

## ***Strengthening of Armenian Dram:***

### ***Implications and Consequences***

#### **Instead of describing the situation**

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The child named “The Armenian Economy” is a chronic patient confined to bed. The weak immune system (the institutional structure), unplanned food ratio (tax policy) and the gastric ulcer (non-competitive, monopolistic markets) did their black deed. An unusual precedent: the blood pressure of the youth, who is not even 15 yet, is getting rather high (currency appreciation).

The nurse-practitioner (the Central Bank) is an earnest professional: he is managing extremely well to keep the patient’s temperature at 36.6 C (inflation by up to 3%), and his successful efforts come even to the point of straitjacketing the body’s capacity to struggle. The family doctor, (the government) under whose medical care the child is growing up, is watching with a blank face the “salient” actions of the nurse-practitioner. The doctor in chief, who is also the child’s father, has yet restrained from expressing his opinion.

#### **Back to square one:**

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The policy of patronizing the local producer, which was gradually bearing fruits till 2004, is already a past phase. The appreciation of dram means the following: “it’s enough to brag that the local producers have been consistently substituting *the imported goods*”. Very soon the imported chicken, eggs, sweets and meat will again appear on our tables. The appreciation of dram can also mean that already this fall the Armenian farmer will understand that while selling his grapes, it is not necessary that he be offered a price, which is getting higher with each successive year. This list might continue endlessly.

There cannot be two opinions regarding the issue: the economic policy of Armenia has changed. It is a topic for another discussion though, whether this change is conscious or not.

#### **The media campaign against the mega-profits of importers: jealousy or a serious warning?**

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There is still one truism not fully acknowledged among us. The imported tobacco, bread, fuel, sugar and other goods comprise a significant part of the CPI calculation basket. When for known reasons the prices for these goods do not respond to appreciation, i.e. they do not decrease by any means, then in this particular aspect, no decrease in the price level is recorded, which would have allowed the Central Bank to reveal fresh monetary resources to the economy in order to restore the previous price level. This in turn would alleviate the dollar-dram ups and downs. “Markets” are capable of both short-term and long-term self-regulations. Consequently, the harm caused by monopolistic imports is far more detrimental than the amounts pocketed. There is no need to doubt the effectiveness of the classical fiscal and monetary policies. Those are holistic only in a system, all the segments of which are competitive.

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## The agonizing ambivalence of inflation and exchange rate

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1. Inflation – the responsibility lies with the Central Bank (no shocks). Economists claim that even if this index deviates from the planned level by 1-2%, nothing terrible will happen.
2. Exchange rate – the policy is free floating, no one wants to take the responsibility.

The Central Bank seems to be afraid of losing the reputation of the one implementing the policy of free floating exchange rate. And for whom are we developing this reputation? Perhaps for the international community. And who is the Central Bank responsible to? Of course the RA residents. Has the reputation of exercising a free floating exchange rate policy gained anything for Armenia? It is difficult to come up with a congruous “yes”, as well as a congruous “no”. To claim that it has been decisive for the RA foreign investments would be erroneous.

Nowadays the business sector is facing uncertainty. The advocates of dram can tease business people that the last should think “in terms of dram”. This is probably an attempt to transcend the reality, and Armenia is not among the countries that can enjoy the advantage of being less dependent on foreign currency. The coin has two sides though: promoting dram may develop wrong expectations if the process is negligent of the reality, which in turn, like the snowball effect, will degrade the existing state of affairs even more. The RA Central Bank is not capable of mopping up such volumes of foreign currency and exchanging those with dram. The obstacle is dram expansion, resulting in inflation concerns. However, a question does surface: if the Central Bank is confident that the transfer of the economy to dram is THE imperative on the agenda, it should demonstrate similar confidence in taking the responsibility for mopping up the foreign currency entering Armenia.

However,

1. the exchange rate in Armenia is free floating. There is a deep-rooted anxiety: if the Central Bank acquires foreign currency, enlarging only the Net Foreign Assets, then it is already a policy for the regulation of the exchange rate, which is a taboo;
2. there is a monetary policy, which ratifies the planned level of the monetary base, the violation of which may lead to high inflation rate. Taboo # 2.

Ironically, both taboos have certain myths underlying. First, free floating exchange rate does not mean that the Central Bank would never engage in foreign currency transactions. The need in such transactions is rather frequent, and a reasonable policy implies that these needs will be addressed smoothly over time. The Central Bank may make announcements about how much foreign currency it intends to get from the market, and this in itself is also an exchange rate market policy. The transactions should not be postponed to the point of feeling the blade on the nape. And there is no need to be scared of the criticism of individual international experts.

Perhaps it's high time to change the paradigm?

*The paper is elaborated based on the opinions passed by the participants of the discussion on “Strengthening of Armenian Dram: Implications and Consequences”, which took place on April 29, 2005. The roundtable discussion was attended by independent analysts, government officials, entrepreneurs, and representatives of the international organizations.*

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