

ARMENIA: Promoting Competition and Creating Contestable Markets in Armenia

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The preparation of this policy note was led by Sara Nyman (Senior Economist and Competition Policy Specialist, Task Team leader, GMTCI) and Mariam Dolidze (Senior Economist, Co-Task Team Leader, GMTE2). Valuable inputs were provided by Graciela Miralles Murciego (Senior Economist and Competition Policy Specialist, GMTCI), Armineh Manookian (Economist, GMTE2), Olga Sipka (Competition Consultant) and Evgenij Najdov (Senior Country Economist, GMTE2). Genevieve Boyreau (Program Leader, Equitable Growth, Finance and Institutions, ECCSC); and Martha Licetti (Practice Manager, GFCMT) provided guidance.



Abbreviations and Acronyms

AMD	Armenian dram
ASA	Air Service Agreement
BTI	Bertelsmann Stiftung's Transformation Index
CAA	Civil Aviation Authority - General Department of Civil Aviation
CBA	Central Bank of Armenia
EAI	Economic Activity Index
EIU	Economist Intelligence Unit
EEU	Eurasian Economic Union
EU	European Union
FEZ	Free Economic Zone
FDI	Foreign direct investment
GoA	Government of Armenia
LPI	Logistics Performance Index
GDP	Gross Domestic Product
MTEF	Medium term Expenditure Framework
MoE	Ministry of Economy
NCLR	National Centre for Legislative Reform
NCP	National Competition Policy
NPL	Nonperforming loan
NSS	National Statistics Service
OECD	Organization for Economic Cooperation and Development
PSRC	Public Services Regulatory Commission
RIA	Regulatory Impact Assessment
SCPEC	State Commission for the Protection of Economic Competition
SCR	South Caucasus Railways
SOE	State Owned Enterprises
VAT	Value-added tax
WBG	World Bank Group

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A. Introduction

This policy note has been produced under the Competition Reform Assessment ASA with the objective of identifying key constraints to competition in Armenia and providing recommendations on a set of actionable reforms that could help foster market contestability and competition in key sectors and across the economy. In particular, the policy note seeks to identify a menu of priority reform areas for potential engagement between the World Bank Group (WBG) and the Government of Armenia (GoA). Information for this note was initially collected during a mission held in September 2018 and was subsequently validated with relevant agencies of the Government of Armenia. The assessment employs the Markets and Competition Policy Assessment Toolkit of the Markets and Competition Policy Team of the WBG's Equitable Growth, Finance and Institutions Vice Presidency. In addition, selected sections of the OECD's Product Market Regulation Indicators questionnaire were employed to gain a sense of how Armenia compares to peer countries in the region on some specific regulatory issues which may restrict competition. Finally, a conference was held in June 2019 based on the findings emerging from this policy note and discussions with key policy makers during this conference have been used to develop a plan of action for engagement between the WBG and GoA in the short term. A summary of this conference and the action plan are included in a supplementary note delivered under this ASA.

1. The program of the new GoA puts great emphasis on the need for opening markets and promoting competition on the merits within the private sector, recognizing that in the past market capture and the lack of market contestability have stood in the way of Armenia's private sector development. The GoA understands the importance of improving competition policies and has pledged to implement reforms to make markets more contestable and level the playing field. Competition in a number of sectors in Armenia had traditionally been shaped to a significant extent by *de facto* advantages provided to certain players, including informal advantages for some importers in customs administration, an ability of some firms to consistently under-report on activities, and discriminatory tax audits of some unconnected players. Prior reforms have focused primarily on anticorruption actions. While these actions are important, going forward, creating competitive and efficient markets, would require further efforts to improve market rules and regulations to open up markets, create a level playing field and ensure effective enforcement of the Law on the Protection of Economic Competition (the Competition Law).

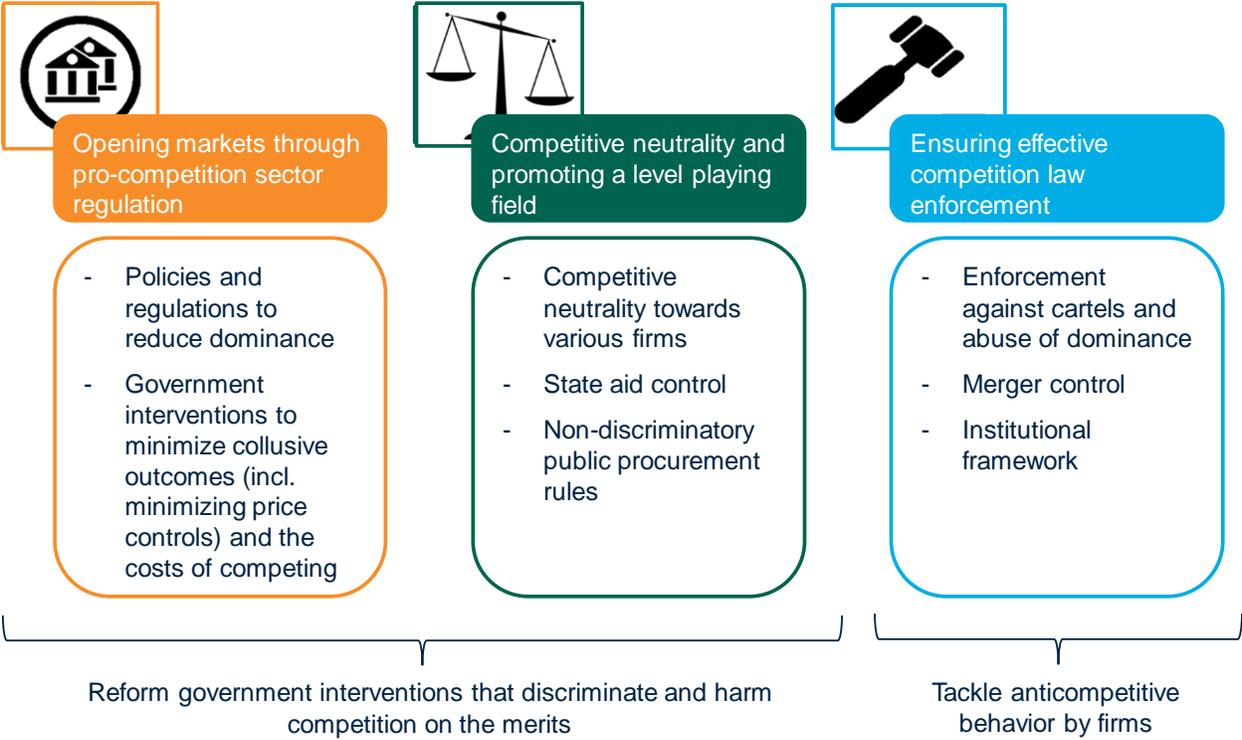
2. Market competition drives productivity and ultimately growth. Productivity growth is a key to economic growth and competition has been shown to enhance productivity through three channels. First, in a well-functioning economy, competition leads to a reallocation of resources from low to high productive firms (Arnold et al., 2011), where less productive firms either shrink or exit the market. Second, competition induces existing firms to become more efficient to survive (Aghion and Howitt, 2006; Blundell et al., 1999; Conway et al., 2006; Nickel, 1996). Greater competition incentivizes firms to make more efficient use of resources and to dynamically improve efficiency by adapting production processes or upgrading quality to achieve higher markups.¹ In addition to increasing incentives for process innovation, promoting competition encourages product innovation aimed at “escaping competition”. On the

¹ As an example of this channel, Carlin et al. (2004) show, using a dataset of about 4,000 firms in 24 transition countries, that firms facing between one and three competitors saw real sales grow by almost 11 percent on average over three years, while monopolists suffered from a 1 percent decline in real sales. Similarly, Nickell (1996) found that a 10 percent increase in price markups resulted on average in a 1.3–1.6 percent loss in total factor productivity growth.

contrary, in an environment where policies are not designed to encourage competition, firms often seek to leverage political dynamics and connections to gain market share through regulatory advantage, instead of seeking profits through innovation and efficiency. Third, competition in input (upstream) markets, such as transportation, energy, telecommunications is a key driver of competitiveness and growth in downstream sectors—the users of these inputs. (Barone and Cingano, 2011).² Sustainable growth through expansion of markets and productivity cascades into increased prosperity and opportunities, allowing consumers to access a wide variety of well-priced quality products increasing welfare and providing sustainable opportunities for job creation.³

3. Well-functioning and competitive markets are enabled through a comprehensive competition policy framework that includes a set of policies and laws ensuring that competition in the marketplace is not restricted in a way that reduces economic welfare.⁴ In general, a holistic competition policy framework encompasses three pillars that aim to address both anticompetitive firm behavior and anticompetitive government interventions that can contribute to a lack of competition. These pillars comprise: (i) opening markets through pro-competition sectoral regulation; (ii) promoting a level playing field; and (iii) ensuring the effective enforcement of the competition law (see Figure 1).

Figure 1. Three pillars of a comprehensive competition policy



Source: World Bank Group Markets and Competition Policy Team

² Barone and Cingano (2011) show that in OECD countries, pro-competition reforms in input services sectors (telecommunication, transport, energy and professional services) increase value added, productivity and export growth of downstream service-intensive sectors.

³ See World Bank (2017). A Step Ahead: Competition Policy for shared Prosperity and Inclusive Growth. Washington, D.C.

⁴ Massimo Motta. 2004. Competition Policy. Cambridge Books, Cambridge University Press.

B. Perceptions on competition in Armenian markets

4. In the last few years, there have been advances in reforms to improve conditions for private sector entry, expansion and competition - albeit at a relatively slow pace. Various improvements in tax and customs administration have been implemented, in part with the support of the WBG, in an attempt to tackle corruption which can create an unlevel playing field between firms (e.g. through the new Tax Code published in late 2016). The WBG has also supported investment climate reforms aimed at removing regulatory obstacles for the private sector in Armenia, including a comprehensive review of the regulatory stock (regulatory guillotine), business inspection reforms, developing one-stop centers for regulatory procedures, as well as assessments of the impact of new regulations.⁵ In addition, competition issues have been incorporated into the Regulatory Impact Assessment process (in place since 2015). The law on centralized procurement was strengthened (in 2015 and 2017) to ensure a more competitive and transparent procurement process. Some progress has been made in opening up the telecommunications and civil aviation to greater entry competition. And amendments to the competition law were approved in 2018 after several years.

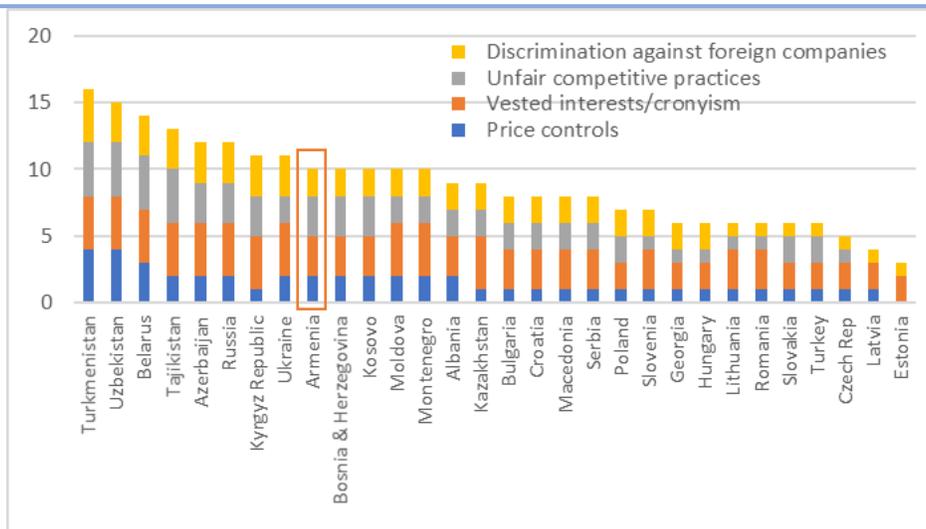
5. Nevertheless, it appears that investors still consider there to be significant risks relating to the competition environment which may partially explain Armenia's declining FDI inflows. Economist Intelligence Unit (EIU) indicators capture market players' perceptions of risks posed by government rules and practices that increase business risks and affect competition based on merit. Investors in Armenia face one of the highest risks in conducting business among other European and Central Asian (ECA). Indeed, according to the EIU's Risk Tracker, business risks related to weak competition policies are the second-highest in the region, just after Ukraine (Figure 2). These perceived risks are mainly related to vested interests and cronyism, and unfair competitive practices that hinder the creation of a level playing field for firms in the market.⁶ These indicators are mirrored by the analysis of the Bertelsmann Stiftung's Transformation Index (BTI), which is derived based on experts' assessments. According to 2016 BTI data, Armenia scored 5 out of 10 on the extent to which the fundamentals of market-based competition are in place; and 6 out of 10 on the extent to which rules prevent the development of economic monopolies and cartels, below the regional average of 6.5 and 7.1 respectively. These risks (along with external conditions) may partially explain the declines in FDI to Armenia seen since investment flows peaked in 2009, leaving Armenia's FDI flows (as a share of GDP) currently amongst the lowest in its comparator group.

⁵ Armenia has improved its performance in business climate indicators in recent years, increasing its Distance to Frontier ranking in the Doing Business Index (DBI) from 61 in 2010 to 74 in 2017. Armenia has also seen some improvement in its ranking in the Global Competitiveness Index (GCI) from 97 in 2009-10 to 73 in 2017-18.

⁶ Such figures are confirmed by the analysis of the Bertelsmann Stiftung's Transformation Index (BTI), which is derived on the basis of experts' assessments. According to 2016 data, Armenia scored 5 out of 10 on the extent to which the fundamentals of market-based competition are in place; and 6 out of 10 on the extent to which rules prevent the development of economic monopolies and cartels, below the regional average of 6.5 and 7.1, respectively.

Figure 2. Business risks related to weak competition policies remain high compared to peers

(Risks from various components, higher score implies greater perceived risk)



Source: The Economist Intelligence Unit, 2017.

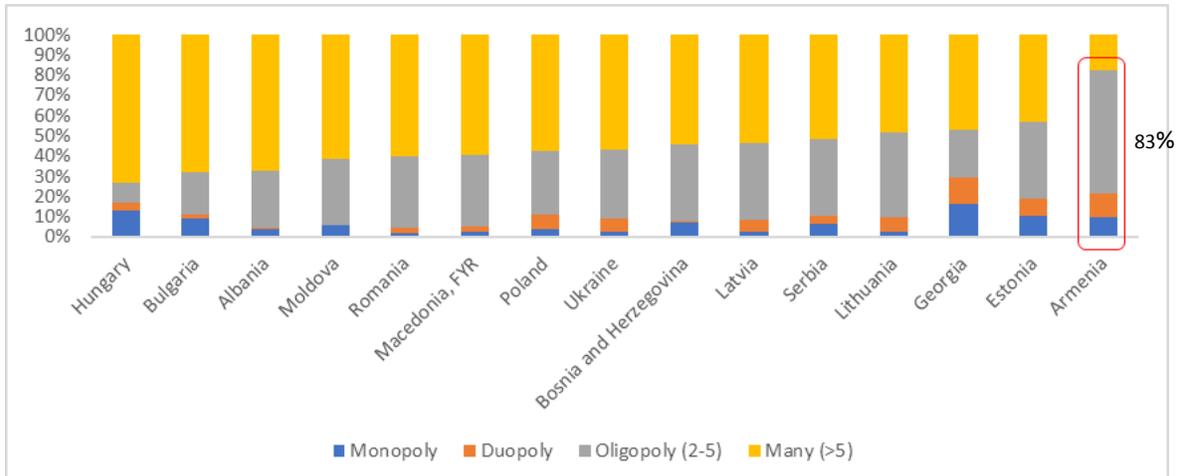
6. Many Armenian markets have few participants and are highly concentrated, which could raise the risk of non-competitive market outcomes. Data from the Enterprise Survey indicates that 83 percent of all manufacturing markets in Armenia are monopolies, duopolies or oligopolies - the highest share among peers in the ECA region (

7. Figure 3). Using data from the tax authorities, it appears that subsectors in manufacturing and services have become increasingly concentrated over time based on an assessment of the Herfindahl-Hirschman Index⁷ (HHI) as a measure of concentration (Figure 4). In 2015, highly concentrated subsectors⁸ in manufacturing and services accounted for 66 and 42 percent of revenues, respectively; although they only employ 42 and 30 percent of workers in these sectors.

⁷ The HHI is a commonly accepted measure of concentration that characterizes market structure. The HHI is calculated by squaring the market share of each firm participating in a particular market and summing up the resulting numbers. This index started to be used extensively since 1984 – when the US Department of Justice included it in its merger guidelines - and now its application is standard by competition authorities and the competition policy community.

⁸ Defined as subsectors with Herfindahl-Hirschman (HHI) index above 2,500. Taking as reference standard HHI thresholds, markets are classified as unconcentrated (HHI below 1500), moderately concentrated (HHI between 1500 and 2500) and highly concentrated (HHI above 2500).

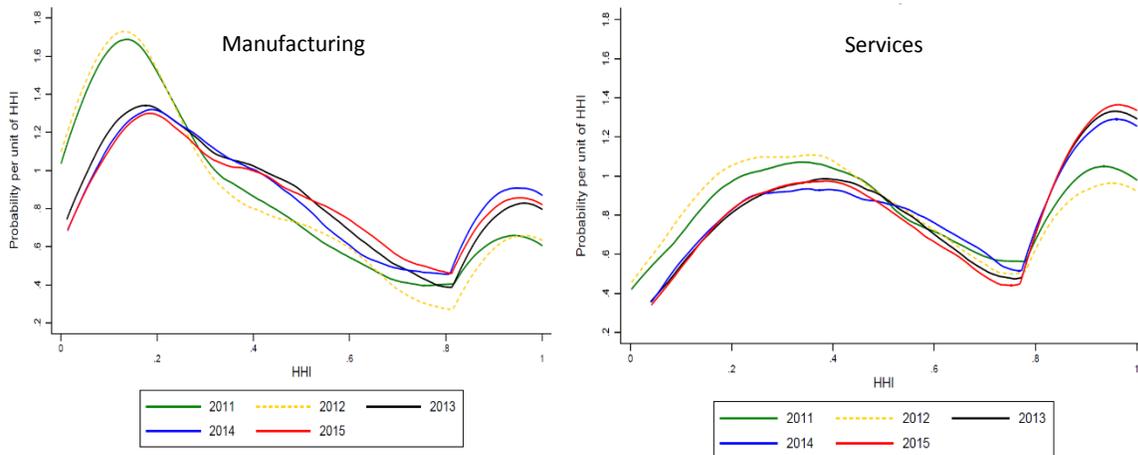
Figure 3: Armenia has a higher proportion than regional comparators of manufacturing subsectors that are monopolies, duopolies or oligopolies



Source: Authors' calculations based on Enterprise Survey data for 2013 for Armenia and latest available data for other countries.

Note: The shares reflect the percentage of establishments that answered “none”, “1”, “2-5” or “many” to the question “For fiscal year [indicated in parenthesis], for the main market in which this establishment sold its main product, how many competitors did this establishment’s main product/product line face?”, respectively. E.g. “None” was coded as “Monopoly”.

Figure 4: The distribution of HHIs for manufacturing and services subsectors has tended to shift to the right over time, indicating that these subsectors have generally become increasingly concentrated over time



Source: 2011-2015 data from Armenia State Revenue Committee. Analysis produce for the Armenia SCD.

C. Summary of key findings across the three pillars of a holistic competition policy

8. Holistically assessing the ecosystem of policies that affect competition in Armenia is important to ensure that pro-competition reforms are sustainable and systematized into policy-making.

Governments can impact market outcomes either through direct participation (as a buyer or supplier of goods and services), or through indirect participation (for example, through regulation, taxation, subsidy or other influence using various policy and regulatory instruments).⁹ Both types of interventions have an effect on competition dynamics. Lack of political will, institutional capacity constraints and limited regulatory powers can also affect the design and impact of competition policy reforms. The type of competition policy intervention required will depend on the specific market (or policy) failure. Taking a systematic approach across the three pillars of a holistic competition policy (Figure 1) - to address both anticompetitive firm behavior and anticompetitive government interventions - can ultimately encourage a productive and innovative private sector to enter and expand, and thus boost Armenia's competitiveness and growth in an inclusive way.

9. There are opportunities for GoA to boost competition and market contestability by strengthening market rules and their implementation in three key areas:

- (i) **Opening markets through pro-competition sectoral regulation:** including by strengthening the capacity of the Public Services Regulatory Commission (PSRC) (and bodies that set sector regulations) to analyze market dynamics and competition in the sectors on which they have a mandate and by strengthening the ability of the National Centre for Legislative Reform to effectively implement the competition checklist that is currently part of their Regulatory Impact Assessment procedure.
- (ii) **Promoting a level playing field:** by reviewing Armenia's economic strategy from the perspective of competition and a level playing field, by building a state aid inventory which could inform a strategy for implementing a framework for state aid control, and by developing guidelines to embed competition in public procurement.
- (iii) **Strengthening the competition law and its enforcement:** by developing a methodology to identify anticompetitive actions of public bodies as per the amended Competition Law, reviewing implementation of provisions for establishing dominance and abuse of dominance, and developing a methodology to determine penalties that allow for better deterrence.

These three areas could be complemented by developing a National Competition Policy (NCP) to implement a coordinated approach to foster competition across sectors/markets.

10. This policy note will provide key findings on the bottlenecks to effective competition in Armenia as they relate to each of these three pillars. It will then provide a proposal for technical support to address these areas.

⁹ Consistent with the World Bank Markets and Competition Policy Assessment Toolkit (MCPAT), Government interventions described are considered to include Government policies, regulations, rules, procedures and actions of Government officials that affect decisions made by market players regarding economic matters.

Pillar 1. Opening markets through pro-competition sector regulation

The following section outlines key findings concerning market dynamics in key sectors and constraints to competition in those sectors. The sectors covered have been identified as potential priorities due to their importance for Armenia's connectivity (transport and telecoms) or due to their status as promising sectors for export diversification (agribusiness). It also briefly looks at regulation that limit the possibility of firms to enter markets and compete.

Land transport (Rail)

11. The Russian-owned South Caucasus Railways (SCR) is the monopoly concessionist in the operation of Armenia's rail infrastructure – with a concession for a period of 30 years until 2038, with the option of extension for another 10 years. SCR is responsible for the maintenance of fixed and mobile infrastructure assets, and for the operation of both passenger and cargo services. While in principle provisions for open access to rail infrastructure exists¹⁰, methods for calculation of access charges and the actual charges have not yet been published by the regulator (Public Services Regulatory Commission, PSRC) and this could be done only on a request of the infrastructure operator. In addition, no competitor has been yet licensed.¹¹

12. SCR's pricing structure does not meet the requirements of Armenia industry since SCR sets its charges on the basis of space only rather than based on weight. This price model is not well suited to Armenia's demands, given the make-up of Armenian trade (with Armenia importing low value/high volume goods and aspiring to grow its exports of high value/low volume goods, such as wine, brandy, and other agroprocessing products), where transport in 40ft containers is required for imports, while the country's exports are better suited to 20ft containers. Thus, Armenian importers using rail must pay double the price for transport of the same weight. The cost implication of this is compounded by the fact that shipping company rules do not allow containers to stay in Armenia for more than 28 days. Given difficulties in filling a 40ft container, these containers often return partially filled. Market players reported that there is scope in the market for a second rail operator that could differentiate itself on its service and pricing model to fit Armenian needs.

13. Usage of rail in Armenia has been declining in favor of road freight. The SCR-operated railway connects Armenia to Poti Port in Georgia which then allows for a route to Russia. In this sense, SCR does face some competitive pressure from trucks on the route from Armenia to Georgia. Stakeholders in the logistic sector report that rail tariffs in Armenia increased by three times in the past year and private sector players expressed concerns over the quality of service, in terms of delays, reliability and safety, with trucking becoming relatively more competitive compared to rail in terms of quality, price and cost structure. Logistics sector market players report that SCR is now considering reducing prices for 40ft containers only after Georgian truckers recently offered a better deal on these containers. However, these negotiations on price appear to occur through associations – e.g. through the Association of Freight Forwarders and the Union of Business and Manufacturers of Armenia.

¹⁰ Article 16 of a 2008 regulatory law ("Ra Law About Railway Transport") references an equal access provision.

¹¹ Licenses are issued by the public administration body authorized by the RA Government (Paragraph 5, Article 7(1) of the RA Law on Railway Transport).

14. SCR appears to have broad discretion to set its tariffs¹². The PSRC indicated that it views its role in the rail sector as being focused almost exclusively on regulating adherence to investment commitments under the concession agreement, rather than on tariff regulation. There also appears to be a lack of regulation of standards and performance, with no penalties for non-performance.¹³

15. Providing for access to infrastructure by new cargo and passenger rail operators under clear terms can improve competition dynamics. There are three different modes of competition in the rail sector: (i) *competition in-the-market* between vertically-integrated rail companies (In North America - US, Canada - it has been possible to sustain such type of competition between vertically-integrated railroads); (ii) *competition in-the-market* between train operating companies with mandated access to track infrastructure (in use in Europe and Australia); and (iii) *competition for-the-market* when providers of rail service providers to bid to obtain an exclusive franchise on a specific destination pair (commuter services in the Netherland, Germany and Sweden).¹⁴ Table 1 provides an overview of different modes and degree of market opening in comparator countries based on information available in the OECD Product Market Regulation Database¹⁵. In Armenia there is no competing railroad infrastructure to allow for competition between vertically integrated railroads. Further, there is no prospect of competition for the market in the medium term as the concession agreement has been awarded to a concessionist for the period of 30 years plus a 10 year extension. And while, in theory, the law allows for access by third party operators, methods for calculation of access charges have not yet been published by the regulator and this requires a request by the current concessionist. Thus, it is important for Armenia to further focus on regulating access to service providers to allow competition to achieve optimal level of service and quality, higher level of productive efficiency and efficient pricing of rail services to end users.

Table 1. Legal requirements for entry into the railway services sector (passenger and freight transport)

	Entry franchised to a single firm	Entry franchised to several firms that compete in the same geographic area	Free entry (upon paying access fees)
Armenia			√
Croatia	√		
Estonia			√
Latvia			√
Lithuania			√
Russia		√	
Slovak Republic		√	
Turkey	√		

Source: Product Market Regulation Database OECD 2013 and Armenia Product Market Regulation World Bank 2018

16. Access rights are particularly relevant in the case of highly integrated transnational networks. Clarification of access rights lies in mandating access and setting charges, but also in the removal of existing or potential barriers to entry that might distort competition by favoring certain competitors against others. Issues could be not just barriers in terms of price of access but also rules on technical

¹² Taking account movements in the Swiss France.

¹³ World Bank Group, Armenia Public Expenditure Review, June 30 2016.

¹⁴ Ibid p. 8;

¹⁵ Note data for Armenia is from 2018, while data for comparator countries is from 2013 since this is the latest available from the PMR database. Database available at OECD website http://www.oecd.org/eco/reform/Database_PMR_.xlsx.

requirements (related, for example, to incompatible rolling stocks) or safety standards that should be clarified.¹⁶ It is worth noting that even in cases where there is no immediate potential market entrant, the existence of clear access rights can improve competition dynamics by imposing the threat of future entry.

17. In addition to clarifying access rights, to open the rail market to competition a degree of vertical separation of the vertically integrated concessionist could be required. Unlike many of its comparator countries, Armenia does not have any form of separation in place between infrastructure management and operation of rolling stock. This can be an issue since vertically integrated company does not have incentives to provide access to infrastructure on fair and non-discriminatory terms, resulting in foreclosure of competition and raising rival's costs.¹⁷ In fact, in practice in other countries many integrated incumbent rail service providers were seen to have sought to use their position as owner of the tracks to restrict or deny access. For example, in Germany an early version of the track access charging system used by Deutsche Bahn, which included volume discounts, favored its own passenger subsidiary (DB Regio) over rivals.¹⁸ Thus, mandating a certain degree of vertical separation of the integrated concessionism, in addition to access, may be needed. In its simplest form it may consist of accounting separation, but countries have used other types of vertical separation as well. Table 2 provides an overview of different models of vertical separation provided by comparator countries based on information available in the OECD Product Market Regulation Database.

Table 2. The nature of vertical separation between the operation of railroad infrastructure and the provision of railway services (actual transport of passengers or freight)

	no separation	accounting separation	legal separation	ownership separation
Armenia	√			
Croatia			√	
Estonia			√	
Latvia			√	
Lithuania		√		
Russia		√		
Slovak Republic			√	
Turkey	√			

Source: Product Market Regulation Database OECD 2013 and Armenia Product Market Regulation World Bank 2018

18. For example, the EU rail transportation framework requires access and vertical separation which has led to opening up of transportation services to competition, especially for freight transport. In Poland railway freight transport is carried out by over 30 companies,¹⁹ in Romania there are 24 private rail freight transport companies,²⁰ while in Latvia, which by population is comparable with Armenia, has 2 private rail freight transport companies operating in competition with the national incumbent.²¹

¹⁶ See Javier Campos, Pedro Cantos, 'Rail Transport Regulation' (1999) p. 42-43.

¹⁷ On vertical integration approach - OECD, Structural Reforms in Rail Industry (2005), p. 28; OECD, Recent Developments in Rail Transportation Services (2013) p. 11.

¹⁸ Ibid. p 10.

¹⁹ Ibid, p. 153.

²⁰ Ibid, p. 158.

²¹ Ibid, p. 145.

19. For the last two decades the Armenian air transport market has been characterized by a low frequency of air flights and high airfares. This appears to have been partially a result of a mixed competences of the General Department of Civil Aviation (CAA) that held both a *de facto* policy maker and a regulatory role and also of restrictive practices to protect the two Armenian airlines against competition. The national carrier Armavia played an unofficial but a significant role influencing regulatory decisions, as well as negotiations of bilateral air services agreements. Armavia also had exclusive rights through an investment agreement with the government in 2003 for a period of ten years.²²

20. Armenia's competitiveness in the sector has been low historically. A 2012 USAID Study on competitiveness of Armenia's air transport sector found that, when benchmarking infrastructure charges of Zvartnot Airport in Yerevan with 18 other airports, the cost of an Airbus A320 two-hour turnaround in Yerevan was as much as 38.5% higher than the sample average (sample included airports in Kiev, Moscow, Vienna, Baku, among others). With the exception of Moscow, the connectivity was poor with most markets served 1-3 times weekly and only 6 of them with a daily flight. There was only competition on 4 out of 48 routes. For others, there was no competition. Namely, if there were competing airlines servicing a route this was operated on a code-share basis, jointly selling available capacity. Finally, in addition to lack of choice and inconvenience for customers, air fares were expensive. Cost of most routes per kilometer in other regions ranged 0.07 USD/km to 0.17 USD/km while in Armenia this is over 0.20 USD/km.²³ Similar findings were also presented in the World Bank Armenia Accumulation, Competition and Connectivity Study from 2013 noting that flights were significantly more expensive in Armenia than to and from Georgia.

21. In 2013, following the bankruptcy of Armavia, the Government set an agenda to open up the air sector. Currently, Armenia has signed 60 ASAs through open skies - around 10 contain fifth freedom rights. The EU-Armenia Aviation Agreement was initialed in November 2017²⁴, and its implementation will mean that Armenia's civil aviation legislation will need to be in line with EU regulation within two years. While this is expected to make the permissions process easier, the CAA does not believe that it will lead to significant entry.²⁵

22. Efforts to liberalize the market are a step in the right direction, but room remains for further improvement, including in developing domestic routes. Armenia does not have any domestic routes although there has been recent interest in investing in Kapan Airport for internal tourist and local transport. This investor was given a certificate for operation after approaching the CAA and they have invested in one plane and two helicopters. The airport is set to be functional in the coming year. While Armenia has around 15-20 airports, the CAA has generally not been active in promoting in Armenia's airports, with the exception of Stepanavan Airport for which it has tested investor interest.

23. Relatively high costs of operations appear to have been an issue for the profitability of airlines flying to Yerevan Zvartnots Airport – with European routes particularly lacking. In recent years, players such as Lufthansa, Brussels Airlines, Czech Airlines and BA have exited the market. According to some

²² World Bank, Republic of Armenia Accumulation, Competition, and Connectivity (2013), xix-xxi.

²³ USAID, Enterprise Development and Market Competitiveness, Competitiveness of Armenia's Air Transport Sector

²⁴ Along with Eu-Armenia CEPA (Comprehensive and Enhanced Partnership) Agreement

²⁵ In a positive direction, a low-cost carrier Germania has entered the market in 2018.

accounts this is due to high landing and handling fees at Zvartnots Airport. However, a Ministry of Economy (MoE) study found that the major issue for profitability on Yerevan routes was fuel costs (as opposed to differences in airport fees which are comparable to other airports). Jet fuel costs can be around three times higher than in neighboring countries, such as Iran and Russia. Before the change in government, it was previously reported that there was a monopoly on aviation fuel imports due to informal advantages provided to the importer. Despite this, the CAA states that Zvartnots Airport is currently operating at capacity, after the entry of new airlines such as Middle East Airlines, Air Cairo, Fly Dubai, Air Tel Aviv and Aegean Air in the last five years. Nevertheless, there remains a gap in terms of European routes.

The CAA is also supporting the development of Armenia's second airport, Gyumri, to become a destination for low cost carriers with routes to Europe. The measures implemented include benefits not afforded to Zvartnots Airport, namely a 50% discount for navigation, elimination of taxes, elimination of the required payment for weather services. Currently, there are only Russian airlines flying to Gyumri (around 8 or 9 different airlines). While one Armenian airline entered in 2017, it exited quickly as it was reportedly not able to compete. One reason for this may be that Russia imposes higher navigation costs on foreign airlines compared to domestic airlines, while Armenia charges uniform navigation fees. Negotiations have also been held with Wizz Air and Ryanair – but this has not materialized into any entry commitment.

Telecommunications

24. Overall private sector players expressed satisfaction with ICT services in terms of coverage, access and prices. LTE coverage is at 88% of the populated areas with the GoA's aim being to reach 100% in 2019. A summary of the availability of fixed broadband is given in Figure 3 and Figure 4, along with a summary of the number of operators present across localities. For fixed wireless broadband, 75% of localities have only one operator, while 0.5% have no coverage. For fixed wired broadband, 26% of localities have only one operator, while 63% have no access.

25. Fiber backbone and last mile services are reportedly available in most regions – with fiber backbone provided by large operators (Ucom, Rostelecom and VEON Armenia) and last mile services provided by smaller regional ISPs. This appears to have been achieved largely without the need for large subsidies – operators stated that while the cost of roll out in rural areas was around 1.5 times the urban cost, provision remained viable especially given that they face lower competition in rural areas.

Figure 3. Number of operators in wired fixed broadband per locality by province

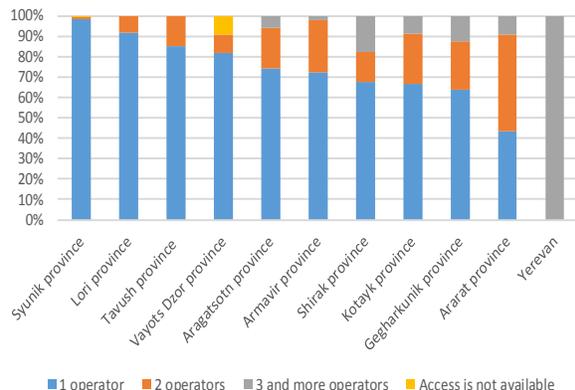
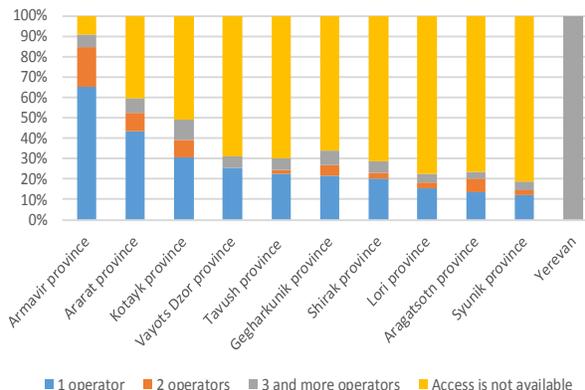


Figure 4. Number of operators in wireless fixed broadband per locality by province



Source: Authors' own elaboration on data provided by PSRC, 2018

26. While operators were broadly satisfied with the legal and regulatory framework for mobile and fixed telecoms regarding access and licensing, there may be scope for strengthening in some areas such as interconnection and infrastructure sharing. The below provides a summary of areas where there may be room for improvement in the regulatory framework to allow for more competitive market dynamics and outcomes:

- **Methods for regulating interconnection could be improved.** Interconnection is currently set at AMD 7.4 per minute, whereas operators believe it should be around AMD2-3. Both service providers and the regulator mentioned that there was scope for improvement in the methodologies the PSRC used to regulate interconnection (currently PSRC uses a European average cost as a benchmark). PSRC requested assistance on improving its interconnection methodology.
 - The PSRC is working on a market analysis to declare three operators as SMPs in the wholesale mobile termination markets on individual mobile networks and thus regulate termination rates.
- **PSRC plans to develop asymmetric regulation for mobile termination rates.** PSRC reports that it has already carried out asymmetric regulation for the retail fixed line communication market and the international IP transit services markets (in a situation of asymmetric regulation, an operator with significant market power (SMP) may be subject to additional regulatory obligations as opposed to symmetric regulation where all operators are subject to the same regulation regardless of whether or not they hold SMP). PSRC further plans to develop asymmetric regulation for the retail fixed and mobile termination rates in operator's individual networks. Beeline has argued that an asymmetric regulation model could be more appropriate given MTS's prominent market position.
- **There are no plans to release remaining 4G spectrum in a way that would encourage for new entry.** While spectrum is typically released through auction, it appears there is significant discussion between the government and the three incumbents on spectrum allocation and assignment in this process. While market players argue that market size does not justify the entry of a fourth player, it is not clear why any limit on the number of players should exist. Moreover, holding competitive open auctions would inject an additional degree of competition into the market and could raise the value the GoA could realize for spectrum.

- **Operators reported that issues in laying fiber were often faced at the municipal level** with regard to hindrances in access to underground ducts.
- **Informal restrictions on smaller players.** Before the change in government, some large operators appear to have put smaller providers at a disadvantage by using government connections (e.g. to influence tax audits).
- **Operators do not currently share infrastructure – and this may become more important as 5G roll out begins.** After attempts to share infrastructure on a voluntary basis failed four years ago, operators all invested in their own infrastructure. This has not yet been a major issue given the small size of the country, but it may become more relevant in the next three years (particularly for active equipment) as new investments will come online for 5G and infrastructure will be renewed. At this point, interventions by the PSRC on infrastructure sharing would become important and the existing rules under the RA Law on E-Communications should be further reviewed and specified for sound implementation.

Energy

27. In the electricity sector, amendments to the energy law allows for the vertical separation of distribution and supply to allow for more competition in supply but this is yet to be implemented. GoA is being supported by USAID and World Bank Group to issue contracts under new market rules. Relevant amendments in the energy sector legislation and a market liberalization concept/strategy have been supported and advised by USAID. The World Bank is supporting the PSRC with drafting new model Power Purchase Agreement for small renewable energy projects under 30MW that will operate under new market rules. The aim is to complete this process by 2020.

28. The gas sector is completely monopolized by one Russian supplier, which is protected by an intergovernmental agreement. There are no plans to open up this sector at present. No customer choice or third party access is possible.

29. While there have been positive moves in electricity sector in Armenia, peer countries generally perform better across electricity and gas when considering openness of their energy markets to customer choice. Although current reform processes in Armenia aim at allowing for customer choice of suppliers and at enabling third party access in electricity sector. However, the 2013 OECD Product Market Regulation data shows that most comparator countries have already allowed choice and entry. In case of gas Armenia lags behind most comparator countries in the degree of market opening (See Table 3 and Table 4 below).

Table 3. How are the terms and conditions of third-party access (TPA) to the electricity/gas transmission grid determined?

	Electricity			Gas		
	regulated TPA	negotiated TPA	no TPA	regulated TPA	negotiated TPA	no TPA
Armenia	√					√
Croatia	√			√		
Estonia	√			√		
Latvia	√					√
Lithuania	√			√		
Russia	√			√		

Slovak Republic	√	√
Turkey	√	√

Source: Product Market Regulation Database OECD 2013 and Armenia Product Market Regulation World Bank 2018

Table 4. Can consumers choose their electricity / gas supplier?

	Electricity		Gas	
	consumer choice	no consumer choice	consumer choice	no consumer choice
Armenia	√			√
Croatia	√		√	
Estonia	√		√	
Latvia	√			√
Lithuania	√		√	
Russia	√		√	
Slovak Republic	√		√	
Turkey	√		√	

Source: Product Market Regulation Database OECD 2013 and Armenia Product Market Regulation World Bank 2018

Agribusiness

30. In general, formal policy and regulatory interventions in the agriculture sector appear to be relatively unrestrictive to competition. For example, prices of agricultural products are not controlled in any market, licenses are generally easily obtainable and license fees are low (license fees for wine production are for example around USD60 per year), and overall subsidies to the agricultural sector are low compared to neighboring countries (all direct support to the sector totaled around c. USD25 million in 2016).

31. Subsidized loans for agribusiness firms are the major form of subsidy to market players. These are provided through banks through reduced interest rates. In principle, any bank is eligible to be part of the scheme, but participation is ultimately determined through a negotiation with the Ministry of Agriculture over the subsidy the bank requires from the GoA in order to offer the government's target interest rate.²⁶

32. There have been some reforms in the structure of the fertilizer subsidy scheme in recent years. GoA had previously directly distributed subsidized fertilizer to farmers but in recent years (since 2015/2016) had started holding tenders for private sector distribution under the subsidy scheme. There have now been some moves to remove the subsidy on nitrogen fertilizer.²⁷ However, further details of these reforms could not be gathered during the mission and there have been no market studies to assess the results of these reforms in terms of new entry or fertilizer availability. The GoA continues to subsidize potassium and phosphate fertilizers (33% and 46% of the market price respectively up to a total amount of around USD590,000), as well as subsidizing diesel for farmers.

33. There appears to be one large Russian importer of seed. There is currently no seed research facility in Armenia and only some very limited breeding.

²⁶ In 2014, about 80,000 farms out of a total of 330,000 farms in Armenia were granted low-interest loans worth AMD 66 billion.

²⁷ Which had been around 35% of the market price in 2016.

34. A major objective for GoA is boosting the currently relatively low productivity of Armenian agriculture which is attributed mainly to the small size of landholdings. The government is looking to implement a policy of progressively taxing of idle lands as well as providing direct support to landowners on land (although it is not clear whether this part of a broader investment promotion strategy). In previous years, the Ministry of Agriculture had proposed subsidies for returning of non-utilized agricultural land into cultivation.

35. The GoA is also aiming to encourage the use of contract farming which is not widely used except in wine and brandy production. The strategy for pursuing this objective is not clear but it would be important to ensure that while such contracts can be highly efficient, they should be designed in a way that does not unnecessarily hinder competition.

36. Coordination by processors in agricultural associations may affect price formation – leading to protests over low farmgate prices. The Ministry of Agriculture has recently been concerned with protests from grape farmers regarding the farmgate price they receive. While there is no formal regulation on prices, it is well known that all vineyards set the same price for purchasing grapes. This price is transparently announced in the markets. The presence of a vineyards association and transparency on prices may facilitate this type of agreement on price which can depress the farmgate price. Vineyards claim that their prices reflect the relatively low quality/lesser variety of the grape they receive – although it is not clear whether farmers have the ability/incentive to grow better varieties given the price they receive.

37. The main drivers of an unlevel playing field for processors in the agriculture sector were reported to be more informal factors, such as:

- *Ad hoc* tax audits for certain unconnected players were common before the change in government.
- Differences between firms in the period of VAT refunds for exporters (even after recent reforms, the refund period varies from 3 to 98 days).
- Smaller or unconnected players are reluctant to enter public tenders to supply their products given low likelihood of selection.

Embedding competition principles in public policies

38. For the last two to three years, before a recent restructuring of the Regulatory Impact Assessment (RIA) process, the National Center for Legislative Reform was applying a checklist of competition issues as part of the Assessment system. To date, of 45 regulations that have been subject to a RIA, 16 have been identified as having negative impacts on competition. The competition checklist is based on questions that help understand whether a proposed regulation restricts the ability and incentives of firms to enter and compete. Where negative effects on competition appear to be present the NCLR was responsible for proposing a less distortive alternative.

39. The competition checklist and its implementation show room for improvement. The developed checklist includes, among other, questions on assessing whether new regulation limits the number of market players by granting exclusivity rights, whether it exempts market players from general application of competition rules, freedom to set prices, or customer choice etc. While such checklist is a valuable tool

for assessing the impact on competition of proposed regulation, the checklist also includes several questions which may be difficult to answer and which are ambiguous in their interpretation with regard to the impact on competition. Moreover, to be able to truly capture impact and to suggest regulatory alternatives, more capacity on competition issues is needed by the implementing agencies. To date, regulatory alternatives intended to reduce competition restrictions at NCLR are designed by a team of non-competition specialists. To that end, enhancing collaboration with SCPEC in the RIA process would be important to help better assess potential impacts on competition.

40. Further support is needed to build technical capacity for officials who will conduct the RIA under the new structure. Previous RIA officials welcomed valuable support in implementing the checklist and designing of regulatory alternatives, in linking their work on competition to SCPEC and PSRC, and in estimating impacts of past RIA competition assessments in order to further advocate for reform. It is hoped this will be the case under the new structure (where the RIA process is likely to be centralized in the center of government).

Pillar 2: Promoting a level playing field

Armenia's economic growth strategy and measures to control potential distortions from the granting of state aid

Instruments of Armenia's Economic Growth Strategy

41. There may be scope to incorporate competition principles into the GoA's economic growth strategy. The MoE is responsible for shaping Armenia's economic growth strategy. To the extent that this strategy will seek to support priority sectors, an analysis of the implications of these policies for competition may be valuable. Existing support to Armenia's industrial growth consists largely of tax advantages, including:

- For exporters: VAT refunds on exported goods, zero-rating of exported goods and related services, CIT exemptions for firms that export over a certain amount.
- For foreign investors: income tax holidays and exemption from customs duties (although it is not clear that these incentives are still available).
- Deferral of VAT payable on import of certain machinery
- Exemptions for firms operating in FEZs.

Tax expenditures based on VAT came to 5.4% of GDP (according to the 2018 budget), while expenditures based on income and profits (from the agricultural sector where profits earned from the sale of agricultural products are exempted from profit tax until 2024) came to around 1.4% of GDP in 2018.

42. Some aspects of these incentive schemes may have led to an unlevel playing field, for example:

- CIT exemptions for firms that export above a certain absolute amount favor large firms. This provision has now been removed from the law but the group of exporters that already benefit from this provision will continue to benefit from it for the next two years. Only one holding firm (consisting of 24 subsidiary firms) had benefited from this provision.
- Firms with a subsidiary in the agriculture sector could benefit from the exemption on agricultural profits through transfer pricing. Armenia's new transfer pricing regulations – which are likely to

become effective from January 2020 - may help with this situation²⁸. It is also understood that GoA is considering whether to continue the exemptions for the agricultural sector.

- Differences in the period before VAT refunds are received in practice were reported by some players (for reasons beyond administrative errors).
- VAT payment deferral and exemption of customs duties have been implemented based on Law on Foreign Investment, the RA Tax Code, the RA Law on Value Added Tax, and criteria set out in the Government's Decrees No. 1225-N of October 5, 2017 and No. 1118-N of September 17, 2015. However it has been reported that the decisions to grant these benefits were made selectively on a case-by-case basis with only a few market players meeting the relevant criteria.

43. Prior to the change in government, some players also received direct loans from GoA, including in sectors such as agribusiness. Precise details of the recipients of these loans were not publicly available but it has been reported that this had put players that did not receive loans at a disadvantage.

State aid control

44. State aid is broadly defined as any financial transfer of public resources by a government or any public body which confers a benefit to a specific recipient and which distorts or threatens to distort competition. It encompasses tax exemptions, loan guarantees, grants, government resources provided at prices below market levels (such as land, spectrum, or water), subsidies, cash transfers, accelerated depreciation allowances, and capital injections, among others.¹ Goals can include creating jobs, reducing pollution, investing in R&D and innovation, supporting SMEs, and increasing access to services or goods, among others.

45. However, state aid can be detrimental to productivity, creating advantages to dominant firms, facilitating anticompetitive behavior, and driving efficient players out of the market. First, support measures to firms can facilitate *anticompetitive behavior*; they can create or protect dominant players in markets, unduly incentivize firm consolidation (which increases the risk of cartel formation) and create barriers to entry that prevent future competition. Beneficiaries may use the public support to increase their market power through the adoption of a sustained below-cost price strategy which forces the exit of equally or even more efficient competitors unable to compete with the distorted prices of the beneficiary. Second, they can generate *market inefficiencies*; incentives can discourage beneficiaries from enhancing productive efficiency and innovating, while also potentially crowding out investment from more or equally efficient firms that do not benefit from the incentive scheme. Both channels lead to non-competitive market outcomes such as lower affordability, access, product variety or quality, and to lower investment, productivity, innovation or output.²⁹ Finally, state aid entails a significant opportunity cost for the granting public authorities in terms of resources that could be spent on other public goods and services, meaning it is crucial to ensure that these funds are being used effectively.

²⁸ Transfer pricing regulations are included in the new Tax Code, effective 2018, however they refer to four decrees for bylaws which are not yet in place.

²⁹ Aghion et al. (2015) find that sectoral industrial policies (such as subsidies or tax holidays) have a larger impact on productivity growth when targeted at competitive sectors or where they are allocated in such a way as to preserve or increase competition (for example by inducing entry or encouraging younger enterprises). Aghion, P., J. Cai, M. Dewatripont, L. Du, A. Harrison, and P. Legros. 2015. "Industrial Policy and Competition." *American Economic Journal: Macroeconomics* 7 (4): 1–32.

46. Armenia has not implemented a framework to control state aid and minimize distortions from such advantages on competition.³⁰ A state aid control framework seeks to embed the principles of transparency, selectivity and competitive neutrality³¹ in the granting of state aid which are important to maximize the benefits of government support to markets. As mentioned above, some investment incentives and other financial advantages in Armenia continue to be granted on a case-by-case basis risking creating an unlevel playing field between firms and perpetuating market concentration by leaving non-beneficiary firms in a weak position or out of the market. While such state aid is aimed at supporting specific economic policy objectives, it might also generate competition distortions if criteria are not clear or are not transparent. Putting in place a state aid control framework can help to minimize these distortions, and to prevent previously informal advantages provided to some firms from being replaced by formalized advantages.

Currently, the Competition Law includes some limited provisions on state aid, but these have not been enforced as a specific framework for identifying, reporting, and controlling state aid has not yet been put in place. According to Competition Law, government support that hinders competition is prohibited³² except in cases when the support in question is envisaged by the law based on a conclusion by SCPEC. The commitment to put in place a state aid control framework is part of Armenia's Comprehensive Economic Partnership Agreement (CEPA) with the European Union (EU) and it will provide the authorities with a tool to more systematically, strategically and efficiently support the private sector.

47. Previous efforts to enact and implement a legislative package which would operationalize the state aid framework have not been successful.³³ Support to this area would therefore need to take a pragmatic approach taking into account SCPEC's capacity to implement the framework. A possible starting point could be the building of a state aid database to take stock of existing schemes which could evolve into a state aid inventory/on-line portal and/or with the help of which a strategy on state aid could be developed.

48. An unlevel playing field caused by *de facto* advantages for certain players in terms of the implementation of the tax code emerged as a significant issue for a number of the private sector players interviewed. Discriminatory audits/enforcement which allowed some firms to take advantage of the system (transfer pricing between subsidiaries, under-reporting, etc) while penalizing others was identified as a significant problem by a number of interviewed firms. Although many were optimistic that this would no longer be an issue with the new government. It should be noted that a state aid control framework

³⁰ Unlike EU countries and some Eastern European and Central Asian countries,

³¹ Competitive neutrality is a principle according to which all enterprises, public or private, domestic or foreign, should face the same set of rules, and where government's contact, ownership or involvement in the marketplace, in fact or in law, does not confer an undue competitive advantage on any actual or potential market participant.

³² Penalties are defined both for the recipient and provider of prohibited state aid. Article 171.6 of the RA Administrative Infringements Code establishes responsibility (warning and penalty) for the officer of an economic entity for the receipt of prohibited state aid, and Article 171.10 establishes responsibility (warning and penalty) for provision of prohibited state aid by the competent official of a central or local government body.

³³ Work was undertaken through the EU Twinning Project in 2013 to draft a legislative package for implementation of Armenia's state aid framework. However, at that time the Ministry of Economy, that would have responsibility for submitting the package to Parliament, stated that it was not the right time to implement the framework.

would not pick up these issues, and this would instead require continued strengthening of tax and customs administration systems.

49. Competitive neutrality³⁴ in the granting of state aid is important to maximize the benefits of government support to markets. Putting in place this framework could become increasingly important (i) as the GoA further develops its industrial policy; and (ii) to prevent previously informal advantages being formalized in future through instruments of state aid.

Competition concerns in the public procurement framework

50. The Ministry of Finance (MoF) reports some success in boosting competition from recent reforms to the public procurement framework (with a new procurement law passed in 2017). The MoF reports that the average bidders per tender increased to 4 in 2017 compared to 2.8 bidders in 2016. All large state procurers now use electronic procurement. Of the AMD 280 billion value of tenders, around AMD190 was procured competitively in 2017. This means that 32% of public procurement by value is still done on a non-competitive basis – a substantial amount.

51. However, from discussions with market players it appears there is room to encourage further competition and the following areas of the framework could be improved:

- **Use of non-competitive procedures:** Single sourcing is still used by utilities and around 1.8% of the total value of tenders went through an urgent single source process in FY2017. This is a process for which purchases are deemed to be urgent. There is no monetary cap for use of this procedure and each procuring authority has the ability to approve using an urgent single sourcing procedure.
- **Insufficient market research obligations for tender design:** Market research is a critical aspect of value for money procurement. Lack of accurate estimations might not only impact the tender design and in turn the number of potential bidders that can be qualified but it can also result in choosing procurement procedures that restrict competition and/or trigger *ex post* modifications of the procurement contract.³⁵
- **Rigid qualification criteria (e.g. experience, financial) might affect entry/ability of firms to qualify:** For example, to qualify a bidder's turnover for the last three years must be not less than the price offered – which may prevent new entrants from bidding. These requirements might be appropriate for some tenders, but not for all of them. In general qualification criteria should be developed based on a market assessment of prospective bidders' capacity. MoF has reported that efforts are being made to relax the requirements for proving qualification for small tenders (for tenders in value of less than AMD 10 million, up from the current level of AMD 5 million)³⁶

³⁴ Competitive neutrality is a principle according to which all enterprises, public or private, domestic or foreign, should face the same set of rules, and where government's contact, ownership or involvement in the marketplace, in fact or in law, does not confer an undue competitive advantage on any actual or potential market participant.

³⁵ The World Bank Group is supporting activities to help address this issue as part of a country level strategic procurement analysis under a forthcoming project on procurement. The project will also include a deliverable on realistic cost estimation. Unrealistic or inaccurate cost estimation can also restrict completion and increase the risk of corruption.

³⁶ Presently a draft government decree on making modifications and additions to Government Decree No. 526-N of May 4, 2017 is being circulated which envisions that for procurement items with an estimated value below AMD 10 million, a participant should only submit a declaration on its meeting the qualification criteria as defined in the RA procurement legislation in order to participate in procurement procedures. Given that under the procedure as approved per the above decree, this limit is AMD 5 million, the mentioned change will encourage broader possibility for participation of start-ups and small businesses in procurement procedures.

- **Public procurement officials might design/award tenders in anticompetitive way:** This includes for example: overly-restrictive technical specifications which only a few bidders can meet, scope to award tenders on quality grounds, scope for significant ex-post modifications. Regarding the first example, there is a need to standardize product specifications for commonly used goods.
- **Remaining gaps in the ongoing reform process** which would help to boost competition further are: (i) standardization of technical specifications through the development of a catalogue of specifications; and (ii) the improvement of procurement planning.

Pillar 3: Ensuring effective competition policy enforcement

52. Recent amendments have given SCPEC the possibility to identify/sanction “Anticompetitive Actions of Public Bodies” (actions, conduct or legislation by a state body or official that restricts, prevents or blocks competition). However SCPEC does not currently have experience of implementing this provision. Between 2010 and 2017, SCPEC identified around 221 issues based on its conducted reviews which the institution deemed involved powers of other state bodies. Proper enforcement of this provision could help tackle the mentioned issues and could be an important part of a government-wide strategy to embed competition principles in public policy.

53. Burdens for firms considered dominant may limit competition on the merits. The law contains market share thresholds to establish dominance (e.g. a firm is deemed dominant if it has over one third of the market or if it has 4 or more facilities under its management with AMD 1.5 billion annual turnover)³⁷ Due to regional commitments, recent changes in the RA Competition law introduced restrictions for firms that lie over these thresholds to compete on the merits (e.g. by prohibiting unjustifiably high or low prices and other efficiency enhancing strategies).

54. Economic concentrations involving firms considered dominant in the sense of Article 6 of the law are subject to declaration to SCPEC prior to execution. However, subjective criteria such as market shares or dominance as a trigger for review of a concentration might be problematic. For instance, market share calculations are dependent upon what territories or alternative products are considered to be in the market, and so they can be over- or understated by interested parties. Notification thresholds based upon assets or revenues as those included in the Article 9.1(1) of the law sales tend to be less ambiguous and not easily subject to manipulation.

³⁷ Behavioral criteria to determine dominance have been introduced in the law (Article 6.2(1)). Nevertheless, market shares still play an important role in establishing a dominant position. See Article 6.2-6.4 of the RA Competition Law: “2. An economic entity shall be deemed to have a dominant position in the commodity market, where: (...) (2) as a seller or acquirer it captures at least one third of the given market in terms of sale or acquisition volumes; or (3) each of two economic entities having the largest sale or acquisition volumes in a commodity market shall be deemed to have a dominant position in the given commodity market, where they jointly capture, as sellers or acquirers, at least one third of the given market in terms of sale or acquisition volumes; or (4) each of the three economic entities having the largest sale or acquisition volumes in the commodity market shall be deemed to have a dominant position in the given commodity market, where they jointly capture, as sellers or acquirers, at least two thirds of the given market in terms of sale or acquisition volumes.” In addition, Article 6. 5 also uses quantitative thresholds to determine dominance: “5. An economic entity shall be deemed to have a dominant position, where: (1) four or more trade facilities (trade network), the annual sales turnover whereof exceeds the total sum of AMD 1.5 billion, are under general control of the given economic entity, or (2) four or more trade facilities (trade network), the annual sales turnover whereof exceeds the total sum of AMD 1.5 billion, operate under the same trademark or other identification mark owned or used by the given economic entity.”

55. Anti-cartel enforcement is limited. Lack of tools to collect direct evidence of cartels. SCPEC does not have the ability to carry out dawn raids and it has limited cooperation with prosecutor. Although there are provisions in the framework for a leniency policy, the policy has been difficult to implement, and a lack of track record reduces the efficacy of the policy. Such limitations have severely impacted the ability of SCPEC to prosecute collusive practices. Lack of implementation tools to identify efficiency-enhancing agreements and exempt them from general prohibition of Competition Law.

56. Fines are suboptimal to deter compliance with the Competition Law. The cap for penalties has been amended to up to 10% of annual turnover in line with international practice. Up until such changes took place penalties imposed had generally been low (the highest penalty was USD 500,000 in 2008).³⁸ Other offences also face low penalties (AMD 5 million or USD 100,000 for failure to declare a concentration³⁹; or non-compliance with SCPEC information request⁴⁰).

57. Moreover, new amendments of the Competition Law are ambiguous over which agencies have ultimate jurisdiction for enforcement of ex post competition rules in regulated sectors. Under the amended Competition Law, there is some ambiguity over whether final competence over ex post antitrust enforcement for regulated sector has now been transferred to PSRC and the Central Bank of Armenia. As noted above, it is unclear how will this be implemented in practice and this will require measures for managing the interface between agencies or concurrent jurisdiction. Moreover, these agencies would benefit from increased capacity to undertake its potential new role in detecting and sanctioning anticompetitive behavior of firms in regulated sectors.

Cross-cutting: Developing a National Competition Policy

Building upon the three pillars of an effective competition policy framework described above, it may be beneficial to capture under a single National Competition Policy the different elements necessary to foster a more dynamic competitive environment in Armenian markets. This exercise typically involves understanding the available regulatory and non-regulatory tools and how they interact with each other. What will be the domestic standing of the national competition policy (NCP) in terms of capacity to influence other policies and regulations and how these domestic principles relate to current or potential international commitments.

The institutional setup to implement a NCP would also be critical. This assessment would imply understanding whether a single entity could be in charge of implementation such as the Productivity Commission in the case of Australia or implementation would require coordination among different bodies, notably involving the Ministry of Economic Development as well as SCPEC.

D. Proposed approach to progress markets and competition reforms in Armenia

³⁸ In determining the level of penalty for each case, the Commission takes into account the presence of aggravating and alleviating circumstances and their assessment as part of the factual circumstances and specifics of the case.

³⁹ See Article 36 of the RA Competition Law: "4.1. The amount of fine imposed for failure to declare concentration shall constitute up to five million drams."

⁴⁰ See Article 36 of the RA Competition Law: "7. The amount of fine imposed for the failure by an economic entity to submit, within the prescribed time period, documents or other information prescribed by a letter of the Chairperson of the Commission or by a decision of the Commission or by legislation or for submitting inaccurate or incomplete information shall constitute up to five million drams."

Based on the above, Table 5 summarizes the key issues across the three pillars of competition policy as well as examples of potential areas for further assessment, support and reforms. It is not intended to be exhaustive but captures an important set of the issues encountered.

Figure 5 outlines promising and actionable areas for support to the GoA in the short term (i.e. over the next 8 months). In some cases, these activities could align with and complement the ongoing work of other Global Practices (GPs) of the WBG (e.g. Finance, Competitiveness and Innovation (FCI) GP on deep dive sectoral assessments, Governance GP on public procurement and competition assessment under the RIA).

Table 5. Summary of key issues and potential areas for support

Issue	Potential support/reforms	Timeline (short/medium term)	Impact (Assuming sound implementation)	Feasibility
Pillar 1: Opening markets through pro-competition sector regulation				
<p>Scope to improve RIA Competition Assessment:</p> <ul style="list-style-type: none"> • Checklist requires improvement to focus on harmful effects • Lack of implementation capacity in NCLR 	<ul style="list-style-type: none"> • Revise and strengthen competition checklist based on MCPAT and international practice along with involving the specialized body, i.e., the Commission in further elaborating and improving competition issues contained in the checklist. • Peer learning workshop on implementation 	<ul style="list-style-type: none"> • Short 	High	High
<p>PSRC lack of market analysis expertise in network regulation</p> <ul style="list-style-type: none"> • E.g. in determining telecoms players with Significant Market Power • Particularly relevant now PSRC has final decision on ex post competition cases rather than SCPEC 	<ul style="list-style-type: none"> • Workshop on markets and competition assessment in telecoms and transport • Develop revised cooperation framework with SCPEC for handling ex post competition issues 	<ul style="list-style-type: none"> • Short (workshop) • Medium (capacity for ex post enforcement and cooperation with SCPEC) 	High	Medium
<p>Scope for MoE’s Economic Strategy to be developed incorporating competition principles</p>	<ul style="list-style-type: none"> • Assess MoE Economic Strategy measures based on potential effect on competition 	<ul style="list-style-type: none"> • Short (assessment and recommendations) 	Medium	Medium
<p>Rail: Potentially inadequate provisions for access to monopolist’s infrastructure to encourage entry</p> <ul style="list-style-type: none"> • Regulation on access and access tariffs not defined – although entry 	<ul style="list-style-type: none"> • Consider potential viability of opening market to a second operator • Develop access regulation 	<ul style="list-style-type: none"> • Medium 	Low	Low - Medium

Issue	Potential support/reforms	Timeline (short/medium term)	Impact (Assuming sound implementation)	Feasibility
of a second operator could provide differentiated services				
<p>Aviation:</p> <ul style="list-style-type: none"> • Previous de facto monopoly in aviation fuel • Some report prohibitive fees at Zvartnots Airport (landing and handling) • A number of players have exited in recent years • European LCCs have not yet entered despite negotiations in recent years • Potential to develop Gyumri Airport to attract more European LCCs – currently only Russian airlines • Potential to develop more domestic routes – currently only one air operator certificate issued for a domestic route 	<ul style="list-style-type: none"> • Consider benefits of developing further domestic routes and/or licensing additional air operators • Review reasons for lack of entry of European LCCs at Gyumri • Review and address drivers of de facto fuel monopoly 	<ul style="list-style-type: none"> • Medium 	High	Medium
<p>Telecoms</p> <ul style="list-style-type: none"> • Methods for regulating interconnection could be improved • No plans to release remaining 4G spectrum in a way that could allow for new entry • Lack of infrastructure sharing regulations may become an issue when 5G roll out begins • Lack of asymmetric regulation may hinder competition dynamics. 	<ul style="list-style-type: none"> • Strengthen methodology for determining interconnection rates • Develop infrastructure sharing regulation • Assess benefits of releasing spectrum in a more pro-competition way 	<ul style="list-style-type: none"> • Short (interconnection) • Medium (other actions) 	Medium	Medium - High (interconnection) Medium (others)

Issue	Potential support/reforms	Timeline (short/medium term)	Impact (Assuming sound implementation)	Feasibility
	<ul style="list-style-type: none"> Assess benefits of implementing asymmetric regulation 			
<p>Energy</p> <p><i>Electricity:</i></p> <ul style="list-style-type: none"> Legal amendments to open electricity supply market enacted but not implemented (through separation of distribution -supply monopoly) <p><i>Gas:</i></p> <ul style="list-style-type: none"> Monopoly in gas distribution and supply 	<ul style="list-style-type: none"> Develop implementing regulation for separation of distribution and supply of electricity- including third party access conditions Assess potential to quantify impact of gas distribution/supply monopoly 	<ul style="list-style-type: none"> Short – medium Medium 	<p>Requires further assessment</p> <p>Requires further assessment</p>	<p>Requires further assessment</p> <p>Low</p>
<p>Agribusiness</p> <ul style="list-style-type: none"> De facto monopoly on import of seed from Russia Removal of subsidy scheme and direct government distribution in some agri-inputs but changes in market structure are unclear Transparency of prices/quantities among agro-processing association members raises risk of collusion on farmgate prices Moves towards greater contract farming unintentionally restrict competition if not well designed 	<ul style="list-style-type: none"> Detailed assessment of key value chains to identify specific recommendation to improve market dynamics. Review and provide recommendations on the role of agro-processing associations in sharing information / determining market parameters. Assess impacts of removal of subsidy scheme to provide further recommendations to strengthen market outcomes 	<ul style="list-style-type: none"> Short (assessment of key value chains and market dynamics with recommendations) 	<p>Medium</p>	<p>High</p>

Issue	Potential support/reforms	Timeline (short/medium term)	Impact (Assuming sound implementation)	Feasibility
Pillar 2: Promoting a level playing field				
Lack of mechanisms to control potential market distortions of State Aid.	<ul style="list-style-type: none"> • Support approval of State Aid Law or improve the provisions of the RA Law on Protection of Economic Competition pertaining to State Aid. • Implementation of State Aid framework • Developing templates for State Aid inventory; • State Aid database portal; • State Aid institutional setup (Ministry, SCPEC, State Aid grantors national and subnational) 	<ul style="list-style-type: none"> • Short ('Decision on identifying the government agency for performing inventory) <ul style="list-style-type: none"> • Medium (inventory) • Medium (legal and institutional set up and implementation) 	Medium	Medium
Competition concerns in public procurement framework <ul style="list-style-type: none"> • Insufficient market research obligations for tender design (suboptimal estimations) • Rigid qualification criteria (might affect entry/ability of firms to qualify) • Non-competitive procedures: Single source (utilities) and Urgent single source (urgent purchases) remain common • PP officials might design/award tenders in anticompetitive way (restrictive technical terms, short delays between publication and bidding, potential to award tenders 	<ul style="list-style-type: none"> • Develop guidelines to embed competition in public procurement <ol style="list-style-type: none"> 1. To select the most pro-competitive procurement procedure; 2. To design the terms of the tender in order to favour competition; 3. To prevent anticompetitive decisions during the tendering process; 4. To avoid anticompetitive decisions after the tendering process. 	<ul style="list-style-type: none"> • Short / Medium 	High	High

Issue	Potential support/reforms	Timeline (short/medium term)	Impact (Assuming sound implementation)	Feasibility
on quality grounds, ex-post modifications)	<ul style="list-style-type: none"> Quantitative analysis of public procurement data to identify anti-competitive trends 			
Pillar 3: Ensuring effective competition policy enforcement				
Lack of experience in identifying/eliminating Anticompetitive Actions of Public Bodies (AAPB)	<ul style="list-style-type: none"> Peer learning workshop on implementation of prohibition of AAPB (e.g. Peruvian and Ukrainian experience) Develop a methodology to identify AAPB 	<ul style="list-style-type: none"> Short 	High	Medium - High
Burden on firms considered to be dominant limits competition on the merits <ul style="list-style-type: none"> Rigid low market share thresholds establishing dominance Limited ability for so-called “dominant firms” to compete on the merits (e.g. prohibition of unjustifiably high or low prices and other efficiency enhancing strategies) due to provisions added as a result of regional EEA commitments. Subjective criteria such as market shares or dominance as a trigger for review of a concentration might be problematic. 	<ul style="list-style-type: none"> Limit abuses of dominance to those that may result in market foreclosure of equally efficient firms through the development of secondary legislation on monopolistically high and low prices along the lines of the analysis applied to excessive and predatory pricing respectively. Consider amending obligations for dominant firms to notify concentrations in favor of asset/turnover based thresholds 	<ul style="list-style-type: none"> Medium 	Medium	Medium
Limited powers to identify anti-competitive agreements <ul style="list-style-type: none"> Lack of tools to collect direct evidence of cartels (no dawn 	<ul style="list-style-type: none"> Enhance SCPEC ability to collect direct evidence by legally empowering the SCPEC to conduct dawn raids. 	<ul style="list-style-type: none"> Long 	Medium - High	Medium

Issue	Potential support/reforms	Timeline (short/medium term)	Impact (Assuming sound implementation)	Feasibility
<p>raids/Limited cooperation with prosecutor; new leniency (exemption from sanctioning) policy difficult to implement).</p> <ul style="list-style-type: none"> Lack of implementation tools to identify efficiency-enhancing agreements which does not allow to treat these agreements as permissible ones within the scope of legal regulations set under the Law on Protection of Economic Competition. 	<ul style="list-style-type: none"> Develop secondary legislation to grant exemptions for permissible agreements. Implement an effective leniency (exemption from sanctioning) policy. 			
<p>Suboptimal fines to foster deterrence</p> <ul style="list-style-type: none"> Low level of penalties for failure to notify a concentration or to comply with an information request by SCPEC). 	<ul style="list-style-type: none"> Consider increasing fines for failure to notify a concentration or to comply with an information request by SCPEC. Develop a clear methodology to calculate penalties adequate to the infringements . 	<ul style="list-style-type: none"> Medium 	Medium	Medium
Cross-cutting: Developing a National Competition Policy				
<ul style="list-style-type: none"> Lack of coordinated mechanisms/incentives to implement a coordinated approach to foster competition across sectors/markets. 	<ul style="list-style-type: none"> Developing a National competition policy including regulatory and institutional mechanisms for implementation. 	<ul style="list-style-type: none"> Short 	Medium	High

Figure 5. Short term actionable areas for potential support to the GoA

