in building a track record, the types of institutional investment ventures discussed in this section could be important stepping stones toward setting up other projects aimed at mobilizing investments from the diaspora, such as launching an emerging-market diaspora bonds program. Joint diaspora-Armenia design and management of these operations would be essential to their successful implementation and to building mutual trust and a track record.

Sovereign Diaspora Bonds Program

In recent years, especially following the emergence of market-based economies in Eastern Europe and the former Soviet Union and the strong performance of some Latin American countries throughout the 1990s, the number of countries that have attempted to gain access to international capital markets has increased substantially. Yet, for a large number of countries, including Armenia, access to international capital markets remains a much-desired outcome. We will argue throughout this section that, if undertaken properly, sovereign bonds issued to the Armenian diaspora (hence, sovereign diaspora bonds) could be a major stepping-stone toward Armenia's full-fledged access to international capital markets; they could be the most important step toward formalizing the diaspora-Armenia business link.

Why would Armenia—in light of even a remote possibility of an Argentine-type crisis—want to tap capitals markets, if it is paying International Development Agency rates on most of its external debt?⁴⁰ Even if it does need that extra financing, is Armenia really capable of tapping capital markets to care for its fiscal and external financing needs?

Given the composition of Armenia's debt, the effective interest rate paid on its total debt is indeed still quite low. Not only this, but the stock of Armenia's

⁴⁰ The International Development Agency, a member of the World Bank Group, undertakes lending activities in developing countries whose GDP per capita does not exceed a specific benchmark (approximately \$900 per year). The agency's rates are highly concessional and are typically below 1 percent per year. According to the most recent data available from the Global Development Finance database, the end-year 2000 average interest rate for Armenia's total debt was 0.8 percent per year, with average maturity of 35 years. For comparison, the average interest rate for Azerbaijan is 1.5 percent per annum, with the same average maturity.

external debt, especially after a recent debt-equity swap with Russia, is not really dramatic, if measured as a percentage of its GDP (slightly over 40 percent).⁴¹ Yet this is not the full story: bearing in mind Armenia's current capacity to service its debt (for example, as a share of export receipts or total fiscal expenditures), debt service obligations are far from being trivial. It is, in fact, the debt service capacity and obligations (and not the *stock* of debt) that economists have in mind when referring to Armenia's heavy debt burden.

As we have seen above, however, Armenia needs to attract more external financing to break the vicious circle discussed in the introduction to this paper, some of which might be debt generating (that is, it would add to already outstanding external debt). It turns out that the country needs financing but cannot really borrow much, not only because it does not have access to funds, but also because it cannot afford to accumulate more debt. Of course, improving the government's revenue-generating capacity is the sure way out of this.⁴² Yet, doing so is more of a medium-term solution and has to do not only with political will but also with the government's capacity to implement tax reforms.

The solution is, therefore, in addition to attracting non-debt-generating flows discussed in previous sections, to gain access to external financing to (1) smooth (or, *de facto*, delay) its debt service obligations, and (2) extend the maturity of the debt becoming due, in both cases to ease the short-term pressures on the budget to finance the debt. In both cases, however, a low rate of interest and long maturity are necessary conditions to achieve the goal. Now, this may all seem very logical and perhaps even obvious to some, but how does one do this in practice, when it comes to Armenia? Where does Armenia get low-rate and long-maturity funds to do all this?

International Experience

Before we answer this question, let us take a look at the recent international experience with accessing capital markets. Table 1 contains selected statistics from a number of countries that made their first-ever attempts to issue emerging-market bonds since 1997. A quick reference to table 1 reveals that even though Armenia has only one-fourth of the average new issuer's GDP per capita (which has serious implications on Armenia's ability to save and, therefore, to service its debt), at least in terms of providing a stable macroeconomic environment and business climate, Armenia can be a match for the average market entrant. Even

⁴¹ If measured in net present value (NPV) terms, this number looks even better, in view of the very long maturity of Armenia's overall debt stock (see previous footnote).

⁴² Armenia certainly has a lot of room for improvement in this regard, with estimated tax revenues for 2002 standing at only around 15 percent of GDP. For comparison, in 2001, Bulgaria, Estonia, and Kazakhstan collected 28.8, 34.5, and 23.4 percent of their respective GDPs in taxes.

Table 1. Selected Indicators for a Sample of Recent Emerging Market Entrants, 1997–2002

Country	First Emerging Market Bond Launch Date	Amount, USD equiv.	Spread ¹	Maturity (years)	Average Growth of GDP, % ²	GDP per Capita (USD)	Balance (percent of GDP) ³	Fiscal			Economic Freedom Index	Inflation ²
								Reserves (months of imports) ³	Gross Reserves (months of imports) ³	Inflation ²		
Bulgaria	11/12/01	223	378	5.3	3.9	1,603	-1.0	5.2	3.4	3.4	10.6	
Chile	4/20/99	500	185	10.0	6.2	4,861	-0.1	7.8	2.0	2.0	6.2	
Costa Rica	4/23/98	200	250	5.0	3.5	3,986	-2.9	2.5	2.95	2.95	20.1	
Dominican Rep.	9/20/01	500	576	5.0	7.6	2,468	-2.3	0.6	3.0	3.0	6.3	
Egypt	6/29/01	1,500	333	10.0	5.6	1,490	-1.2	7.0	3.55	3.55	61.5	
El Salvador	8/4/99	150	534	7.0	3.2	2,025	-2.7	4.4	2.0	2.0	4.8	
Estonia	6/17/02	95	156	5.0	3.7	4,332	0.4	3.2	1.8	1.8	4.4	
Hungary	1/26/99	579	67	10.0	3.6	4,773	-4.8	3.7	2.55	2.55	18.7	
Latvia	5/4/99	159	343	2.0	5.3	2,778	-0.8	2.3	2.65	2.65	10.2	
Peru	2/6/02	500	479	10.0	1.4	1,936	-2.8	8.7	2.8	2.8	3.1	
Romania	6/3/97	352	267	5.0	5.0	1,557	-4.8	2.9	3.3	3.3	69.3	
Slovak Republic	1/28/98	200	84	0.5	6.4	4,090	-4.8	3.0	3.1	3.1	7.8	
Ukraine	8/11/97	450	328	1.0	-15.0	990	-3.7	1.1	3.8	3.8	449.3	
Sample Average	...	...	306	5.8	3.1	2,838	-2.4	4.0	2.8	2.8	51.7
average without Ukraine	...	...	304	6.2	4.6	2,992	-2.3	4.3	2.8	2.8	18.6
average of transition countries (w/o Ukraine)	...	...	216	4.6	4.6	3,189	-2.6	3.4	2.8	2.8	20.2
Armenia (2002, estimated)	...	...	...	...	6.3	760	-3.9	3.9	2.65	2.65	1.74

Source: Bondware; IMF International Financial Statistics; World Bank World Development Indicators; Heritage Foundation.

¹ Compared to identical risk-free securities

² Once lagged three-year average. For example, if the emerging-market bond was issued in 2001, this number would be an average of the indicator in question (that is, real GDP growth or consumer price inflation) for 1998–2000.

³ Once lagged. For example, if the emerging market bond was issued in 2001, this number would be the value of the indicator (that is, gross international reserves or the fiscal balance) for 2000.

though this pattern may not provide Armenia with a chance to access capital markets at present (unless it pays prohibitively high rates of interest to secure it), it certainly provides ground for enthusiasm!

What if, instead of attempting to issue conventional sovereign debt, Armenia—by emphasizing its macroeconomic discipline and improved investment climate—targets the diaspora as a way of raising funds to finance public infrastructure projects at home? Underwritten in countries with strong Armenian communities (particularly in the United States, France, and Russia), the primary audience for these types of instruments would be (noninstitutional) diaspora Armenians, who would be driven by intentions to invest in Armenia financially but are otherwise unable to do so in person or unwilling to tolerate the risks of dealing with private investment funds. For them, the sovereign risk carried by these diaspora bonds could be easy to stomach, and even forego, leading to reduced required rates of return to invest.

Econometric results obtained by one of the authors, based on a sample of thirty-seven developing countries that issued sovereign bonds between 1980 and 2002, demonstrate that external factors, such as international interest rates and liquidity, can be as important as the internal (country-specific macroeconomic policy) indicators in terms of their ability to predict the probability of sovereign market access.⁴³ Therefore, even though Armenia is lagging behind on some indicators that are not immediately influenced by policy (such as per capita income), given favorable conditions in international markets and sufficient improvement of indicators inside of policy makers' control (such as reducing fiscal deficit, further improving the business climate, etc.), the country would be able to make a diaspora bond possible.⁴⁴

Historically, a number of countries—with or without access to conventional capital market resources—attempted to issue emerging-market bonds to their diaspora members or closed groups of holders identified by religious or ethnic characteristics. The best example of this is Israel's development bonds program (see box 6), which started off in the early years of Israel's independence. Having contributed significantly to Israel's development programs in the early years of independence, the program remains active today and continues raising funds from the Jewish diaspora in the United States to finance large-scale public investment programs.

Other cases of closed-circle offerings of sovereign bonds include India (to

⁴³ See David Grigorian, "On the First-Time Sovereign Bond Issues," forthcoming International Monetary Fund Working Paper (September 2003).

⁴⁴ We do not touch upon the issues of underwriting of diaspora bonds here as these issues are technical and are outside of the scope of this paper. We will only note that underwriting constitutes a major task and may cost up to 1 percent of the bond issue.

Box 6. Israeli Development Bonds

During the early years of Israeli independence, the government of Israel found a way to raise capital for its survival. On September 3, 1950, David Ben-Gurion, Israel's first Prime Minister, met with a group of fifty American and Israeli leaders in Jerusalem's King David Hotel. They ultimately decided to bring the idea of Israel Bonds to the American public; in October 1950, Golda Meir met with American Jewish leaders in Washington to lay plans for launching Israel's first bond issue in the United States.

The Development Corporation for Israel (originally founded as the American Finance and Development Corporation for Israel) was created in February 1951 to offer the securities in the United States. The Knesset, acting on the proposal from the September 1950 conference, adopted a law authorizing the flotation of Israel's first bond issue, known as the *Israel Independence Issue*. This action was significant, for it was the first time Israel had asked for a public loan instead of a philanthropic gift.

In May 1951 David Ben-Gurion launched the Israel Bond sales drive in the United States. He arrived in New York on the third anniversary of Israel's statehood and officially launched the Israel Bond Organization at a rally in Madison Square Garden. A coast-to-coast tour to build support led to an overwhelming result: \$52.6 million in bond sales generated for Israel. This apparent success of the bonds program enabled Israel to accelerate its development program.

Golda Meir, in making a tribute to the Israel Bond Organization once said, "You have a stake in every drop of water we pour into our land, in every mile of road built, in every kilowatt of power, in every field, in every factory." When asked about what collateral she could offer, she said the only collateral she had was the children and future of the State of Israel.

Currently Israeli bonds are used to finance major public sector projects such as desalination, construction of housing, and communications infrastructure. The bonds can be redeemed upon maturity or before that, upon bondholder's visit to Israel in person.

Source: <<http://www.israelbonds.com>>

its diaspora in the United States and elsewhere), Pakistan (to Islamic and Gulf countries' banks), and Lebanon (whose domestic debt is partly held by the Lebanese diaspora). In all cases, we hypothesize (but also intend to test in our future research), there is a *diaspora* or *patriotic discount* successfully exploited by these countries. This hard-to-measure discount is the difference between the rate of interest an issuing country pays to sell a bond internationally,⁴⁵ and the rate of interest it would pay to sell the bond to its diaspora members. This discount—

⁴⁵ This rate would typically be determined by both internal (that is, the country's macroeconomic standing) and external (that is, international capital market liquidity and volatility, interest rates, growth in developed countries, etc.) factors.

which, we believe, could be sizable if the issue is appropriately handled—is what policy makers in Armenia should try to capture and capitalize upon.

Other Benefits of a Sovereign Diaspora Bond Issue

But the *patriotic discount* is not the only benefit to be had from issuing diaspora bonds. In addition to providing Armenia with access to low-cost, noninflationary (that is, not through printing more money), and nondistortionary (that is, not through levying more taxes) financing of developmental needs, diaspora bonds would be a source of longer-maturity funds than those that would be available to the government if it decided to issue conventional emerging-market instruments.⁴⁶ An added feature of diaspora bonds for policy makers in Armenia is the assurance they carry in terms of reduced potential rollover risks (again, because diaspora Armenians would be guided by long-term objectives of Armenia's development, as opposed to short-term profit considerations), hence reducing the risks of default and Argentine-type financial crises. To further reduce this risk, the bonds could be made transferable (to encourage interfamily gift-giving, etc.), and only partly redeemable (before maturity) upon the individual's visit to Armenia (see, for example, box 6).

In addition to raising funds and expanding diaspora involvement in Armenia, one of the most important benefits of a diaspora bond program for the Armenian government would be that the projects funded by the proceeds will become a part of the government's public investment program and its priorities. As tangible as the returns on investments currently undertaken by private diaspora individuals (and even by investment funds in the future) are, public investments in infrastructure, communication, education, and health care in a developing-country framework—if planned and managed properly with the diaspora's help and participation—are likely to generate economic returns outweighing those of private investments. Hence, not only will the bond program enable the government to raise more funds, but it will also allow it to channel resources to priority areas of long-term development.

Risks of and Preconditions for a Diaspora Bond Program

Despite the benefits of a diaspora bond program, the authorities should be well aware of the prerequisites of and dangers associated with it, to avoid possible abuse of this novel undertaking. It goes without saying that, if undertaken, the success of the issue and the magnitude of the diaspora discount would largely be dependent on Armenia's ability to market the bonds. More improvement in the

⁴⁶ This simply suggests that the terms (the rate and the maturity) of diaspora bonds would be more favorable than those suggested by the country's fundamentals (that is, by the factors that define the country's market access and the terms of the issue).

quality of governance and the political will to reform will undoubtedly translate into a higher diaspora discount and therefore a lower cost for funding that is raised through the bond program. Conversely, lack of progress in those areas may increase the cost of borrowing and even jeopardize the entire undertaking. One needs to keep in mind that because the funds raised by the diaspora bonds will be managed by the government, this program is the most institutionally intensive (in that it requires more changes in governance and institutional setup to succeed) of all the projects mentioned in this paper.

But there is more to it than just improving Armenia's *current* policies and image in the diaspora. International experience suggests that issuing tradable sovereign bonds would require kissing goodbye any political and economic opportunism, which may impact the rollover risks and interest rates on these bonds in the future. This, in effect becomes a self-imposed mechanism that Armenia might decide to adopt as the fastest possible way of building credibility and a track record.

Why would Armenia, or any country in its shoes for that matter, not find it beneficial to renege on its obligations or pursue policies that are contrary to those mentioned above? The answer is simple: the downside of a default on these securities could be even more painful than defaulting on conventional emerging-market bonds—especially given the fact that conventional emerging-market access for Armenia is not forthcoming yet. Defaulting on or mismanaging this debt could close the doors for Armenia's access to international capital markets for many years to come. As dramatic as this might sound, this could well be viewed as an added feature of diaspora bonds, making it more attractive for diaspora Armenians to hold them.

In summary, Armenia may not be quite ready for conventional sovereign bond issues yet, but in terms of demonstrating macroeconomic discipline and being an environment with an open trade regime and an improving investment climate, Armenia should soon be able to build a trust record necessary to issue sovereign diaspora bonds. This would require taking measures to improve governance and, through that, the government's reputation with the diaspora. Issuing diaspora bonds would be an important and credible step for both sides toward economic rapprochement. The need to issue these bonds is clearly there, and so is the need for Armenia to do good on its promise (once the bonds are issued) because its credibility and its future would be at stake.

Conclusion

The specific economic and geopolitical circumstances surrounding Armenia dictate an urgent search for quick and effective mechanisms of achieving rapid

Table 2. Summary Indicators of Institutional Intensiveness and Social Impact of Various Channels of Diaspora Involvement

	Privately Managed			Publicly Managed
	Direct Investment	Investment Funds	Development Bank	Diaspora Bonds
Scale of Investment Required to be Effective	LARGE	MEDIUM	SMALL	SMALL
Risk Tolerance Required	HIGH	MEDIUM	LOW	LOW
Institutional Intensiveness	NONE	SOME	MORE	HIGH
Personal/Physical Involvement Required	SIGNIFICANT	MINOR	NONE	NONE
Social and Developmental Impact	SMALL	SIGNIFICANT	LARGE	LARGE

economic growth. In this regard, Armenia, unlike many transition countries in the region, has a resource to tap into: its diaspora. Unfortunately, the diaspora's vast intellectual and financial capital remains underutilized, leaving much to be desired in terms of effective and coordinated diaspora actions and strategy on the ground in Armenia.

Armenia should do everything to welcome more active involvement of the diaspora in the homeland's economic and social policies. Public-relations campaigns should be devoted to advertising volunteer and repatriation programs and opportunities; disseminating stories of successful cooperation and personal devotion; and explaining on behalf of both sides the benefits of various modalities of diaspora involvement. Steps should be taken to eliminate barriers for diaspora (as well as other foreign) investments in Armenia. For its part, the diaspora should intensify its efforts to establish channels for broader-based and more effective involvement in issues influencing economic growth and social development. In this regard, the recommendations made in this paper are summarized in table 2, which should provide a general road map for policy making in this area.

The numbers cannot always lie, and perceptions cannot be wrong all the time. The presence of asymmetries in perceptions that persist over time simply implies that something is, indeed, not being done properly. More efforts are certainly needed on both sides to address the source of any misperceptions related to the investment climate and public sector governance.

Issues such as the *efficiency* of diaspora involvement and *prioritization*—especially when the involvement is limited—should be central to any efforts to

bring about more active engagement. It is not clear which side should do more and which side could get away with doing less, or which side should move first with certain initiatives. One thing is clear: any step from either side toward rapprochement will lead to more trust, more action, and eventually get the two parties closer to a resolution of the issues of common concern. This is the way we see the nature of the diaspora-Armenia link.

To conclude, time is Armenia's most dangerous enemy. The window of opportunity that opened up after the collapse of the Soviet Union—giving Armenia a chance to start with a clean slate—is closing. The results of inaction now would most likely lead to a hysteresis effect in virtually all aspects of economic and social life, and at times even be irreversible, if measured by hardship and the suffering of the poor and undernourished in Armenia, and discouragement and lost hopes of most in the diaspora.⁴⁷

⁴⁷ A phenomenon, observed when an object under pressure does not return to its original shape, once the pressure is taken away. The reasons why the fundamental reforms initiated now will be easier to implement and have much greater impact than those (equal in scope and scale but) implemented, say, ten years from today are at least twofold. First of all, once special-interest groups are formed that control the private sector and have influence over public-sector decision-making, it will be difficult and extremely costly for reformers to fight them. Second, efforts to remedy years of below-optimal investment in education and infrastructure development would result in a much slower recovery of private sector growth ten years from now than it would at present.