Chapter I

FRAMEWORK FOR THE HOUSING SECTOR TRANSITION

This chapter describes the socio-economic framework conditions of Armenia's housing sector. It presents the macroeconomic background relevant to the housing sector as well as major demographic developments and their impact on housing developments and policies. It also provides an overview of the history of transition since independence in 1991, stressing in particular housing privatization and other reforms that the Government has initiated in view of the changing framework conditions of the housing sector.

A. General information

Armenia is a landlocked mountainous country with an area of 29,743 km^2. It shares borders with Azerbaijan, Georgia, the Islamic Republic of Iran and Turkey. Of its territory 90% is 1000 m or more above sea level and 40% above 2000 m, with an average altitude of 1830 m.

The Republic of Armenia became independent following a referendum on 21 September 1991. A new constitution was adopted in July 1995. Armenia is a parliamentary democracy.

Figure I. Map of Armenia – administrative boundaries and major cities

The boundaries and names shown on this map do not imply official endorsement or acceptance by the United Nations.

B. Economy

1. Parameters influencing the economic development during transition

Armenia's socio-economic development in the past 15 years has been greatly affected by the break-up of the Soviet Union in 1989, which was followed by the declaration of independence of the Republic of Armenia and its adoption of an economic reform policy to establish a market economy.

The starting conditions for Armenia's economic transition were harsh. The collapse of he Soviet Union led to the dissolution of the Council of Mutual Economic Assistance (CMEA) and consequently the disruption of trade among the Soviet bloc countries. For Armenia this mainly meant the sudden loss of the main export destination for its industrial output. When it was part of the Soviet Union, Armenia was heavily industrialized, with 44.5% of its GDP in 1990 originating in the industrial sector. Its output consisted mainly of capital and intermediate goods, which were exported to other parts of the Soviet Union. With the collapse of CMEA, this pattern of trade was destroyed and with it the raison d'être of a large part of Armenia's industrial sector.[1]

The impact of regional conflicts added to this already difficult situation. In addition to the human cost, there was the economic effect of closed borders, which left Armenia virtually isolated and led to a further deterioration in the standards of living.

Moreover, the country was still recovering from the consequences of a massive earthquake in December 1988, which affected almost 40% of the country, destroying the town of Spitak and neighbouring villages and causing major damage to the cities of Gyumri and Vanadzor. It is estimated that the earthquake caused the death of 25,000 people and left 500,000 homeless.[2]

2. Transition policies

Like most former Soviet countries, Armenia embarked on the transition process with a "shock therapy" aimed at introducing market-oriented reforms as rapidly as possible. The reforms included price liberalization, the transfer to the private sector of State-owned land, housing and enterprises, the introduction of tax reform and a general reduction in State involvement, the introduction of tight monetary policies to control inflation, and the adoption of free-trade policies.

Although these measures led to a certain degree to macroeconomic stability, they could not prevent a fall in income and a deep depression, from which the economy has not yet fully recovered. At the beginning of the transition, Armenia experienced five years of accelerating inflation and four years of sharply falling output, as table 1 and figures II and III demonstrate.

[1] United Nations Development Programme (UNDP), *Growth, inequality and poverty in Armenia* (2002), p. 1.

[2] UNDP, loc. cit., p. 1.

Table 1. Growth in real GDP and change in consumer prices (per cent a year)

	Gross domestic product	Inflation
1990	-7.4	10.3
1991	-11.7	274.0
1992	-41.8	1346.0
1993	-8.8	3732.0
1994	5.4	5273.0
1995	6.9	176.7
1996	5.9	18.8
1997	3.3	13.8
1998	7.3	8.7
1999	3.3	0.6
2000	6	-0.8
2001*	9.6	3.1
2002*	12.5	1.1

Sources: UNDP, Growth, inequality and poverty in Armenia, 2002 and
The Economist Intelligence Unit, Country Report Armenia: February 2003 (*).

Figure II. Real GDP growth

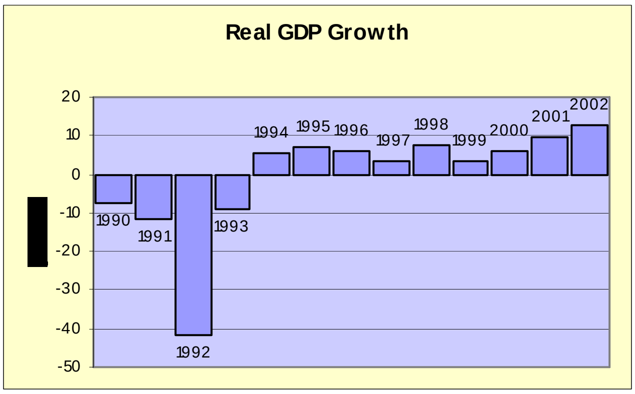
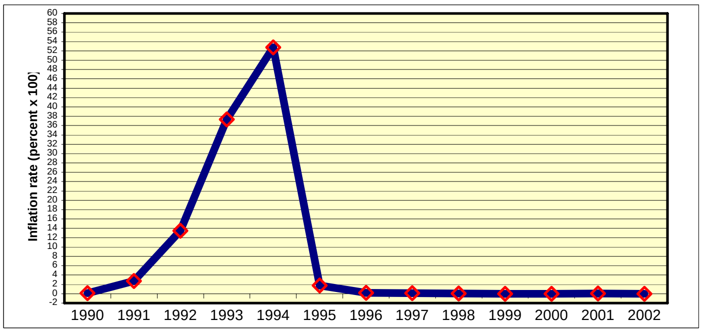


Figure III. Inflation rate



3. Key economic data

The situation has stabilized in recent years. Armenia has seen strong real GDP growth during the past five years. Until 1994 the agricultural sector was the principal engine of growth, but since 1994 the construction and the service sectors have taken over this role. The restructuring of the banking sector since 1994 and the opening of the sector to foreigners have resulted in a modest increase in banking and insurance services and have contributed to the rise in the share of the overall service sector in GDP. The industrial sector has suffered from a lack of restructuring and from Armenia's restricted access to neighbouring and world markets. However, in recent years – owing to a large extent to increasing foreign investment - operations at several large chemical and metallurgical enterprises have resumed. This has increased these sectors' markets in the Commonwealth of Independent States (CIS), thereby contributing to a recovery in output. At the same time inflation has been brought under control and has reached consistently low levels in recent years.[3]

[3] Economist Intelligence Unit, *Country profile 2002: Armenia*.

Table 2. Key economic data

	2001	**2002**	**2003[1]**
Real GDP (% change)	9.6	12.5	7.0
Consumer price inflation (average; %)	3.1	1.1	5.5
Consumer price inflation (year-end,%)	2.9	2.0	6.0
Exports of goods (millions of US$)	353	525	560
Imports of goods (millions of US$)	773	800	860
Current-account balance (millions of US$)	-201	-170	-204
Current account balance (% of GDP)	-9.5	-7.3	-8.0

[1] Forecasts

Source*: The Economist Intelligence Unit, Country Report Armenia: February 2003.*

4. Income, employment and poverty

Income

It is estimated that, through the economic recession in the early 1990s, the net cumulative loss of income that the Armenian people had suffered by 2000 amounted to the equivalent to 4.9 times the income of 1989.[4] Many Armenians have lost their jobs. Employment already started to decline after the disastrous earthquake in 1988, but the situation worsened sharply with the transition process in the early 1990s. The decrease in industrial output was responsible for most of the decline in employment, mainly owing to the collapse of CMEA.

By 1997 industrial output stood at only 44% of its 1990 level. Between 1990 and 2000,. approximately Employment in services also declined in the early 1990s, although less dramatically than in industry.[5]

Employment

The agricultural sector served as the main absorber of the workers made redundant elsewhere. Between 1990 and 2000, the agricultural sector absorbed over 280,000 workers, as many former industrial workers returned to their villages to establish a claim to privatized land. Development was thus turned around and Armenia became an increasingly agrarian economy as shown by the figures in table 3 and figure IV.[6]

[4] UNDP, loc. cit., p. 3.

[5] Loc. cit., p. 44.

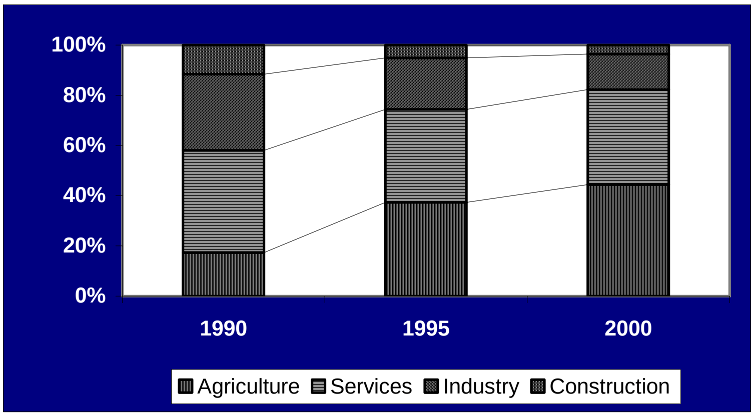
[6] Loc. cit.

Table 3. Sectoral composition of employment (in per cent)

	1990	1995	2000
Agriculture	17.4	37.4	44.4
Services	40.6	37.0	37.9
Industry	30.4	20.5	14.1
Construction	11.6	5.1	3.6

Source: National Statistical Service (from UNDP, Growth, inequality and poverty in Armenia, 2002).

Figure IV. Changes in employment patterns



Poverty and income inequality

The dramatic rise in unemployment and the decline in income have led to widespread poverty in Armenia. According to research by the United Nations Development Programme (UNDP) and household income and expenditure surveys carried out by the Government of Armenia together with the World Bank for the years 1996, 1998/99 and 2001, over half the population is "poor" and about a third of those are "extremely poor," where "extremely poor" is defined as households not being able to afford the value of a minimum food basket and "poor" as households not being able toafford the minimum food basket plus essential non-food consumption items.[7] Unlike in most other developing economies and economies in transition, poverty in Armenia is much worse for urban households than for rural families, as demonstrated in table 4.

Table 4. Poverty in 2001 (in per cent)

	Incidence of extreme poverty (head count)	Incidence of poverty (head count)
Total	15.9	50.9
Urban	18.2	51.3
Rural	11.2	50.1

Source: UNDP, Growth, inequality and poverty in Armenia.

[7] Loc. cit., p. 52.

The difference in extreme poverty between urban and rural areas is mainly to the result of the sharp decline in industrial activity described above. As most of the urban income depended on the industrial sector, its decline had an immediate effect on urban household income, while the agricultural sector was not so affected. The relatively egalitarian land reform, which provided widespread access to land, allowed rural households to grow most of their own food.

Income inequality has risen dramatically since the transition to a market economy. The increase is primarily owing to changes in the labour and capital markets. The functional distribution of income changed markedly. The share of wages in total income plunged, while the share of profits, transfers and remittances increased. In addition, wages also became increasingly differentiated: the Gini coefficient for wages more than doubled, from a remarkably low 0.20 before the transition to 0.41 in 2000.[8]

5. Economic policies and privatization

One of the most remarkable features of Armenia's transition was the privatization of land, enterprises and housing.

(a) Land reform and privatization

The scale of land privatization in Armenia surpassed that of all other former Soviet republics. Armenia has transferred nearly all land to smallholders and dismantled almost all its large-scale farms. Farmland as well as single-family houses and flats in multi-apartment blocks were rapidly privatized in the 1991-1993 period.[9]

Privatization started in the agricultural sector in 1991 with land, cattle and agricultural equipment. By late 1993, 90% of land had been transferred to private ownership. In mid-1997, 63% of arable land, 80% of orchards, 91% of vineyards and 95% of cattle and sheep herds were in private hands. By January 2003 some 453,100 hectares of arable land, allotments and land parcels around private homes had been privatized. By 1996 output from collective farms was almost negligible compared to that from private farms. The privatization programme created 324,000 farms. It is estimated that the number of farms has increased to about 370,000 as a result of fragmentation caused by inheritance, etc.[10]

The distribution of land was remarkably equitable. The size of land units to be privatized was calculated by dividing the total area of irrigated arable land, non-irrigated arable land and mown grassland by the number of individuals living in a village. A family of three people received one unit, a family of up to six people received two units, while families of more than six received three units of land. The allocation of a particular land parcel was determined by lottery. In many villages, the land was classified into poor, average and good quality, and families received parcels of each category. This process resulted in a large number of very small and fragmented farms. In total there are about 1.3 million land parcels in the country. The average farm size is only 1.3 hectares with every farm having four or five parcels in different locations. It is, for example, not uncommon for a person to own ten fruit trees in a garden or just half a row of grapevines. Even for cereal production the average farm size amounts to only 1.1 hectare.[11]

(b) Privatization of urban land, buildings and apartments

By 1999 most residential apartments in multi-storey buildings had been privatized. Today, 96% of the total housing stock is privately owned. As with rural property, the right to privatize a flat was assigned to the resident family, not to individuals. Initially, the associated land parcels were not privatized and remained in public ownership. Only owners of private individual

[8] Loc. cit., p. 91.
[9] United Nations Economic Commission for Europe (UNECE), *Land administration review: Armenia* (October 2001).

[10] Loc. cit.
[11] Loc. cit.

houses have also become owners of the land occupied by those structures and related land parcels. The Law on Multi-unit Building Management, introduced in 2002, foresees that the land under and 1 m around an apartment building is part of the common property of the privatized building. Land that is not privately owned belongs to the State and is managed by *marz* authorities if it is situated outside the administrative boundaries of a municipality and by local authorities if it lies within a municipality. Urban land in Armenia covers approximately 36,620 hectares. The urban area in private ownership totals 6,987 hectares.[12] This figure is likely to increase when buildings start to register the land belonging to them according to the above-mentioned Law.

C. Population

The overall population of Armenia – according to the preliminary 2002 census results – stands at 3.2 million. According to official statistics, 64% of the population lives in urban areas and one third in the capital Erevan. Internal and external migration are high. The search for employment is the main reason for both internal migration to the capital and for emigration mainly to the Russian Federation. It is estimated that 800,000 people left the country in 1991, and 600,000 more between 1992 and 1996.[13] At the same time there has been a considerable amount of migration to Armenia, in particular through the influx of ethnic Armenian refugees, owing to regional conflicts.

Table 5. Population, 1 January 2003 (in thousands)

	Total	Urban	Rural
Armenia	3213	2065.7	1147.3
Erevan	1103.3	1103.3	
Aragatsontny marz	138.4	32.9	105.5
Ararat marz	271.9	79.9	192
Armavir marz	276.4	98.4	178
Gegharqunic marz	237.8	79	158.8
Lori marz	286.2	169.8	116.4
Kotayk marz	272.6	154	118.6
Shirak marz	283.4	174.1	109.3
Sjunic marz	152.7	104.1	48.6
Vaiots Dzor marz	56	19.6	36.4
Tavush marz	134.3	50.6	83.7

Source: Department of Statistics.

[12] Loc. cit.

[13] UNECE, *Environmental performance review: Armenia* (New York and Geneva, 2000), pp. 25-26.

One particularity of the Armenian population is its “diaspora,” which is estimated at nearly 5 million people, most of whom live in the United States, Australia and Europe, in particular France. Another remarkable feature is the refugee population inside Armenia, which today totals around 360,000.[14] It is estimated that 70% of these refugees are settled in rural areas. In the urban areas, a number of refugees were able to settle in apartments, others are living in community centres or abandoned buildings.

D. Government housing policy

As with the overall socio-economic situation, the situation of Armenia’s housing sector was severely affected by the break-up of the Soviet Union, the ensuing transition with its privatization policies, the 1988 Spitak earthquake and the influx of a large number of refugees. Owing to the overall devastating economic situation, the annual production of housing plummeted and many dwellings were left unfinished.

The Government’s housing policy for the past 15 years has been strongly influenced by these factors and has led the Government to concentrate on those population groups that were particularly badly hit by the overall developments. This includes in particular the 500,000 people who lost their homes during the Spitak earthquake and the 360,000 ethnic Armenian refugees who came into the country between 1988 and 1992.

The Government was confronted with the need of these vulnerable groups at a time when the State budget was severely restricted. With international assistance the Government was able to start some construction to give these people shelter. However, despite international assistance, the possibilities for new construction were still very limited so the Government had to find less costly alternatives.

A step in this direction was the introduction of housing vouchers, which the recipients can use to acquire existing housing through market mechanisms. This system, which is currently funded by the Government and international donor organizations, is viable owing to the existing supply of vacant dwellings as a consequence of emigration. It is predominately implemented in the earthquake recovery zone, where it helps to provide households without regular shelter with a permanent home. In addition, the system facilitates the recovery of city centres by moving families out of the temporary shelters which have been erected in public spaces.

With the help of the above-described measures the Government has, to a substantial degree, been able to address the housing needs of the most vulnerable who have lost their permanent homes. The Government, however, is now increasingly having to provide solutions to the housing sector as a whole and to address the current problems in the housing sector comprehensively. This includes, in particular, the management of the existing housing stock.

The existing housing stock is in a poor condition. There is a serious backlog of repairs across the housing stock, a legacy of both the Soviet era and the transition. As a consequence of privatization, 96% of the dwellings in multi-unit apartment blocks now belong to private citizens. The dissolution of traditional structures for maintenance and repair in the early 1990s, and the failure to replace them immediately with an adequate new system of management and maintenance, has led to a deterioration of housing services and housing conditions. The new owners were, and to a large extent still are, unaware of the obligations that come with private property, in particular with regard to the common spaces. This results in the neglect of responsibilities and the further decay of the housing stock. Assistance to owners in managing their privatized housing is therefore becoming one of the Government’s main housing-related priorities.

The Government is continuing to adapt to the new framework conditions of the housing sector and to create the necessary basis for improving the management of the existing housing stock, in particular the privatized multi-unit apartment blocks. In this context, the adoption of the Law on Condominiums and the Law on Multi-unit Building Management are to be mentioned. Both aim at providing a framework for dealing with the challenges of the privatized housing stock. As a result of these laws, the first steps have been taken to establish

[14] According to the Department of Migration and Refugees.

an adequate management system for the privatized housing stock, including the creation of a system of condominium associations. However, this process has not yet gone far enough and awareness of the responsibilities associated with private property and in particular the common spaces is still very low among the new owners.

The Government has also adjusted its institutional framework to the new situation, in particular by continuous efforts to define and redefine the functions and responsibilities of the different governmental institutions and the different levels of government. This process is not yet completed and further measures to clarify the roles and responsibilities of the different actors involved in the housing sector will have to be taken. Measures have also been taken to facilitate the development of market and civil institutions. The foundations of a private housing finance system, including a system of property registration, a licensed valuation profession, as well as a mortgage law, have been put in place. However, the banking system is still weak and the volume of mortgage lending via banking intermediaries negligible. Consequently, individuals still have very few options for improving their housing conditions.

In the following chapters these and other challenges within Armenia's housing sector will be analysed, policy options discussed and conclusions and recommendations made.