

REPUBLIC OF ARMENIA

POVERTY REDUCTION STRATEGY  
PAPER

YEREVAN, 2003

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*Government of the Republic of Armenia*

## LIST OF ABBREVIATIONS

AMD	Armenian Dram
AIDS	Acquired Immunodeficiency Syndrome
bn	Billion
CBA	Central Bank of the Republic of Armenia
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
DFID	Department for International Development
EBRD	European Bank for Reconstruction and Development
EG	Expert Group
EU	European Union
GDP	Gross Domestic Product
GOA	Government of Armenia
GTZ	German Technical Cooperation
G&NFS	Goods and Non-Factor Services
h/h	Household
HIV	Human Immunodeficiency Virus
IDA	International Development Association
ILO	International Labor Organization
ISLC	Integrated Survey of Living Conditions
IMF	International Monetary Fund
km	Kilometer
LFS	Labor Force Survey
MDG	Millennium Development Goals
MFE	Ministry of Finance and Economy of the Republic of Armenia
mn	Million
MP	Member of Parliament
MTEF	Medium Term Expenditure Framework
NA	National Assembly of the Republic of Armenia
NGO	Non-Governmental Organization
NPV	Net Present Value
NSS	National Statistical Service of the Republic of Armenia
OECD	Organization for Economic Cooperation and Development
PAIS	Poverty Assessment Indicators System
PSC	Participatory Steering Committee
PPP	Purchasing Power Parity
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
RA	Republic of Armenia
SAC	Structural Adjustment Credit
SC	Steering Committee
SSIF	State Social Insurance Fund of the Republic of Armenia
TOR	Terms of Reference
UN	United Nations
UNDP	United Nations Development Program
USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollar
VAT	Value Added Tax
USSR	Union of Soviet Socialist Republics
WB	World Bank
WG	Working Group
WHO	World Health Organization
y-o-y	year-on-year

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## INTRODUCTION

1. Republic of Armenia declared its independence in 1991 stepping into a period of radical and fundamental reforms in political, social and economic systems. Nevertheless, since the very early days of independence Armenia found itself in an extremely difficult situation. In addition to the problems related to break-down of the USSR and structural reforms as well as lack of preparedness of the country's institutions to act in market environment - factors inherent to all other newly independent states – the Government of Armenia had to find solutions for sheltering hundreds of thousands refugees from Azerbaijan, eradication of the Spitak devastating earthquake in 1988, rehabilitation of bordering areas suffered from shelling by Azerbaijan because of the Artsakh conflict, etc. The situation was further aggravated in view of transportation blockade, complete disruption of former economic ties, suspension of activities and liquidation of many industrial enterprises, as well as other destructive factors.
2. These and other negative developments resulted in deep economic and social crisis in the 1990s, one of the most devastating consequences of which was widespread impoverishment of the population, income inequality and polarization of the society of appalling level.
3. The existing poverty and inequality situation gives rise to a number of hazards and threats, which may lead to the following consequences:
  - (i) Persistence of social polarization in the country may deepen the rupture between various social layers, which in turn jeopardizes socio-economic development of the country and establishment of a strong state, since the perception of national and social interests will gradually fade away;
  - (ii) High poverty rates hamper establishment of civil society and harmony, hence establishment of a country with domination of rule of law and democracy;
  - (iii) The multi-thousand group of poor people continues to lag behind general human development regularities, which will result in a degradation of human capital;
  - (iv) Widespread poverty restricts self-establishment and realization potential due to which the most active part is forced to migrate. Demographic, social and economic consequences of the latter are eye-striking already today;
  - (v) Persisting impoverishment enhances passiveness, psychological depression, nihilism and pessimism amongst the vast majority of population, as a consequence of which motivation, initiative and participation of the population in social, economic and socio-cultural life of the country reduces to a minimum.
4. All these undoubtedly undermine the foundations of national security. The urgency to address these problems on the part of the society and government has necessitated elaboration and implementation of the Poverty Reduction Strategy Paper.
5. With the objective to prevent the inherent threats and get the vast majority of population out of the existing situation, the PRSP pursues the objective to reduce poverty as a hindrance to economic, social and human development and progress of our country.



## PRSP DEVELOPMENT PROCESS

6. The Poverty Reduction Strategy Paper has been developed with the support of scientists, experts, public and political figures and all those who are interested in eradication of poverty in Armenia. The PRSP development process is not similar to any other program developed previously, since it includes the participatory approach as one of its most important components. This is one of the most important guarantees for the successful implementation of the PRSP.
7. The development of PRSP was initiated on 15 May 2000 by Decision No. 267 of the Prime Minister. Based on the Decision a **Steering Committee** (SC) was founded, headed by the Finance and Economy Minister and consisting of representatives from line ministries dealing with social and poverty issues, standing committees of the Armenian National Assembly, National Statistical Service, political parties, NGOs and the donor community. The main responsibility of the PRSP SC was to organize and to coordinate the development of the Interim<sup>1</sup> and later of the full-fledged PRSP.
8. For the day-to-day management of PRSP development the PRSP **Working Group** (WG) under the direct supervision of the SC was established on 14 April 2001, where, similar to the SC, governmental, non-governmental as well as international organizations were represented. The PRSP WG was responsible for the day-to-day management of the PRSP development process, drafting the final document, providing information on various components of the program and ensuring its transparency, organizing the participation of the civil society and donor community in PRSP development, incorporating their comments in the document and submitting the final document to the PRSP SC.
9. The work on the full-fledged PRSP started in November 2001, when a team comprised of WG members and independent experts prepared the PRSP **Terms of Reference** (TOR). The TOR defined priority PRSP objectives and targets for political, social, economic and governance development, and identified the main directions for policies as well as specified the relevant rules regulating the PRSP development process. The PRSP TOR was widely discussed within central, regional and local governments, NGOs, scientific and educational institutions, the mass media, international and donor community. Numerous publications, radio and TV programs, information booklets, analytical bulletins, round tables, club discussions, seminar-workshops and other events were organized on the main concepts of the PRSP TOR.
10. Parallel to discussions on the TOR, around 50 independent experts, who were selected through an open competition announced by the SC, were developing the PRSP. In accordance with the TOR, the experts were divided into the following five **Expert Groups** (EG):
  - (i) Poverty assessment and analysis;
  - (ii) Methodology and methodological issues;
  - (iii) Social strategy;
  - (iv) Economic strategy;
  - (v) Governance, participation and monitoring.
11. The Medium Term Expenditure Framework (MTEF) was being developed by the government parallel to the PRSP development. Since it was necessary to harmonize and coordinate the PRSP and MTEF documents a special expert group was formed, which actively participated in discussions on the draft PRSP and provided numerous comments and suggestions. As a result of the work of this group a number of measures proposed in the draft PRSP were incorporated in the 2003-2005 MTEF and the necessary funds were allocated in the 2003 state budget, which made it possible to start their implementation already in 2003.
12. Expert groups finalized their work in September-October 2002 and the Steering Committee circulated the draft PRSP for discussions among all the stakeholders. In the subsequent three months, a large number of comments and suggestions resulting from discussions were received. The results of processing these comments and suggestions revealed that they mainly referred to defining priorities in

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<sup>1</sup> The Interim PRSP was developed by the government and widely discussed by the public and approved in March 2001 as a guideline for developing the Full-fledged PRSP. See [www.gov.am](http://www.gov.am)

the document and in its structure as well as to the necessity to harmonize the PRSP with programs being implemented in the country through support from the donor community. An Expert PRSP Consolidation Group was set up on February 12, 2003, in order to consolidate and finalize the Document, incorporating all the received comments and proposals. The expert group completed the work in May 2003.

### ORGANIZING THE PRSP PARTICIPATORY PROCESS

13. With the objective to publicize the PRSP development and to organize the public participation, the NGO Institute for Human Rights and Democracy and Analytical Informational Center for Economic Reforms CJSC of the government of Armenia were selected through an open competition organized by the SC.
14. Throughout April-November 2002 the mentioned agencies organized and implemented (i) public discussions with participation of representatives from the civil society, deputies of the National Assembly, local governments and the press; (ii) seminars in all regions of the country with the participation of the civil society, private sector, central, regional and local governments; (iii) preparation, publication and dissemination of information and analytical materials for the public, including through the Internet<sup>2</sup>; (iv) TV and radio programs; (v) articles in marz and national press; (vi) public opinion surveys; and (vii) public awareness campaigns in communities, various representative groups of the population, educational institutions, etc. A PRSP Internet site<sup>3</sup>, including information also on the participatory process, has been set up and is being regularly updated.
15. At the same time, PRSP development participatory process was not limited to activities of the above-mentioned agencies selected through the competition. In accordance with the tripartite agreement between the Government of Armenia, the World Bank and the UNDP (signed on 17 June 2002) a list of measures for PRSP development participatory process was approved, the coordination and implementation of which was done by the joint UNDP/GoA project "Creation of a Social Monitoring and Analysis System". Activities related to the Participatory Process were also conducted by experts developing the PRSP.

### CIVIL SOCIETY PARTICIPATION

16. Viewpoints and comments of various groups of society were included in the draft PRSP, and conditions were created for broader civic participation and social partnership, in result of public and expert discussions, printed and electronic materials, information collection and dissemination and involvement of the more active organizations. Representatives from governmental bodies, non-governmental and private sectors, as well as international organizations and the donor community were involved in the process.
17. Some participants acted as partners of organizations implementing the Participatory process. These include 11 TV companies, 6 radio stations, editorial boards of 14 newspapers, associations of NGOs (Trade Union Confederation of Armenia, Anticorruption Coalition), about 20 NGOs operating in marzes and in Yerevan, PRSP working groups formed in ministries and regional governments, staff of regional Monitoring and Analysis units, international organizations operating in Armenia.
18. **Participation of governmental bodies** Representatives from the government were included in PRSP Steering Committee and Working Group. In order to ensure the active participation of all central and regional governmental bodies, by the Decision No. 48 of the Prime Minister dated 30 January 2002 working groups were formed in all ministries and agencies, headed by deputy directors of the agencies, which ensured continuous cooperation between specific ministries or agencies and individuals or groups responsible for the relevant area in PRSP. Representatives from ministries and Marzpetarans participated in joint discussions on the draft PRSP with experts and representatives from the donor community and presented their comments and recommendations on the draft.
19. **Involvement of marzes** Discussions and round-tables were conducted in all marzes of Armenia. Yerevan had the broadest involvement in the participatory process, followed by Shirak, Lori and Gegharqunik. NGOs involved in the PRSP participatory process in Gyumri and Vanadzor organized numerous discussions. Gegharqunik was also one of the most actively involved marzes, where events

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<sup>2</sup> See [www.gov.am/en/gov/iprsp](http://www.gov.am/en/gov/iprsp), [www.undp.am/pubs/pover/index.html](http://www.undp.am/pubs/pover/index.html)

<sup>3</sup> See [www.gov.am/en/gov/iprsp](http://www.gov.am/en/gov/iprsp)

were organized jointly with NGOs in the town of Martuni and with representatives from marz's schools in village Shorja. Discussions were organized in Ararat, Gegharunik, Vayots Dzor and other marzes with the support of Monitoring and Analysis Units' staffs. Discussions on specific issues, such as agriculture, employment and education, were conducted in Syunik, Lori and Vayots Dzor marzes correspondingly. Experts from the groups for development of social policies initiated a discussion in Lori marz. Events organized in marzes revealed that there is a significant lack of information in marzes, especially in rural areas, and many people are left outside of discussions and decision-making processes due to lack of awareness on these possibilities, lack of information, knowledge and communications.

20. **Participation of community governments** The PRSP SC initiated the dissemination of the draft PRSP to all communities of the country for comments and recommendations. Almost half of the communities responded by discussing the document and by coming up with a large number of recommendations, which were summarized and further passed to Expert Groups. A number of representatives from community governments participated in a three-day workshop on the issues of community governments.
21. **Participation of the non-governmental sector of the civil society** Within the framework of the joint UNDP/Government of Armenia project "Creation of a social monitoring and analysis system" a study of civil society groups in Armenia was conducted in Spring 2000. This study revealed that despite some differences in the level of civil society development between Yerevan, marzes, and urban and rural areas, some progress was achieved in this respect. In particular, a various organized groups, such as NGOs, Water Users Associations, specialized centers, business centers, etc., are being formed especially in marz centers and small towns, as well as in some villages. Out of more than 20 types of civil society organizations the following were the most active in the participatory process: (i) NGOs; (ii) scientific and educational structures; (iii) mass media; (iv) private sector; (v) trade unions; (vi) community governments.
22. **NGOs**, being one of the most developed groups of civil society, were actively involved in PRSP development. NGOs have submitted their comments and recommendations on the draft PRSP throughout all the stages of PRSP development. Some NGOs have discussed the draft within their organization, as well as with their beneficiaries and other NGOs active in the same field. NGOs were actively involved in topic discussions, as well as all public and club discussions. A number of NGOs have organized their own discussions or were actively involved in events organized by the group responsible for the participatory process (e.g. Women's Council of Martuni, "Millennium" association for educational studies, "Education for sustainable development" NGO, "Asup" NGO, "Support to universal management of quality" NGO, "Burg" youth environmental center, Association of Shirak NGOs, "Versia" analytical-information center). In discussions related to other topics, numerous NGOs have emphasized poverty issues and included the PRSP on the agenda (e.g. Women's Republican Council, "Mush-2", "Vega", "Araza").
23. **Scientists and university lecturers** directly participated in PRSP discussions and PRSP development in a number of directions, including direct involvement in the development of the program as members of the Working Group and Expert Groups. Representatives from scientific and educational institutions have been involved in numerous events organized within the framework of the participatory process. Higher educational institutions (Yerevan State University, Medical University, Brusov Foreign Languages Institute, Pedagogical Institute, Engineering University) have provided consultancy to experts developing the PRSP.
24. **The mass media** is also one of the most developed groups of the civil society, which was actively involved in PRSP activities. The mass media covered all the large-scale public discussions and a number of specialized discussions. A number of newspapers and radio stations, as well as some TV channels have broadcasted various presentations on PRSP issues and related intensive discussions. A number of representatives from mass media have presented their comments and recommendations on the PRSP.
25. Representatives from **trade unions** have participated in a number of club discussions. Numerous heads of sectoral trade unions participated in the discussion on "Trade unions and the PRSP participatory process". A number of heads of sectoral trade unions have presented their recommendations on the draft PRSP.
26. **Participation of political parties** Deputies and experts of the National Assembly were actively involved

in both the PRSP SC and EG-s. At the same time, deputies were invited to and actively participated in seminar and topic discussions and round-tables. A discussion of the draft PRSP with political parties of the opposition was organized in Yerevan on 28-29 November 2002, where deputies from opposition parties in the National Assembly and representatives of various political parties participated.

27. **Participation of the private sector.** The private sector also contributed to PRSP development through its representatives in the PRSP WG and EGs. At the same time, three round-tables were organized especially for associations of businessmen, farmers and industrialists, to discuss the PRSP economic policies.
28. **Participation of international organizations.** International organizations were very active in the PRSP through provision of consulting and financial support to those who coordinated and developed the PRSP. The donor community provided joint comments on the TOR and the drafts of PRSP. Seminars were organized by donor organizations to provide technical assistance to PRSP experts and the Working Group (UNDP, WB, GTZ). A number of organizations (WB, UNHCR, DFID, CRS, OXFAM GB, AED, and others.) provided support in organizing the participatory process events and have referred to the PRSP in their projects, and also have emphasized the importance of the participation of civil society groups during discussions on various projects.
29. **Participation of the Diaspora.** Organizations representing the Diaspora participated in joint discussions on the PRSP, the NGO Center of the Armenian Assembly of America provided support in organizing discussions in the area of education.

#### **PUBLIC AWARENESS AND FEEDBACK**

30. Information provision on the PRSP started already during the development of the Interim PRSP, however, mass media coverage, through information provision and special programs, became more intensive later during the development of the Full-fledged PRSP. A number of national newspapers have dedicated pages to PRSP coverage and more than 100 articles were published in different national and marz papers. Programs were broadcast by the national radio and other radio stations, a number of radio discussions were organized, during which listeners had the opportunity to participate in live discussions and Q&A sessions. TV programs about PRSP were broadcast by Prometevs, Armenina, Abovyan, Yerevan and Gavar TV channels, a number of which included live interviews with experts. Reports were also broadcast by MIR TV station. A number of interviews on PRSP were conducted and the main seminars organized within the framework of the PRSP were covered by Public TV's "Dzeragir" program. Information on PRSP is presented in PRSP Development Process section of the Government's web page, as well as on other web-pages created by NGOs efforts<sup>4</sup>. A number of 2002 issues of the "Hayatsk Tntesutyan" bulletin were devoted to the PRSP. Advisory-analytical booklets on a number of topics both directly referred to or touched upon in the PRSP were published. The informational-participatory brochure for the wide public titled "What is PRSP?" was published in 2500 copies.
31. Various mechanisms were used for collecting recommendations and incorporating them in the PRSP, including recording comments and recommendations brought up during discussions, using e-mail for receiving comments and sending them further to PRSP experts and the Working Group, conducting surveys, to collect information on social and economic conditions in communities, collecting recommendations by filling-in bulletins during discussions. Information on the level of incorporation of recommendations in the PRSP was disseminated through publishing the recommendations in "Hayatsk Tntesutyan" bulletin, posting summaries of discussions to participating organizations by e-mail, sending experts' responses to organizations which had originally submitted the recommendation, direct discussions between experts and organizations submitting recommendations, as well as providing opportunities for discussing individuals' recommendations.

#### **CONSTRAINTS, RESULTS AND FUTURE STEPS RELATING TO PARTICIPATORY PROCESS**

32. A number of **constraints** to the participatory process emerged, overcoming of which needs both urgent action, and implementation of long-term policies. These constraints included: lack of faith in the implementation of the PRSP; difficulties of accessing information (small number of copies of the press

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<sup>4</sup> See [www.forum.am](http://www.forum.am), [www.hra.am](http://www.hra.am)

and their not being affordable for the poorer groups of the population); “Soviet” mentality, specially among middle-aged and senior citizens; low level of institutional development of the civil society; lack of knowledge on fundamental democratic values and their not being well-rooted in communities; the inactive mid-level governmental structures; reluctance often prevalent in the attitude of governmental bodies toward public participation; frustration and disappointment resulting from difficult social conditions, little or no hope for the future resulting from lack of possibilities for overcoming difficulties; little knowledge pertaining to participation in community government, inadequate skills among some community governments, little or no initiatives from the public.

33. Quantitative **results of the participatory process** are the following: more than 100 written recommendations were received, which were mainly incorporated in the draft PRSP; more than 1800 people participated in events organized within the framework of the participatory process; and overall, about 700 recommendations were recorded based on questionnaires completed at the end of discussions. Although it is difficult to produce a numerical assessment of the incorporation of recommendations, it can be stated that about 40 percent of recommendations received have been included in the PRSP, and about one-third were taken into account partially.
34. Topic seminars, round-tables, discussions, surveys of public opinion in marzes and communities. In order to discuss urgent issues of PRSP development and present the intermediate results of the work of experts to representatives from the civil society, governmental structures, including marz and community governments, and the donor community two large-scale seminars at Writers House in Tsaghkadzor were organized for more than 100 participants (March 9-11, 2002, July 23-25, 2002). On June 28-30 and September 27-29, 2002 two topic seminars “Poverty reduction issues in Armenia and community governments” and “Social partnership. Actors, developments” were also conducted at Writers House in Tzaghkadzor. Later, on August 12-28, 2002, the PRSP SC initiated, expert discussions with specialists from relevant ministries and agencies at the Ministry of Finance and Economy, and on September 6, also with specialized NGOs.
35. Other than large-scale seminars, awareness campaigns were carried out, 14 round-tables, 7 club discussions and 4 public discussions were organized in more than 120 organizations of 80 communities in Yerevan and 9 marzes. In total 12 issues of “Hayatsk Tntesutyán” bulletin were devoted to the PRSP, in total 18000 copies, 5 joint publications of regional newspapers, 12 informational booklets in 22800 copies, two journals, as well as 18 special pages and more than 100 articles in the press were published. 23 TV programs with a total duration of 13 hours, 17 radio programs with a total of 6 hours, 3 live radio discussions and 2 live TV discussions were broadcast, 2 surveys with 1000 respondents each were conducted in Yerevan and in 35 communities of 7 marzes.
36. **Achievements of the Participatory Process.** Due to the participatory process, the PRSP tends to become a program developed not by the authorities, but by the participation of the public and independent experts. Due to the participatory process an atmosphere of dialogue has been created from top to bottom. Through awareness campaigns, meetings and discussions the public and organizations representing it have directly participated in the development of the PRSP.
37. Through information provided by mass media and dissemination of printed materials and informational booklets, meetings, discussions with expert groups, TV and radio debates the public was informed on the process of PRSP development and poverty issues. A framework of cooperation and partnership has been formed between participants of the PRSP awareness building and participatory process and, and it is very important to maintain and further deepen this framework during the next stages: PRSP implementation, monitoring and evaluation.
38. At the same time, this completed phase of the participatory process was a valuable experience and provided for a number of lessons learned from the work done. During discussions, the interaction of various groups dealing with the same set of problems revealed that exchange of experience is very important both in itself and for coordination of future activities. In this regard, exchange of information on data, experience and implemented projects regarding a specific area, region or problem was a significant achievement and a signal pointing to the necessity of further activities in the given direction.
39. **Further steps.** As a first step after the approval of the program, it is planned to organize and implement PRSP information provision activities. The necessary mechanisms for public participation in PRSP

implementation, monitoring of its results and social impacts will be developed. It is expected that civil society organizations and groups will establish partnership relations with the government. During the implementation of the PRSP, civil society groups will contribute their potential for the implementation and monitoring of PRSP policies, programs and sub-programs at both national and community levels. Awareness building activities will be conducted in order to ensure the participation of vulnerable groups of the population in the PRSP implementation. Mechanisms for social partnership will be developed so that institutional framework for cooperation between the state and civil society organizations and groups is established both for PRSP and other purposes. Broad discussions will be organized for exchange of opinions and experiences between governmental bodies, donor community and civil society organizations. Surveys of opinions of the poor and vulnerable groups, as well as of civil society representatives will be conducted. The participation of organized groups of the civil society in PRSP review activities will be broadened, and their involvement in decision-making for effective implementation of the PRSP will increase.

## SECTION 1. POVERTY SITUATION ANALYSIS

### CHAPTER 1. DEFINITIONS OF POVERTY AND EVALUATION METHODOLOGY

40. Poverty evaluation is derived from its definition. Modern definitions are based on the concept of poverty as a multidimensional issue. According to the World Bank<sup>5</sup>, poverty is manifested as:
- (i) *Lack of opportunity*: Low levels of consumption/income, usually relative to a national poverty line. This is generally associated with the level and distribution of human capital, social assets and physical assets, such as land, and market opportunities, which determine the returns to these assets. The variance in the returns to different assets is also important.
  - (ii) *Low capabilities*: Little or no improvements in health and education indicators among a particular socio-economic group;
  - (iii) *Low level of security*: Exposure to risk and income shocks, which may arise at the national, local, household or individual level.
  - (iv) *Empowerment*: Empowerment is the capability of poor people and other excluded groups to participate, negotiate, change and hold accountable institutions that affect their well-being.
41. On the basis of the above definition, poverty here is considered as impossibility to meet minimum biological, social, and cultural needs. “Biological needs” should be perceived as meeting minimum food and personal hygiene needs, as well as minimum seasonal clothes, residential unit and affordability of minimum consumption of water, heating and electricity. “Social needs” include health, education, job, and minimum social life (marriage, births of kids, death related ceremonies, interaction with judicial systems) together with relevant material capacities, stability of intra-household relations and accessibility of minimum information (press, television, radio or other mass media), as well as socializing with other people (telephone, transport, other means of communication) and possibilities to participate in public events. “Cultural needs” include minimum affordability of cultural values (not in the context of subjective demands and perceptions, but rather by objectively defined groups, such as minimum participation in already traditional ceremonial life, opportunities to read and listen to music, etc.).
42. A person will be defined as a poor or non-poor given the combination of the above three groups, and meeting exclusively material (biological) needs will not entail enlargement of social opportunities of a person and poverty reduction. Majority of poverty studies undertaken both in Armenia and other countries are nevertheless anchored to indicators of “biological needs”, partially covering health and education accessibility. These predominantly lack other social needs and social and cultural factors.
43. Poverty, being a multidimensional concept, brings about the necessity for development and introduction of a system of indicators for its assessment. Poverty Assessment Indicators System (PAIS) will be developed and introduced as the basis for poverty monitoring methodology (development of PAIS will start in 2004), which will allow to assess various aspects of poverty at national and regional levels as well as characteristics of poverty among vulnerable groups of the population, so that we will have a more complete picture of poverty and will be able to follow its changes. PAIS will specify the following in a coordinated manner:
- (i) definitions and characteristics of various types of poverty;
  - (ii) poverty assessment indicators and methods for their calculation;
  - (iii) sources for collecting data on poverty indicators and mechanisms for obtaining them regularly;
  - (iv) types and frequency of studies of different aspects of poverty;
  - (v) responsible organizations and institutions for conducting studies and collecting indicators;
- PAIS will be the core of the comprehensive strategic program for PRSP monitoring, analysis and impact assessment, and it will be developed for the management, monitoring and coordination of PRSP

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<sup>5</sup> PRSP Sourcebook. Overview, WB, 2001.

implementation (see Section 5 of this document).

44. Sample household surveys (hereinafter, household surveys) serve the bases for evaluation of the depth of poverty, measurement of various poverty indicators, as well as monitoring poverty programs. With the support of the World Bank, the National Statistical Service (NSS) carried out three such surveys in Armenia, in 1996, 1998/99 and 2001<sup>6</sup>. The 1998/99 and 2001 Surveys generated time series of poverty indicators based on the same methodology of poverty evaluation. This ensures consistency of the indicators in time and comparability with other countries, as well as applicability from the perspective of evaluation of poverty reduction trends.
45. In the absence of PAIS, elaboration and evaluation of PRSP is compellingly based on the NSS methodology with the primary emphasis placed on evaluation of material aspect of poverty.
46. According to the latter, the basis for evaluating poverty of a country's population reflects two absolute poverty lines, i.e. estimation of poverty food line and poverty general line. Both are construed on actual expenses of households for acquisition of food. The minimum level of food consumption is considered to be the quantity of actually consumed food containing 2100 kilocalories per day per capita<sup>7</sup>, while the value of minimum food basket is considered to be the financial resources necessary for acquisition of the above quantity of food. Value of the minimum food basket adjusted with the coefficient of expenditures for commodities and services serves as the consumption basket, or, as mentioned earlier, general poverty line.
47. On the basis of these two poverty criteria, the population of Armenia (households) is divided into three major groups in poverty terms: (i) very poor, whereby average current per capita expenses are lower than poverty food line; (ii) poor, whereby average current per capita expenses are higher than the poverty food line but lower than the poverty general line; and non-poor, whereby average current per capita expenses are higher than the poverty general line. In addition to the poverty level indicator, there are other important indicators such as depth, acuteness of poverty, distribution of incomes, expenses and consumption by decile and quintile groups, as well as the Gini coefficient. Depth of poverty describes how far below the poverty line<sup>8</sup> are the households. Acuteness of poverty shows the number of the poor in the lowest level of poverty<sup>9</sup>. Distribution by decile or quintile groups is an indicator of direct measurement of inequality and it shows the ratios amongst decile or quintile groups or their share in total. Gini coefficient shows inequality of income distribution among the population. The closer this coefficient is to 1, the higher is the degree of income polarization of the population.

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<sup>6</sup> The 1996 Survey was conducted in November-December 1996 and its results are not compatible with the results of the 1998-99 and 2001 Surveys. The reasons lie with methodological differences with the latter, as well as the fact the Survey was conducted in the fourth quarter, when some 35% of GDP is produced in Armenia and incomes and expenditures exceed average annual indicators approximately by 40%. An effort to collate these with the results of the latter Survey was undertaken in the World Bank Poverty Update Paper. This work, however, states that comparisons may serve only as assessments of changing directions rather than bases for drawing conclusions.

<sup>7</sup> According to the FAO instruction for developing countries, the level of daily per capita food consumption is 2100 kilo calories. Guided by this level and in order to ensure international comparability, the NSS has simultaneously estimated the composition of food basket on the basis of types and quantities of food actually consumed by households in the country. The Ministry of Health has elaborated the minimum food rational basket, quarterly estimated by the NSS. This basket contains types and minimum rates of foodstuff necessary for sustaining life of a person. Total energy value of the latter is close to 2400 kilocalories. Nevertheless, in the context of PRSP the basis for evaluating poverty level has been selected to be the minimum food basket containing 2100 kilocalories with the objective to ensure comparability of household surveys conducted in various countries in various periods. This does not preclude sustainability of different approaches and assumptions, which are envisaged for implementation in the framework of this program.

<sup>8</sup> For example, poverty acuteness of 19% means that if a country is in a position to pool resources equal to 19% of the poverty line and efficiently distribute these among the poor, poverty may theoretically be eradicated. For such an action, Armenia would need dram 46.8 billion in 1996, or 7.09% of GDP, dram 44.3 billion in 1999, or 4.47% of GDP, or dram 32.3 billion in 2001, or 2.74% of GDP.

<sup>9</sup> Acuteness of poverty is calculated as arithmetical average of the squares of acuteness.



## CHAPTER 2. POVERTY AND INEQUALITY IN ARMENIA: FACTORS, CURRENT SITUATION AND TRENDS

### 2.1. EVOLUTION OF POVERTY AND FACTORS PRECONDITIONING POVERTY

#### 2.1.1. POVERTY AND INEQUALITY IN SOVIET ARMENIA

48. During the last 20 years of the Soviet Union, and, consequently Soviet Armenia, poverty and inequality had not been important political or economic issues.
49. According to the 1988 data, only 20 percent of the population in Armenia received salaries lower than poverty line. Poverty line was defined at the level of 78 rubles per month per capita (equivalent of USD 87<sup>10</sup>), while average monthly monetary income was 134.4 rubles per capita (USD 149.9<sup>11</sup>). The composition of the income sources was the following: 76% salary, 11% formal transfers, 13% income generated from the sale of agricultural produce and other incomes. Expenses were distributed in the following way: 41% acquisition of foodstuff, 28% acquisition of non-food products, and 9%<sup>12</sup> acquisition of services. Taking into account peculiarities of the Soviet economic and political system (high level of social spending and low variances in salary rates), the inequality level was one of the lowest in the world, with the Gini coefficient estimated at 0.27 in 1987-1990<sup>13</sup>.
50. Reasons for substantial increase in the poverty rates and in the number of poor in 1998-1991 were primarily consequences of factors other than economic. The 1988 December 7 devastating earthquake, besides thousands of human victims, gave rise to a huge part of population, some 400.000 people<sup>14</sup>, dispossessed of shelter, property and basic means of existence. In terms of timing this coincided with immigration of some 360.000 refugees, which flowed from Azerbaijan into Armenia as a consequence of Karabakh conflict. The vast majority of these refugees in absolute terms have added to the number of people that were in desperate need for social protection. Consequences of the conflict were not limited to problems of the refugees. More than 100 populated areas in a number of bordering regions were annihilated because of bombing from Azerbaijan and more than 70.000 people left their homes constituting the group of internally displaced persons<sup>15</sup>.

#### 2.1.2. REPUBLIC OF ARMENIA: SYSTEMIC CRISIS AND POVERTY

51. At the beginning of 90s, the newly independent Armenia entered into a period of radical changes that involved political, social and economic systems and plunged into unprecedented energy crisis. In 1990-1993 GDP shrunk more than two times making in 1993 only 46.9% of 1990 level, the largest decline in GDP among the CIS countries. Due to transportation blockade and tangible reduction of fuel imports, as well as closure of the Armenian Nuclear Power Station, the electricity production in the same period decreased by 58%.
52. As a consequence of the deep economic crisis some 645.000 jobs were cut in non-agricultural sector of

<sup>10</sup> Official exchange rate at the time was 0.9 USD for 1 ruble. For the purpose of comparison it should be mentioned that in the Soviet Union 12%, in average, of the population had incomes lower than minimum subsistence. The share of "population of low living standards" in Armenia was 1.5-6 times "above" 11 USSR Republics. Only in 4 Central Asian Republics this indicators was higher than in Armenia.

<sup>11</sup> Estimated on the basis of data in the "Հծի աի էյ ա օեծծաօ ա 1990 աի օօ", Yerevan, pp. 179, 189.

<sup>12</sup> "Republic of Armenia. Interim Poverty Reduction Strategy Paper.2001", p. 4.

<sup>13</sup> Source: *Հ ածածեօյ ծաօի ծի ս ի ա աեաի աի օ օաաի աի: Աաիի նօս օ ի ածաաի նօսի ա նօծաի աօ Աածի ս օ օաի օծաեյի օ Աչե. Աի ա ծի ս օ աի օ, 2001, նօծ. 125.*

<sup>14</sup> In 1989-1990 majority of the earthquake survivors were paid substantial compensations through the Savings Bank network of the Soviet Union. This, as well as large-scale Earthquake Zone Rehabilitation Program, funded from the Central Budget of the Soviet Union up until its dissolution, contained the increase of income poverty and, in parallel gave rise to property poverty and inequality in the earthquake area. However, tangible reductions in the Earthquake Zone Rehabilitation Program after dissolution of the Soviet Union and freezing of Savings Bank deposits half of which was represented by the above compensations, brought about unprecedented impoverishment of the earthquake area population, in addition to the deep economic crisis in 1992 and on. Up until currently, poverty level in the earthquake area cities is the highest in Armenia.

<sup>15</sup> In contrast to the earthquake area, inflow of refugees and the problem of internally displaced people have immediately resulted in increased income and property poverty because of restrictions faced by relevant aid programs, and up until now refugees and internally displaced people represent one of the least protected and poorest layers of population in Armenia.

the economy<sup>16</sup>, while in agriculture, during 1991-1992, as a result of the land privatization, the number of jobs increased almost twice and, subsequently, productivity fell more than twice, enabling a huge segment of population survive the economic crisis. At the same time, the entire agricultural sector was placed on the subsistence basis drastically decreasing the share of agricultural production for sale.

53. In contrast to the Soviet period, reasons for prevalent spread of poverty during the period of economic crisis were of economic nature and were preconditioned by unprecedented economic decline. Having entailed widespread impoverishment<sup>17</sup> of the population, this decline has drastically widened income inequality as well<sup>18</sup>.
54. Economic and energy crises and accompanying transportation blockade made the socio-economic and living conditions of the population practically unbearable driving hundreds of thousands people to leave the country in expectation to find job, relatively better living conditions and social protection in foreign countries<sup>19</sup>. The period of 1991-1993 left deep scars in the psychological and historical memory of the part of population that stayed in the country.

### 2.1.3. ARMENIA: 1994-2002 ECONOMIC GROWTH, POVERTY AND INEQUALITY

55. Economic growth in Armenia restarted in 1994 and has been continuing till now at a quite high rate, averaging at 6.68% in 1994-2002. The main growth factor has been the start of large-scale financial inflows from two sources in the environment of economic and social activities stabilization, macroeconomic stabilization and adoption of a liberal model of economic and trade regulation. The two sources of financing were official foreign and international assistance, which in average made some 7% of GDP, extended mainly through grants and concessional loans, as well as substantial inflow of unofficial money transfers, which averaged around 8.9% of GDP. Unofficial money transfers generated from persons who migrated from Armenia in 1980-90-ies or who work abroad on temporary basis.

#### 2.1.3.1. Economic Growth and Poverty

56. According to official statistics, up to 2001 employment did not increase as a result of economic growth<sup>20</sup>. In the 1990-1993 economic crisis, after substantial increase of employment in agriculture, situation stabilized in the range of 550 000-580 000 employed people, while each percent growth in non-agricultural sector in 1994-2001 coincided with 0.6 percentage point decrease in employment. The main reason for this was that economic growth in Armenia has not been broad-based and has been concentrated in a few developing clusters, which were linked to grant investments or concessional loans (for example, construction), import substitution (for example, food processing and, to some extent, light industry), or export of goods raw materials for which are mainly imported for processing and finishing purposes (jewelry, and diamond processing).
57. On the other hand, employment remains relatively stable in the inflated and poorly paid social infrastructure. This factor does not allow for proportionate increase of remuneration of employees in this sector, since swift and substantial increase of budget resources allocated for maintenance of this sector

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<sup>16</sup> These cuts totaled 47.4 percent of jobs in non-agricultural sector in 1989. Cuts persisted in 1990-2002. Staff reductions in economic crisis period were embodied in unpaid protracted leaves (idleness), while in the period of economic growth these were carried out as real redundancy measures. It is symptomatic that drastic increase of employment in agriculture after privatization stabilized during the economic growth period, i.e. in the range of 550 000-580 000.

<sup>17</sup> In 1989-1993 average wages reduced from 220 rubles to 25.4 rubles (in 1989 comparative prices) or 8.6 times. Besides, the share of salaries in income structure of the population has tangibly shrunk, i.e. to 36.8% in 1993 down from 78% in 1988. In addition, Gini coefficient of population income concentration has also increased, i.e. it was 0.19 in 1989 and became 0.35 in 1993 (See: Wider World Inequality Database).

<sup>18</sup> Shrinkage of income and radical changes in income structure, brought about by the economic crisis, Gini coefficient made up 0.606 in 1994 (in 1987-1990 it was 0.27) (See: Wider World Inequality Database).

<sup>19</sup> According to the General Board for Civil Aviation of Armenia, in 1992-1994 more than 600.000 people migrated from Armenia. In comparison with the 2001 Census data, population of Armenia was 3,002 million people as of October 2001. According to the NSS data, population of Armenia by the end-2001 was 3,800 million (See: Statistical Yearbook of Armenia, Yerevan, 2002, p24). Thus in 1998-2001 some 800.000 people migrated from Armenia.

<sup>20</sup> In Armenia, as in other CIS countries, employment statistics does not take into consideration shadow employment and self-employment, which are mainly centralized in the sphere of services, at the same time substantially overestimating employment rate in agricultural sector calculated as the number of agricultural household members.

and households consumption directed at this sector is objectively impossible.

58. As a result, new jobs created in developing clusters did not exceed absolute reductions in non-competitive sectors of the economy. Redundancy measures have been undertaken primarily in large and medium size industrial enterprises inherited from the Soviet Union.
59. Despite above-mentioned employment trends recorded during previous years, according to the preliminary data for 2002<sup>21</sup>, employment in 2002 increased by 17.000 people compared to 2001, or 1.34%; in other words, 1 percent economic growth in 2002 resulted in increase of employment by 0.1038 percentage point.

2.1.3.2. Economic Growth and Poverty Reduction

60. According to the 1996, 1998-99 and 2001 household surveys, economic growth has been one of the main factors behind poverty reduction. Reduction of poverty, including reduction in the number of very poor in 1996-1998 (see Table 2.1) took place thanks to the increase in wage income of the employed population, resulting in reduction of the number of employed poor. However, according to the authors of the above surveys, the discrepancies between methodological aspects and sample sizes (4260 households in 1996, and only 900 in Q4 1998) do not allow to consider such comparisons fully reliable. Such comparisons may only be descriptive of poverty development trends.

**Table 2.1. Poverty and economic growth in 1996 and 1998**

	1996	1998
Number of poor population, %	54.7	49.1
<i>including number of very poor population, %</i>	27.7	15.3
Number of non-poor population, %	45.3	50.9
Number of poor population, urban, %	58.8	55.0
<i>including number of very poor population, urban, %</i>	29.6	17.7
Number of non-poor population, urban, %	41.8	45.0
Number of poor population, rural, %	48.0	40.6
<i>including number of very poor population, rural, %</i>	24.4	11.9
Number of non-poor population, rural, %	52.0	59.4
General poverty line, dram per month	10 784	12273
Poverty food line, dram per month	6612	7525
GDP in 1996 prices, Q4, billion drams	223.3	250.4
GDP growth rate 1998 Q4/1996 Q4, %		12.1
Poverty reduction / economic growth, percentage points		0.4628

Source: Armenia. Poverty Update, WB, 2002: Data on 1998 reflect information of the 1998/99 Survey pertaining to Q4 1998.

61. Poverty in Armenia, and particularly the number of very poor, also declined in 1999-2001, according to the data in Table 2.2. The most favorable changes took place in Yerevan, where share of poor decreased by 18.89 percent (against republican average of 9.23 percent), accompanied with lesser inequality of incomes and expenditures, i.e. relevant Gini coefficients decreased by 9.66 and 18.89 percent respectively. This is primarily explained by concentration of economic activities in Yerevan and hence bigger opportunities for income generation than in other parts of the country. In Yerevan, where 33% of the country's total and half of total urban population resides, approximately 50% of industrial output was produced in 2001, as well as 80% of registered retail turnover and 76.3%<sup>22</sup> of services production were recorded in Yerevan.

<sup>21</sup> Socio-economic Situation in Armenia in January-December 2001, Yerevan, 2003, p.102.

<sup>22</sup> See Armenia 2002 Statistical Yearbook, Yerevan 2002, p. 88.

Table 2.2. Poverty in 1998/99 and 2001\*

	1998/1999	2001	2001/1999**
Sum of the poor people (poor and very poor)	55.05	50.9	-7.53
including Urban	58.27	51.9	-10.93
<i>of which: Yerevan</i>	55.17	46.7	-15.3
<i>Other cities</i>	61.68	56.7	-8.07
Rural	50.76	48.7	-4.05
Including number of very poor population, %	22.91	16.0	30.16
including Urban	23.17	18.3	-21.01
<i>of which: Yerevan</i>	21.45	16.8	-21.67
<i>Other cities</i>	25.47	19.6	-23.04
Rural	22.55	11.3	-49.88
Gini coefficient of income concentration	0.593	0.535	-9.78
including Urban***	0.529	0.466	-11.9
<i>of which: Yerevan</i>	0.507	0.458	-9.66
<i>Other cities</i>	0.56	0.477	-14.82
Rural	0.632	0.583	-7.75
Gini coefficient of consumer expense concentration	0.372	0.344	-8.75
including Yerevan	0.434	0.352	-18.89
General poverty line, dram/month	11735	12019	2.4
Food poverty line, dram/month	7194	7368	2.41
Depth of poverty, %	19.0	15.1	-20.52
Acuteness of poverty, %	9.0	6.1	-32.2

\* *Estimations made per capita.*

\*\* *Changes of indicators are calculated in percents.*

\*\*\* *Gini coefficients of income concentration are calculated for the households, which displayed current income.*

*Source: 1998/99 and 2001 household surveys.*

62. In other cities of the Republic, certain poverty and inequality reduction took place: the share of poor population decreased by 8.06 percent and income concentration Gini coefficient decreased by 14.82 percent. However, more limited chances to find jobs and generate income, or engage in agricultural activities in places other than Yerevan and rural areas, are the main reasons for tangibly higher poverty rates in other cities of the Republic. The lowest degree of poverty and inequality reduction is in rural areas, where the share of poor decreased only by 4.18 percent (against the republican average of 9.23 percent), while inequality remains evidently higher than in urban areas. Low rates of poverty reduction are a consequence of unfavorable dynamics of prices for sales of agricultural produce: in 2001 it was 84.7% of the year 1997, while consumer price index was at the level of 102.9%<sup>23</sup> from 1997; in other words, relative deterioration of terms for producing and selling agricultural produce took place. High level of income distribution inequality is preconditioned by large and persisting differentiation<sup>24</sup> amongst agricultural produce for sale and productivity, which particularly depends on climatic conditions and the size of land parcels, as well as on restricted potential for income diversification and involvement in non-agricultural activities compared with urban areas.
63. Major specifics of poverty dynamics during 1999-2001 pertain to changes in its structure, i.e. number of very poor population decreased by 30.16 percent. Such a decrease in the number of very poor basically refers to two factors, one of them being introduction of family allowance system in 1999 (see Table 2.3)

<sup>23</sup> *Estimated on the basis of Statistical Yearbook of Armenia, Yerevan, 2002, p. 430.*

<sup>24</sup> *Gini coefficient for concentration of production of agricultural produce and proceeds on sales thereof in 1998/99 and 2001 totaled 0.728 and 0.734 respectively. Tiny volume of agricultural produce for sale and consumption of own production are the major prerequisites of poverty and inequality in rural areas.*

and the second is economic growth which resulted in increase of incomes generated from hired employment and self-employment. However, the above-mentioned increases, as well as the volume of family allowances have not been sufficient to overcome the poverty line and a substantial share of very poor people moved up to the category of poor. Taking into account that during 1999-2001 family allowance budget decreased from dram 21.1 billion to dram 16.09 billion and the number of households eligible for benefits decreased from 226.5 thousand in 1999 to 173.3 thousand in 2001, the major factor for reduction in the number of very poor should be the increased wages as a result of economic growth. Evidence to this is the fact that during 1999-2001, despite tightened scoring formula, the degree of proper targeting of allowances has not essentially increased. On the contrary, inclusion error (share of non-poor receiving family benefits) in 1999 totaled 22.9%, and in 2001 it was 32.1%. However, family allowances together with other social transfers constituted substantial share of household incomes. Thus, in 1998/99 these constituted 71.4% of total income of the 10% poorest population (of which all benefits represented 12.5%), 45.5% of the next 10% of population (of which 18.7% all benefits), 35% of the third decile group (and 12.9% of total benefits). The 2001 situation is as follows: social transfers constituted as high as 57.7% (including 18.7% benefits) of total incomes of the first 10% of the poorest population, 48.4% of the next 10% (including 15.3% benefits), and 52.9% of the third decile group (including 8.6% benefits)<sup>25</sup>. According to the 2001 Integrated Household Survey, 1 percent growth in the targeting level for family allowances in the four poorest decile groups, where money incomes were lower than the poverty food line, will reduce poverty at national level by average 0.163 percentage points, and the number of very poor will be reduced by 0.66 percentage points.

**Table 2.3. Distribution of social benefits by population income groups, 1998-2001**

	Distribution of Social Benefits by Population Income Groups					Total Benefits (billion drams)
	1	2	3	4	5	
1998	15.6%	30.5%	25.8%	12.4%	15.7%	13.44
1999	31.8%	33.8%	14.6%	9.4%	10.2%	21.10
2001	30.0%	25.31%	22.98%	14.1%	7.6%	16.09

*Note: The 1998 social benefits include child allowances, lonely mothers and other allowances. Pensions, unemployment benefits stipends and privileges are not included. The 1999 social benefits include only family benefits. Benefit distribution indicators are generated on the basis of 1998/99 and 2001 Surveys. The 1998 and 2001 indicators are annual, while the data on 1999 reflect January-June.*

*Source: Armenia, Poverty Update, The World Bank 2002, Results of 2001 Sample Household Survey.*

64. As the Table 2.4 below shows, substantial increase was recorded in respect of employment income of the very poor, which is a direct result of economic growth. The 1998/99 and 2001 household surveys come to evidence that number of hired jobs has not increased<sup>26</sup> in the economy, however, self-employment<sup>27</sup> has increased, on which official statistics is not in a position to collect comprehensive information yet<sup>28</sup>. During 1999-2001 incomes of population, especially of the very poor part, including income from work, increased at tangibly higher rates, than the average growth rates. In contrast to reduction in the number of hired employees, employment of poor and very poor people in this period did not reduce. Growth of self-employment among poor and very poor is almost twice higher than among non-poor population. This trend, at various rates, has been observed at national level, in Yerevan, in other cities and rural areas.

<sup>25</sup> These figures do not coincide with the data in Table 2.3, since family benefit scheme was introduced in January 1999, while the household survey covers the period between July 1998 and 1999 June.

<sup>26</sup> According to the integrated survey results, number of hired workers in 2001 (compared to 1999) reduced by 3.62 percentage points, or 1775 jobs.

<sup>27</sup> According to the same survey, number of self-employed in Armenia in 1999-2001 increased by 41.48%, constituting 174.2 thousand people in 2001 (123.2 thousand in 1999).

<sup>28</sup> According to official statistical data, number of self-employed in 2001 totaled 55 thousand people (48.5 thousand in 1999).

**Table 2.4. Dynamics of indicators on poor population's income from work, hired employment and self-employment in 1998/99 and 2001**

	Income deciles						
	1	2	3	4	5	Average for the 5 first deciles	Average for the 5 last deciles (non-poor)
	<i>2001 to 1998/99, in percent</i>						
<b>Total, Armenia</b>							
Total monthly income	189.7	179.8	160.4	147.0	147.1	156.1	118.1
Income from hired work per employee	212.9	274.4	168.9	169.1	202.9	195.8	162.6
Income from self-employment, per capita	439.9	116.3	152.7	108.9	216.8	150.4	126.9
Number of hired employees	161.1	112.1	72.2	134.9	82.3	100.1	94.3
Number of self-employed	412.1	450.3	346.2	386.3	177.7	288.0	100.5
<b>Including: Yerevan</b>							
Total monthly income	156.3	147.8	139.2	143.5	141.2	143.3	119.7
Income from hired work per employee	229.8	123.8	150.9	245.0	163.2	174.8	190.8
Income from self-employment, per capita	105.9	310.8	227.4	127.8	439.5	238.0	191.1
Number of hired employees	64.3	78.2	83.6	66.1	70.0	72.3	88.3
Number of self-employed	213.2	1293.6	85.7	508.6	66.3	139.3	91.8
<b>Other cities</b>							
Total monthly income	179.8	175.4	169.5	153.9	151.5	160.5	109.0
Income from hired work per employee	211.5	313.4	275.3	149.8	141.3	186.1	98.6
Income from self-employment, per capita	747.4	159.8	94.6	103.1	224.1	146.1	80.8
Number of hired employees	101.9	90.7	52.8	150.6	100.5	95.5	98.4
Number of self-employed	274.9	566.1	436.7	363.9	927.7	485.0	125.5
<b>Rural areas</b>							
Total monthly income	201.3	196.5	173.7	149.2	141.7	159.5	132.1
Income from hired work per employee	241.4	172.0	127.1	140.6	77.0	130.9	128.0
Income from self-employment, per capita	508.0	126.0	144.5	174.6	93.9	142.2	61.9
Number of hired employees	260.3	321.3	249.4	109.1	245.4	208.6	145.6
Number of self-employed	2374	354.0	356.3	233.8	261.9	358.7	131.4

65. However, the gap between employment incomes and employment rates of poor and non-poor population still remains very large despite its substantial shrinkage that took place in 1999-2001, as shown in Table 2.5 below:
66. The impact of economic growth on poverty reduction during 1999-2001 is presented below in quantitative terms: economic growth in this period made 119.8 percent from 1998 level, of which GDP in agriculture made 111.9% and growth in non-agricultural sector made 123.4% of their respective levels in 1998. Poverty rate during the same period decreased by 9.23 percentage points, including 15.26 percentage point in urban areas (18.89 percentage points in Yerevan, and 13.02% in other cities) and 4.18 percentage points in rural areas. Thus, 1 percent of economic growth results in 0.468 percentage points of poverty reduction. In agricultural sector 1% growth of GDP resulted in 0.35 percentage points poverty reduction in rural areas, while 1% growth of GDP in non-agricultural sector led to 0.65 percentage points of poverty reduction among urban population, including 0.804 in Yerevan and 0.554 in other cities.

**Table 2.5. Population employment incomes, and indicators on hired and self-employed people, 1998/99 and 2001\***

	1998/99			2001		
	1 Poor	2 Non-poor	3 1/2	1 Poor	2 Non-poor	3 1/2
<b>Total Armenia</b>						
Total monthly income, dram	2806	19358	0.145	4381	22865	0.191
Income from hired work per employee, dram	5754	18126	0.317	11269	29485	0.382
Income from self-employment, per capita	5698	25759	0.221	8570	32685	0.2622
Number of hired employees, thousand people**	175.3	315.0	0.556	175.5	297.1	0.59
Number of self-employed, thousand people	26.9	96.3	0.279	77.4	96.8	0.799
<b>Including: Yerevan</b>						
Total monthly income, dram	3969	19666	0.201	5689	23.543	0.241
Income from hired work per employee, dram	7090	19497	0.363	12395	37202	0.333
Income from self-employment, per capita	5261	22059	0.238	12521	42170	0.296
Number of hired employees, thousand people	95.7	143.1	0.668	69.2	126.5	0.547
Number of self-employed, thousand people	19.2	36.7	0.524	26.8	33.6	0.796
<b>Other cities</b>						
Total monthly income, dram	2538	16526	0.153	4075	18013	0.226
Income from hired work per employee, dram	6234	20535	0.303	11602	20293	0.571
Income from self-employment, per capita	5422	22331	0.242	7924	18053	0.438
Number of hired employees, thousand people	64.4	109.3	0.589	61.5	107.6	0.571
Number of self-employed, thousand people	5.87	32.2	0.182	28.5	40.5	0.704
<b>Rural areas</b>						
Total monthly income, dram	2293	21059	0.109	3657	27820	0.131
Income from hired work per employee, dram	7515	19919	0.377	9841	25512	0.385
Income from self-employment, per capita	5444	61834	0.088	7744	38277	0.202
Number of hired employees, thousand people	21.4	41.7	0.513	44.7	60.8	0.735
Number of self-employed, thousand people	6.0	17.6	0.343	21.7	23.2	0.938

\* Employment and incomes indicators for the poor are presented as average for the first 5 deciles. Employment and incomes indicators for non-poor are presented as average for the last 5 deciles.

\*\* Employment indicators are calculated through extrapolation of survey results to entire population. They are not in concert with official statistical data. Employment in agriculture is not taken into account.

Source: 1998/99 and 2001 integrated household surveys.

67. Analysis of population income dynamics during 1999-2001 shows that the primary factor preconditioning growth of the incomes has been economic growth (see Table 2.6). Economic growth preconditioned the 58.1% (62.3% in Yerevan) of the incomes growth among poor population (first 5 deciles of income). Social policy measures provided for 45.8% (36.5% in Yerevan) of the growth in poor's income; 0.37% of the growth is attributed to internal and foreign assistance (8.8% in Yerevan); and 7.15% of the growth is attributed to other incomes (7.3% in Yerevan).

Table 2.6. Factor analysis of income dynamics in 1999-2001

	Changes in income during 1999-2001, drams		Changes in income during 1999-2001, %	
	Poor	Non-poor	Poor	Non-poor
<b>Total, Armenia</b>				
Total	1412.5	2962.2	100	100
<i>Economic growth, including</i>	821.6	1379.3	58.1	46.5
Incomes from hired employment	581.1	2807.7	41.1	94.7
Income from self-employment	337.6	368.9	23.9	12.4
Income from sale of agricultural produce	-97.1	-1797.3	-6.9	-60.6
<i>Social policies, including</i>	646.5	954.2	48.6	32.2
Pensions	514.0	726.9	36.4	24.5
Benefits	172.4	227.3	12.2	7.6
<i>Aid-related, including</i>	5.3	2062.7	0.3	69.6
From residents of Armenia	-8.7	-124.2	-0.6	-4.2
From abroad	14.0	2187.0	0.9	73.8
<i>Other income</i>	-100.9	-1434.2	-7.1	-48.4
<b>Yerevan</b>				
Total	2043.6	1412	100	100
<i>Economic growth, including</i>	1273.4	4179.8	62.3	296.0
Incomes from hired employment	659.6	3353.5	32.2	237.5
Income from self-employment	608.8	862.3	29.8	61.0
Income from sale of agricultural produce	4.9	-36.0	0.2	-2.5
<i>Social policies, including</i>	745.8	453.1	36.5	32.0
Pensions	539.9	362.8	26.4	25.7
Benefits	205.8	90.2	10.1	6.3
<i>Aid-related, including</i>	179.4	102.4	8.78	7.25
From residents of Armenia	160.2	-35.9	7.8	-2.5
From abroad	19.2	137.9	0.98	9.7
<i>Other income</i>	-149.8	-3312.6	-7.33	-234.6

Source: 1998/99 and 2001 integrated household surveys.

### 2.1.3.3. Economic Growth and Inequality

68. Despite certain reduction during 1999-2001, inequality in Armenia, and particularly income inequality, still stays at a very high level, rather dangerous for stability of the population, constituting 0.535 in 2001 (0.593 in 1999), which is one of the highest indicators in the world<sup>29</sup>. Like in other CIS countries and in contrast to Western and Central European transition countries, the degree of inequality of consumption expenses is tangibly lower than in case of incomes, with respective Gini coefficients of 0.372 in 1999 and of 0.344 in 2001<sup>30</sup>. The reasons for such discrepancies in Armenia in 1998/99 and 2001 lie with more proportionate distribution of expenses (consumption expenditures of the 1-6<sup>th</sup> decile groups totaled dram 6,973.5 in 1999; average money income dram 3,135; in 2001 these indicators were dram 7,269 and 5,163 respectively; the indicators of the 7-9<sup>th</sup> decile groups were dram 15,798 and 11,883 respectively, and dram 16,325 and 16,396 in 2001; and the indicators of the 10<sup>th</sup> decile group in 1999 were dram 37,013 and 53,539, and dram 37,645 and 56,547 in 2001). Thus incomes and expenditures figures were consistent only in the 7-9<sup>th</sup> decile groups; in 1-6<sup>th</sup> deciles expenditures substantially exceeded incomes, and in the 10<sup>th</sup> decile incomes were higher than expenditures<sup>31</sup>. Income inequalities are primarily preconditioned by reduction of incomes generated from hired employment and social transfers, that changed both in volume (drastically reduced absolute rates of wages, pensions and benefits) and in structure (drastic increase in unequal distribution of wages) terms (compared with the Soviet Armenia),

<sup>29</sup> Since the estimations of inequality and income polarization in this document are based on the official statistical data, which don't cover the actual processes of income creation, distribution and redistribution, and on the other hand the factors that will influence the main demographic indicators in the near future have not been carefully analyzed, it is envisaged to give more attention to these questions during future revisions and update works of PRSP. (See Section 5, Chapter 13)

<sup>30</sup> As a rule, such discrepancies between incomes and expenditures pertains in countries with large share of shadow economy and high shadow incomes, Armenia among them. See *ՀՀ Ժողովուրդի ծախսերի և եկամուտների անհավասարությունը 1999-2001 թվականներին*. Աճի և բնակչության հարցերի վերաբերյալ հարցազրույցներ. 2001, հատված II, Գլուխ 3.

<sup>31</sup> This situation does not have clear explanation, and without additional surveys it is impossible to state which indicator is more reliable, expenditure or income. Most probably real inequality is lower than displayed by income inequality indicators, but at the same time higher than the ones displayed by expenditure inequalities.



while the number of recipients of incomes from hired employment has tangibly decreased. Other incomes, including property and business activity related incomes, as well as informal transfers are distributed very disproportionately, and the growth of their shares in total income leads to a growth in inequality. Inequality reduction during 1999-2001 is primarily preconditioned by faster growth of employment income as shown in the Table 2.7. In addition, inequality in Armenia is related to place of residence. Both in 1998/99 and 2001 inequality in rural areas was higher than in Yerevan and other cities, mainly pertaining to disproportionate distribution of income generated on sales of agricultural produce, which had been the main source of income for rural residents. Inequality reduction in rural areas during 1999-2001 took place due to shrinking share of income generated on sales of agricultural produce and its substitution by hired employment and self-employment incomes that were substantially more equally distributed.

Table 2.7. Income inequality in Armenia in 1998/99 and 2001\*

	1999			2001		
	Structure %	Gini Coeff.	Impact	Structure %	Gini Coeff.	Impact
<b>Armenia</b>						
Money income, per capita, month	100	0.593		100	0.535	
Including: hired employment income	20.01	0.444	-2.045	29.14	0.446	-2.026
Self-employment income	8.65	0.671	0.924	9.77	0.448	-0.659
Income from sale of agricultural produce	26.15	0.713	4.424	14.99	0.742	3.405
Pensions	5.35	0.097	-0.434	9.08	0.177	-3.066
Family benefits				2.75	0.235	-0.669
All benefits	2.05	0.202	-0.269	3.15	0.216	-0.942
Transfers	15.34	0.723	2.823	20.9	0.758	5.096
Other incomes	22.4	0.582	0.133	12.87	0.526	-0.147
<b>Yerevan</b>						
Money income, per capita, month	100	0.507		100	0.458	
Including: hired employment income	29.4	0.411	-2.285	39.3	0.472	0.544
Self-employment income	7.85	0.575	0.608	11.7	0.388	-0.832
Income from sale of agricultural produce	0.4	0.881	0.298	0.29	0.745	0.08
Pensions	5.81	0.1	-0.466	7.53	0.141	-2.394
Family benefits				1.87	0.31	-0.247
All benefits	1.7	0.207	-0.209	2.27	0.227	-0.526
Transfers	21.1	0.683	5.029	0.215	0.696	5.12
Other incomes	33.6	0.583	2.978	17.34	0.521	1.081
<b>Other cities</b>						
Money income, per capita, month	100	0.56		100	0.477	
Including: hired employment income	26.6	0.458	-2.218	35.0	0.462	-0.522
Self-employment income	8.13	0.636	0.711	11.18	0.465	-0.1323
Income from sale of agricultural produce	3.19	0.60	0.158	1.68	0.474	-0.04
Pensions	6.45	0.221	-0.864	12.03	0.174	-3.63
Family benefits				4.61	0.223	-1.137
All benefits	3.81	0.239	-0.523	5.13	0.215	-1.341
Transfers	24.23	0.767	7.773	22.86	0.783	7.012
Other incomes	27.63	0.618	1.778	12.31	0.536	0.737
<b>Rural areas</b>						
Money income, per capita, month	100	0.632		100	0.583	
Including: hired employment income	8.48	0.408	-1.227	13.73	0.398	-2.55
Self-employment income	9.61	0.734	1.1372	6.54	0.483	-0.66
Income from sale of agricultural produce	60.8	0.728	6.693	41.6	0.734	6.251
Pensions	4.32	0.185	-0.566	8.14	0.22	-2.958
Family benefits				2.05	0.281	-0.394
All benefits	1.24	0.388	-0.186	2.29	0.283	-0.689
Transfers	5.31	0.655	0.123	18.8	0.756	3.238
Other incomes	10.21	0.351	-1.595	8.77	0.496	-0.765

\* The "Impact" column describes percentage change of general income inequality in case of 1% change in the relevant income source. Negative value in this column means inequality reduction, and the positive means growth. The rate of impact is dependant on the change in relevant Gini coefficient (inequality in distribution of the given and total income) and the share of the given source of income in the composition of total income.

Source: 1998/99 and 2001 integrated household surveys.

## 2.2. DESCRIPTION OF POVERTY AND SPECIFIC FEATURES

69. Despite certain reduction in poverty and inequality during 1999-2001, poverty in Armenia remains widespread, with approximately half of population being poor and income concentration Gini coefficient persisting at socially tense value of higher than 0.5. Poverty has specific features depending on territorial, seasonal, gender and age differences as well as on the size of families, their education level and vulnerability.
70. Territorial differences of poverty levels in Armenia pertain to the degree to which conditions for agriculture activities are favorable, to the number of bordering regions and to the affiliation to earthquake zone (for urban population). To this end, in 2001 the poorest population was in regions with predominantly rural population and most unfavorable conditions for agricultural activities, or which had suffered consequences of Artsakh conflict the most. Thus, in 2001 highest poverty levels were recorded in Gegharqunik, Aragatsotn and Tavush marzes, 62.2%, 60,3% and 59.7% respectively (republican average was 51.9%)<sup>32</sup>. The next is Shirak where poverty level was 57.8%<sup>33</sup>.
71. Poverty in Armenia is of clearly seasonal nature, as shown in the Table 2.8. Incomes and expenditures reach highest values in the 4th quarter and their minimum level is in the 1st quarter, which, if more proportionately distributed, generally corresponds to the dynamics of economic activity in the country. This situation is true for 1998/99 as well. This factor should be taken into account when designing and implementing economic, especially social protection policies. Given the clearly manifested seasonal nature of poverty, it is appropriate to carry out reforms, particularly those that might have negative impact on living conditions of the population, in the second half of the year.

**Table 2.8. Composition of current expenditures of population in 2001**

	Q1	Q2	Q3	Q4
<i>Per capita dram/month</i>				
Food products	7420	8269	8570	9842
Non-food products	1307	1470	1509	1668
Services	1755	1628	1769	2118
Average by the Republic	10482	11367	11848	13628
<i>Memorandum Item</i>				
GDP in billion drams	150.6	234.4	387.7	402.7
<i>% of the Q4</i>				
Food products	75.4	84.0	87.0	100
Non-food products	78.3	88.1	90.4	100
Services	82.8	76.8	83.5	100
Average by the Republic	76.9	83.4	86.9	100
<i>Memorandum Item</i>				
GDP	37.4	58.2	96.2	100

Source: *Marzes of Armenia in Figures, 1998-2001, Yerevan, 2002, p140.*

72. Poverty analysis in terms of gender and age shows that women are more frequently under the poverty line than the men, but poverty risk for the women is not much higher than that for men. The picture is different in case of households where heads are women (see Table 2.9), and which are much more (33%) vulnerable in terms of falling into extreme poverty, than other households. The main explanation lies with lower rate of employment among women than that among men<sup>34</sup>, hence absence of a man, head of a household, increases the degree of vulnerability to falling below the poverty line.

<sup>32</sup> Share of rural population in Gegharqunik marz in 2001 was 63.2%, in Aragatsotn it was 72% and in Tavush 60%. The Gegharqunik marz is predominantly 1900 meters elevated above the sea level, while ¾ of Aragatsotn marz is more than 2000 above the sea level. The bordering areas suffered most as a consequence of Artsakh conflict are located in Tavush marz (See: *Marzes of Armenia in Figures, 1998-2001, Yerevan, 2002*).

<sup>33</sup> Preconditioned by extremely restricted number of employment opportunities and highest unemployment rates.

<sup>34</sup> According to the Integrated Demographic and Health Survey of 2000, rate of employment of women between 15-49 years old was 32% (46.7% that of men). See: *Armenia: Demographic and Health Survey, Yerevan 2001*.

**Table 2.9. Gender poverty in 1998/99 and 2001, %**

	Men		Women		Households with women as head in 2001, members of household	Average in Armenia	
	1999	2001	1999	2001		1999	2001
Non-poor	45.2	49.5	44.7	48.9	44.9	45.0	49.1
Poor	32.5	35.3	31.8	34.5	33.8	32.1	34.9
Very poor	22.3	15.2	23.5	16.6	21.3	22.9	16.0

\* Source: NSS Integrated Household Surveys 1998/99 and 2001.

73. In contrast to widespread opinions, the risk of pensioners, and especially households having members who are pensioners to fall into poverty in Armenia, like in other CIS countries, is not higher than the risk attributed to the rest of population (Table 2.10). Main explanation for this is the fact that despite insufficiency of pensions in absolute terms, these are more equally distributed than other incomes of population, and represent a stable source of income for predominant share of elderly population; availability of other sources of income would reduce poverty vulnerability for vast majority of pensioners.

**Table 2.10. Poverty among pensioners in 2001, in percent, by members of household**

	Households with pensioners among members	Households consisting of pensioners	Lonely pensioners	Average in Armenia
Non-poor	43.2	64.1	69.2	49.1
Poor	37.6	29.7	25.8	34.9
Very poor	19.2	5.8	5.1	16.0

Source: NSS Integrated Household Survey 2001.

74. Among the age groups the least protected one are children, whose level of poverty in 2001 was substantially higher than in all other groups (Table 2.11). Levels of poverty among working age and elderly people are almost the same, while the risk of inclusion of children in poverty is 18% and 17.7% higher than that of the working age and elderly people, respectively. In addition, the high risk for the age group between ages 30 and 39 to fall into poverty is very characteristic, since this group suffers unemployment risks most of all and faces the highest vulnerability to unemployment.

**Table 2.11. Poverty by age groups in 2001\***

Age group	Poverty, %		Relative risk, %		% of total population	% in poor population	
	Total	Very poor	Total	Very poor		Total	Very poor
Up to 7 years	58.1	19.8	+14.1	+23.75	9.16	10.36	11.15
7-16	57.2	19.8	+12.3	+23.75	21.32	23.74	25.94
Children, total	57.47	19.8	+12.5	+23.75	30.48	34.10	36.09
17-22	50.3	15.6	-1.7	-2.5	11.26	11.03	10.8
23-29	47.1	14.8	-7.4	-7.5	11.04	10.12	10.04
30-39	53.5	17.6	+5.1	+10.0	14.2	14.79	15.36
40-49	47.4	14.0	-6.8	-12.5	13.41	12.37	11.53
50-59	39.3	9.6	-22.8	-40	5.58	4.27	3.29
Total working age population	48.68	14.96	-4.36	-6.5	55.5	52.58	51.03
60 and above	48.8	13.8	-4.1	-13.75	14.02	13.32	11.89
Total	50.9	16.0	0	0	100	100	100

\*Relative risk of exposure to falling into category of poor and/or very poor shows the extent to which the given age group deviates from the average indicator.

Source: NSS integrated household survey 2001.

75. Relative exposure of children to extreme poverty is also the highest, 23.75%, and is much higher than the poverty risk. Note that relative exposure of elderly people to extreme poverty is the lowest among all the age groups, 2.1 and 3.6 times lower than that of working age population and of children, respectively. This comes to prove once more that even small, but equally distributed, incomes will substantially reduce the risk of poverty, especially that of extreme poverty.
76. Poverty level is directly correlated to the size of a household: the more members in a household the higher its exposure to poverty.

**Table 2.12. Poverty and size of household in 1999 and 2001**

	Average h/h size		Average number of children in h/h		Average number of elderly in h/h		Average number of working age in h/h	
	1999	2001	1999	2001	1999	2001	1999	2001
Non-poor	3.83	3.69	0.93	0.73	0.55	0.56	2.35	2.4
Poor	4.52	4.37	1.33	1.11	0.62	0.67	2.57	2.59
Very poor	5.13	5.06	1.69	1.51	0.69	0.66	2.75	2.89
<b>Total</b>	<b>4.29</b>	<b>4.08</b>	<b>1.19</b>	<b>0.95</b>	<b>0.6</b>	<b>0.61</b>	<b>2.5</b>	<b>2.52</b>

*Source: NSS Integrated Household Surveys 1998/99 and 2001.*

There is also a direct correlation between poverty level and the number of children in a household: the larger the number of children the higher the poverty level and the exposure to poverty and extreme poverty. There is another relationship between the number of children and the poverty level: according to regression analyses of the NSS, increase of the number of children of 0-14 years old resulted in 7.5% (in 1999) and 5.3% (in 2001) decline in living standards per child. Note that despite the fact that general poverty level in rural areas is slightly lower than in urban areas, children residing in rural areas are more often poor.

**Table 2.13. Poverty level by the number of children in households in 1998/99, %**

	1 child	2 children	3 children	4 children	5 and more children
Non-poor	51.1	42.0	34.1	34.1	22.8
Poor	30.0	35.0	35.5	31.8	34.3
Very poor	18.9	23.0	30.4	34.1	42.9

*Source: NSS Integrated Household Survey 1998/99.*

77. Sample surveys also display direct correlation between the education level and exposure to poverty. This correlation is clearly manifested in case of people who have higher education, i.e. the risk of falling into poverty and extreme poverty by this group has substantially decreased in 1999-2001 taking into account that the number of very poor has drastically decreased as well. To certain extent, exposure to poverty among people with secondary vocational education has also shrunk. In respect of people with secondary and elementary education, their exposure to poverty increased in 1999-2001, remarkably for the latter. These processes are mainly preconditioned by the fact that if redundancy measures are exercised they will first affect people without professional qualification, and finding new job for a person with secondary or elementary education is much more complicated than for people with professional education. Note that extreme poverty risk is the highest for people with secondary education, again related to lack of profession/qualification, as well as to the fact that people with secondary education constitute more than a half of officially registered unemployed<sup>35</sup>.

<sup>35</sup> In 2001 people with secondary education made up 56.9% of the officially registered unemployed. See: Armenia. Social Snapshot and Poverty. Statistical and Analytical Report. Yerevan, 2002, p. 44.

**Table 2.14. Poverty by education in 1999 and 2001, %\***

	Higher		Secondary vocational		Secondary		Elementary	
	1999	2001	1999	2001	1999	2001	1999	2001
Non-poor	56.7	65.5	47.1	50.9	42.7	46.1	42.9	41.8
Poor	29.4	25.2	32.9	34.2	32.3	37.6	32.3	43.0
<i>Poverty Risk</i>	-8.4	-27.7	+2.49	-2.0	+0.62	+7.73	+0.62	+23.2
Very poor	13.9	9.3	20.0	14.9	25.0	16.3	24.8	15.2
<i>Poverty Risk</i>	-39.3	-41.8	-12.6	-6.8	+9.1	+1.8	+8.2	-5

\* 18 years old and above.

Source: NSS Integrated Household Surveys 1998/99 and 2001.

78. In addition to the above-mentioned factors preconditioning poverty in rural areas (unfavorable conditions for involvement in agricultural activities and low degree of agricultural production for sale) important role is attached to the size of land plots, access to credit, as well as conditions of road infrastructure connecting with main markets. According to the results of 2001 integrated household survey, the larger the size of a land plot, the smaller is the poverty risk. Only a small share of rural households makes use of borrowed funds, i.e. only 18%, of which 58.7% are non-poor households, 32.6% poor and 8.7% are very poor rural households. In respect of roads it should be mentioned that their absence or poor conditions substantially restrict mobility of rural population, increase cost and tangibly limit job opportunities outside a rural community. According to the Survey of Poorest Communities in Armenia<sup>36</sup>, it is not incidental that for the poorest rural communities a distinctive feature is poor road communication with marz centers and other communities.
79. The relation between residential conditions and poverty is clearly manifested among people residing in hostels (populated primarily by refugees) and temporary shelters (populated primarily by refugees and earthquake area residents), where share of poor and very poor population is higher than the average republican indicator, i.e. 34.5 and 37.9% in 2001 in hostels, and 44.6 and 7.7% in temporary shelters.
80. In respect of access to utilities, differentiation of households is linked to place of residence, rural or urban, rather than to purely poverty factors (except for heating issues). Thus in 2001 41.6% of households residing in urban areas had decent residential conditions (kitchen, cold water, bathroom and toilet), while in rural areas only 14.2% of households had such conditions.
81. According to the results of 2001 integrated household survey, 94.2% of households had heating, including 99.8% in rural areas, and 91.5% in urban areas. Central heating was made available to 9.7% of urban households and 1.2% of rural households. The households, who did not have central heating, used wood (56.5%), electricity (17.9%), gas (7.2%), oil (1.7%), and 1.7% of households heated their premises with individually owned heating systems.
82. 85% of households received centralized drinking water supply services. 29% of households had only 2 hours of water per day, 30% had 3-4 hours, 11% had 5-6 hours, 5% had 7-10 hours and 18% had 24-hour drinking water supply. 94.2% of urban and 64.7% of rural households made use of centralized water supply systems. 7% of households used springs or wells, 6% received bringing-in water services, and 1% had own water supply system.
83. Results of the above-presented poverty analysis enable identification of the following major poverty categories:
- (i) Multi-member households, especially households with many children;
  - (ii) Unemployed and employees with low wages (including employees of education, culture and arts sectors);
  - (iii) Refugees and post-conflict groups, especially those residing in hostels and temporary shelters;

<sup>36</sup> See: Armenia Social Trends. Information and Analytical Report, December 2002, Yerevan, UNDP.

- (iv) The part of lonely pensioners and disabled persons who do not have sources of income other than pensions.
84. **Children:** Poverty risk largely depends on structure of a household and number of dependants in it. Households having children below age of 7, or 3 and more kids are among the most exposed to poverty risk. Very poor households are 1.5 times more burdened with children than non-poor families. Presence of a child financially strains family expenses in terms of ensuring education for children, which is considered one of the most important human development factors. Predominant portion of expenses on children education is placed with the household<sup>37</sup>. According to the 2001 integrated household survey, average monthly expense per pupil makes dram 2600.
85. **Unemployed:** Unemployment is closely linked with poverty. According to Sample Labor Force Survey conducted by NSS in 2001, unemployment constituted 32.8% of economically active population<sup>38</sup>, exceeding by 3 times officially registered unemployment. Regression analysis shows that an unemployed member aggravated the depth of poverty of the household by 12.6% (in 2001). In 2001 relative risk of extreme poverty in a household headed by an unemployed made 70%, which is the highest among all age and social categories, and the poverty risk made 8.9%.
86. At the same time, 1/5 part of employed population is very poor. Moreover, poverty studies identified that 45-47% of employed population is poor. According to the methodology of the International Labor Organization (ILO), the employed people, who receive low wages and are not able to maintain minimum needs of their families and dependants, should be considered part of hidden unemployment. Employed poor are primarily represented in the sectors of education, culture and arts, and their average monthly wage for years has lagged two and more times behind average republican indicator.
87. **Refugees:** Dedicated study<sup>39</sup> of vulnerable groups among refugees and local population identified that in terms of at least three types of poverty, indicators describing refugees are substantially worse than those of local people. Thus, human poverty indicator was 1.7 times lower, extreme poverty indicator - 1.4 times lower, and subjective self-perception indicator - 1.2 times lower than similar indicators for the local people. The most hopeless conditions are with refugees residing in temporary shelters. Every fifth of them is seriously ill. 60% of the chronically ill, lonely elderly and handicap people covered by the study were refugees. It means that extremely hard conditions of refugees predefine the picture of poverty both in a particular location and in the country as a whole. In-depth studies of refugees have also identified that persistence of being poor is not only preconditioned by the fact of being a refugee (loss of flat and property, moral and psychological shock, etc) but also by even further increase in their vulnerability because of unsolved poverty problems in the course of many years.

### 2.3. HUMAN POVERTY IN ARMENIA

88. As in almost all transition economies, poverty and inequality in Armenia are issues<sup>40</sup> largely preconditioned by material (income) factors and characteristics of human poverty and inequality per se are different from those peculiar to developing countries. The Table 2.15 shows that social and demographic indicators during transition period have not substantially deteriorated, in particular, the life expectancy indicator, which might have been anticipated in view of drastic increase of poverty and inequality after regaining independence.

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<sup>37</sup> *Education, Poverty and Economic Activities in Armenia, UNDP-Government of Armenia, Yerevan, 2002.*

<sup>38</sup> *Armenia: Social Snapshot and Poverty, Statistical and Analytical Report, Yerevan, 2002, p. 45.*

<sup>39</sup> *See: Poverty in Vulnerable Groups of Population in Armenia, UN Coordinator Fund, UNHCR, UNDP, Yerevan, 1999.*

<sup>40</sup> *See: Making Transition Work for Everyone. Poverty and Inequality in Europe and Central Asia – The World Bank, Washington, D.C. 2000.*

**Table 2.15. Armenia: main social and demographic indicators**

	1989	1995	1996	1997	1998	1999	2000	2001
Life expectancy, years	72.0	72.5	72.9	73.9	74.7	73.2	73.4	73.5
<i>of which: men</i>	69.0	68.9	69.3	70.3	70.8	70.7	70.9	71.0
<i>women</i>	74.7	75.9	76.2	77.3	78.0	75.5	74.7	75.9
Child mortality rate (per 1000 live births)	20.4	14.24	15.52	15.43	14.73	15.44	15.56	15.35
Births (per 1000 of population)	21.6	15.83	15.73	14.39	13.03	12.1	11.4	10.7
Deaths (per 1000 of population)	6.0	8.02	8.09	7.85	7.65	8.0	8.01	7.99
Natural growth (per 1000 of population)	15.6	7.81	7.64	6.54	6.38	4.1	3.39	2.71
Number of public schools	1379	1403	1404	1400	1407	1407	1407	1416
Pupils in schools, thousand	597.8	572.0	584.7	591.8	596.6	583.5	564.6	535.5
<i>% of 7-17 years old population</i>	90.5	83.5	84.9	85.5	85.5	83.5	80.8	76.4
Number of students in higher educational establishments, % of population	1.86	1.74	1.74	1.83	1.96	2.06	2.02	2.18
Number of doctors (per 10000 of population)	42.7	40.9	41.7	42.6	42.9	41.9	40.9	38.2
Number of beds in hospitals (per 1000 of population)	90.2	92.8	87.4	83.6	83.4	78.1	69.4	53.8

**Table 2.16. Major social and demographic indicators in Armenia and other countries (1998)**

	Armenia	Georgia	Azer- bajjan	Eastern Europe and CIS	OECD countries	Developing countries
Life expectancy at birth, years (1995-2000)	73.5 (2001)	72.7	69.9	68.7	76.2	64.4
Infant mortality rate (per 1000 live births)	15.35 (2001)	19	36	26	12	64
Child mortality rate (per 1000 live births)	30	23	46	33	14	93
People with life duration under 65, % (1995-2000)	19.8	17.5	22.1	24.6	12.5	28
Tuberculosis (per 100 000 of population)	28.9	155.4	60.5	67.6	18.4	68.6
Number of doctors (per 1000 of population) 1992-95	382 (2001)	436	390	345	222	78
GDP per capita, US Dollars <sup>1</sup>	705 (2001)	970	480	2110	20900	1250
Public expenditure on education in 1995-97, % of GDP	2.69 (2001)	5.2	3.0	4.9	5.0	3.8
Public expenditure on health, 1995-98, % of GDP	1.34 (2001)	0.7	1.2	4.5	6.2	2.2
Expenditure on pension insurance, % of GDP, 1999	3.8	2.6	4.2	11.5 <sup>2</sup>	9.7	-
Public social spending, % of GDP, 1999	2.2	1.3	2.7	4.6 <sup>2</sup>	6.2	-
Average caloric content per day, 1997	2371	2614	2236	2907	3380	2263
Consumption of electricity, kW.h per capita	1696	1438	2330	8008	4095	884
Human development index, ranking	93	70	90			

<sup>1</sup>Calculations are based on number of de facto population.<sup>2</sup>Countries of Eastern Europe only.

Source: UNDP Human Development Report 2000, Poverty reduction, Growth and Debt Sustainability in Low-income CIS Countries, IMF, WB, 2002.

89. Relatively mild impact of drastic increase in poverty and inequality on a number of major demographic and social indicators during transition and relatively good position of Armenia in terms of human development index of the UNDP<sup>41</sup> (international comparisons are presented in Table 2.16) are explained by sufficiently developed social infrastructure inherited from the Soviet Union, which, though inefficient, obsolete and under-financed, nevertheless is in a working condition.
90. Number of births decreased twice during 1989-2001 preconditioned by drastic decline in living standards of population during transition and reflecting increase of expenditures related to delivery and bringing up of children. The trend of reduction in average size of families is another evidence to the above, recorded during all three integrated surveys.

<sup>41</sup> Relative to per capita GDP level.

91. Increase of mortality rate is not related to economic developments and reflects current aging of population, it has not influenced life expectancy, which has shown stabilization trends in the current period.
92. Another matter of concern is the reduction of the share of pupils engaged in secondary education network, primarily taking place in higher grades of secondary schools (9-10 grades), while share of pupils in lower grades (1-8 grades) remains stable and constitutes around 97%.
93. While maintaining education and health sectors quantitative indicators comparable with OECD countries, Armenia is substantially behind of OECD countries, developing and other transition economies in terms of relative volumes of financing<sup>42</sup> while financing in terms of absolute amounts per capita in Armenia is 5.45 times lower than the average indicator in East-European and CIS countries, 55.1 times lower than the average of OECD countries, and 2.5 times lower than the average in developing countries (for health sector, these indicators are 10, 137 and 2.91 times respectively). In the circumstances of such substantial under-financing these sectors could not survive in the existing volumes if funded only from state resources. The volume of officially recorded co-financing by population of only higher education constituted 0.73% of GDP in 2001 and was twice more than that of state financing. Financing of health sector by population in the first quarter of 2002 totaled dram 23.613 billion<sup>43</sup>, or 1.74% of GDP in 2002 (1.5 times more than the volume of 2001 state financing).
94. Maintaining such levels of state financing for education and health sectors threatens the addressing of issues related to UN declared human development concepts and adopted by our country. Moreover, shifting financing burden on population will aggravate the fundamental problem of human poverty. Results of several surveys<sup>44</sup> undertaken in Armenia showed that 31% of households are not able or hardly can survive incremental expenses needed for education. 7% of poor children do not attend public schools. 70% of ill people do not have access to health services.
95. The above situation is an evidence of limited capacity for the Government to effectively implement redistribution and social functions.
96. **Qualitative Description of Poverty:** Qualitative approach to poverty study addresses human behavior, description of behavior of the poor in particular, in view of its social, cultural, political and economic components<sup>45</sup>. Qualitative studies of poverty in Armenia<sup>46</sup> identify particularly the following matters for concern:
- (i) Increasing social layering, distrust of poor and middle class towards rich, state and local authorities;
  - (ii) Changes in intra-household relations in poor families mainly preconditioned by impossibility of many men to sustain the functions of head of family, poverty risks and its impact on family stability, reduction in the number of marriages and births, and increase in the marriage age, as well as distortion of sex proportions because of mass migration;
  - (iii) Weakening of traditionally strong intra-family ties and shrinking efficiency of informal mutual assistance, particularly for elderly and refugees;
  - (iv) Withdrawal of poor from social life and participation in ceremonies, and the perception of being isolated from the society, which may be considered one of the most dangerous socio-psychological consequences of poverty.

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<sup>42</sup> Relative volumes of financing: financing/GDP.

<sup>43</sup> Report: *Integrated Survey of Expenditures of Medical Institutions and Drug-Stores and Households for Acquisition of Health Care Services*, Yerevan, 2002, p. 26.

<sup>44</sup> See: *Social Indicators of Poverty*, UNDP-NSS, Yerevan, 1998; *Poverty among Vulnerable Groups in Armenia*, UN Coordinator Fund, UNHCR, UNDP, Yerevan 1999; See: *Armenia. Social Snapshot and Poverty. Statistical and Analytical Report*. Yerevan, 1998; *Humanitarian Aid and Community Development Needs in Armenia*, UNDP, 2001; *Education, Poverty and Economic Activities in Armenia*, UNDP-Government of Armenia, Yerevan, 2001.

<sup>45</sup> See: *When Things Fell Apart. Qualitative Studies of Poverty in the FSU*, WB, 2003.

<sup>46</sup> *When Things Fell Apart. Qualitative Studies of Poverty in the FSU*, WB, 2003, Chapters 6 and 7.



## SECTION 2. PRSP GOALS AND MAIN POLICY DIRECTIONS

### CHAPTER 3. PRSP GOALS

#### 3.1. POVERTY AND INEQUALITY REDUCTION

97. PRSP measures aimed at ensuring sustainable and high economic growth and at the implementation of efficient social protection policies are expected to result in poverty reduction at the following rates: to 41% in 2005; to 29.1% in 2010; and to 19.7% in 2015, down from 2001 level of 50.9%. At the same time, very poor population will constitute 14.2% in 2005, 10.6% in 2010 and 4.1% in 2015, down from 2001 level of 16%.
98. Internationally recognized indicators for the measurement of poverty, i.e. number of people with daily expenses below 1, 2 and 4 US Dollars<sup>47</sup>, in 2005 they will constitute 13.8%, 35.9% and 68.3% respectively, in 2010 4%, 20.5% and 42.1%; and in 2015 2.7%, 6.8% and 27.6% (down from the level of 2001 of 29.4%, 58.6% and 81.5%).
99. Such a reduction in the poverty levels will largely depend on accelerating growth rates of employment incomes of and social transfers (pensions and benefits) to poor population.
100. Main indicators of poverty reduction are presented in the Table 3.1 below.

**Table 3.1. Main benchmark indicators of poverty reduction under the PRSP**

	2001	2003	2004	2006	2009	2012	2015
GDP per capita, thousand drams <sup>1</sup>	391.5	489.1	532.8	631.5	808.3	1005.7	1244.2
GDP per capita, USD <sup>1</sup>	704.8	834.2	904.2	1061.0	1338.0	1639.9	1998.6
GDP per capita, PPP USD <sup>2</sup>	2 382.1	2 819.5	3 056.2	3 586.1	4 522.3	5 542.8	6 755.4
Number of poor, % of total population	50.9	46.2	43.7	37.9	30.8	26.3	19.7
<i>Including number of very poor, % of total population</i>	16.0	15.2	14.7	13.5	11.4	8.6	4.1
Number of population having less than 1 USD income per day <sup>3</sup> , % of total population	29.4	23.7	17.9	10.0	4.3	3.4	2.7
Number of population having less than 2 USD income per day <sup>3</sup> , % of total population	58.6	52.0	43.4	31.9	24.3	14.1	6.8
Number of population having less than 4 USD income per day <sup>3</sup> , % of total population	81.5	76.6	72.8	64.0	52.5	33.5	27.6
Number of under-weight children, % of total number of children below the age of 5	3.0 (2000)	2.9	2.8	2.7	2.3	1.8	1.4
Number of under-height children, % of total number of children below the age of 5	13.0 (2000)	12.5	12.0	11.5	9.5	8.0	6.0
<b>Memorandum Item</b>							
<i>Number of de facto population<sup>4</sup>, thousand people</i>	3 002.6	3 013.8	3 020.5	3 038.1	3 074.2	3 125.7	3 196.0

<sup>1</sup> Calculations are based on number of de facto population. <sup>2</sup> PPP for the entire period is assumed at the level of 3.38. <sup>3</sup> Poverty indicators estimated in USD PPP are based on the projections of incomes of the population. <sup>4</sup> 2001 figures are as of October 10, 2001. Projections do not take into account migration.

Source: NSS data, PRSP projections.

101. Inequality will also reduce in the program period. Gini coefficient of income concentration in 2005 will be 0.491, in 2010 0.466 and in 2015 0.446 (0.535 in 2001).
102. Reduction of inequality will mainly depend on the income inequality reduction resulting from income policies of the government (correspondence of minimum wage with poverty food line and ensuring increase of remuneration to employees in social infrastructures and public administration), as well as on increasing pension rates and substantial improvement in benefit targeting.
103. Main target indicators in respect of income inequality reduction are presented in the Table 3.2.

<sup>47</sup> These amounts are calculated using the relative USD PPP in Armenia, which in 2001 was 3.38, and assuming this value unchanged in between 2002 and 2015, i.e. at the level of 2001. 3.38 PPP means that purchasing capacity of 1 US Dollar in Armenia equals to purchasing capacity of 3.38 Dollars in the US.

**Table 3.2. PRSP main indicators of inequality reduction**

	2001	2003	2004	2006	2009	2012	2015
Gini coefficient of income inequality	0.535	0.510	0.498	0.483	0.469	0.458	0.446
<i>Including: for employment incomes</i>	<i>0.446</i>	<i>0.443</i>	<i>0.441</i>	<i>0.438</i>	<i>0.433</i>	<i>0.428</i>	<i>0.423</i>
<i>for social transfers</i>	<i>0.161</i>	<i>0.074</i>	<i>0.068</i>	<i>0.076</i>	<i>0.086</i>	<i>0.082</i>	<i>0.080</i>
Annual income of the 20% poorest population, thousand drams	55.4	85.0	101.4	140.3	192.3	242.7	311.0
Annual incomes of the second 20% population, thousand drams	120.1	159.4	184.8	239.7	339.2	453.1	603.5
Annual incomes of the third 20% population, thousand drams	195.4	242.0	278.5	359.1	510.9	681.1	903.3
Annual incomes of the fourth 20% population, thousand drams	318.3	361.9	408.7	526.2	834.6	1102.2	1443.1
Annual incomes of the richest 20% population, thousand drams	945.5	1235.6	1362.9	1668.7	2207.5	2751.6	3416.9
Incomes of the poorest population, % of incomes of the richest strata	5.9	6.9	7.4	8.4	8.7	8.8	9.1

*Source: NSS data, PRSP projections.*

### 3.2. HUMAN POVERTY REDUCTION

104. As shown in PRSP poverty analysis section, level of human poverty in Armenia is substantially lower than that of material poverty, and human development is comparable with economically far more developed and richer countries. To this end, maintenance of human poverty potential and its further strengthening, as well as substantial reduction of currently more tangible manifestations of human poverty, is one of the utmost priorities of the PRSP.
105. Fulfillment of these priorities will be contingent upon two main factors, i.e. measures to enhance efficiency of relevant structures and increase in public spending.
106. The main objective for the education sector is to upgrade quality of education and enhance the access to it. The expected results of the programmed measures are:
- (i) By 2015 increase of school-life expectancy for 6 years old child to 12.3 years up from 11.6 years estimated for 2003<sup>48</sup>;
  - (ii) The completion rate (ratio of number of graduates to respective number of entrants) for general secondary schools will reach 85% in 2015 (65% in 2002)<sup>49</sup>.
107. The main objectives for the health sector are to upgrade quality of and enhance the access to the health services, particularly for poor population. The expected results of the programmed measures are:
- (i) Reduction of child mortality: under-5 mortality rate will decrease to 10 per 1 000 live births from 15.9 registered in 2002, while infant mortality will be decreased to 8.5 per 1 000 live births from 13.4<sup>50</sup> of 2002;
  - (ii) Reduction of mother mortality from 34.4<sup>51</sup> per 100 000 live births in 2001 to 10 per 100 000 live births in 2015.
108. Target indicators of human poverty are presented in the Table 3.3 below:

<sup>48</sup> The indicator is estimated within the limitation of 6-21 years old period.

<sup>49</sup> The completion rate for basic education is currently near to 100%, and in 2003-2015 this level will be maintained.

<sup>50</sup> Despite of the different methodologies mother mortality and infant mortality indicators of the NSS substantially differ (almost twice as low) from the results of the Demographic and Health Survey of 2000 (See: Demographic and Health Survey of Armenia, Yerevan 2001).

<sup>51</sup> This indicator is calculated as average for three years on the basis of the NSS information.

**Table 3.3. Main target indicators of human poverty reduction**

	2001	2003	2006	2009	2012	2015
<b>EDUCATION</b>						
School-Life Expectancy, years*		11.6	11.8	12.0	12.1	12.3
General secondary school completion rate, %	63	67	69	77	80	85
Consolidated budget expenditures in education sector, % of GDP	2.5	2.4	3.1	3.6	3.8	4.0
<b>HEALTH</b>						
Child mortality rate per 1 000 live births	18.8	15.6	14.4	13.0	11.5	10.0
1-5 years old child mortality rate per 1 000 live births	18.5	17.1	15.0	14.0	13.0	12.0
Mother mortality rate per 100 000 live births**	40.8	27.0	22.0	15.5	13.0	10.0
Consolidated budget expenditures in health sector, % of GDP	1.3	1.4	1.9	2.1	2.3	2.5
<b>ACCESS TO DRINKING WATER</b>						
Accessibility of drinking water network, %						
For urban population	87	90	93	95	98	98
For rural population	45	47	49	51	70	70
Average duration of water supply, hours						
In cities	8	10	12	14	24	24
In villages	14	16	18	20	24	24

\* At the age of 6-21 years old.

\*\* Three-year average.

## CHAPTER 4. POVERTY AND INEQUALITY REDUCTION POLICY PRIORITIES

109. From the perspective of poverty reduction an important precondition is to ensure sustainable high economic growth. As the analysis shows, economic growth is the factor, which in 1999-2001 preconditioned 58.1% increase of the income of population (Table 2.6). In contrast to widespread opinions, economic growth in Armenia in 1996-2002 has become a factor contributing to poverty reduction, despite the fact that economic growth has resulted in substantial reduction of hired jobs; however, these reductions were netted out by substantial boom in self-employment, and accelerated growth of their incomes. Major directions related to poverty reduction aspect of economic growth policies will be enhancement of self-employment and promotion of small businesses and improvement of business environment that will lead to increased work incomes of poor population. Policies for stimulating economic growth will be analyzed and the ones with more emphasized pro-poor orientation will be advocated.
110. Improving governance at all levels will have a significant impact on poverty eradication, including the development and persistent implementation of anti-corruption policies. Governance related factors that impede poverty eradication (factors propagating poverty) would be identified and taken into account in future governance reform programs.
111. Redistribution technologies will be revised, including at political, economic and social levels. Special importance will be attached to increasing the level of public participation in decision-making, underlining the necessity for enhanced public awareness and knowledge. Democratic mechanisms are also considered to be important, emphasizing the need for improving social partnership, social inclusion and social participation. The government anticipates significant contribution and support from the well-off segment of the population and will make efforts to creating conditions conducive to that support.
112. From the perspective of inequality reduction, main priorities are the efficient social and income policies. Social transfers in 1999-2001 ensured 45.8% growth in incomes of poor population (Table 2.6). Priorities of social policies are presented below:
  - (i) In the area of social assistance: ensuring better targeting of family benefits and maximum possible rate of inclusion of the poor in the scheme, increased family benefits to overcome

- poverty food line;
- (ii) In the area of social insurance: increased efficiency, transfer of pensions of non-insurance nature to the state budget framework, increased pensions to overcome poverty food line, regular increase of pensions and transition from number of worked years-based system to insurance contribution system.
113. The main priority in income policies will be creation of opportunities for population to generate income exceeding general poverty line, including the increase of salaries for the employees in budgetary and social sectors so that these salaries exceed the level of general poverty line at least twice, as well as increasing the minimum salary rate to reach the level of general poverty line.
114. Next priority is enhancing financial capacities of the state in order not to jeopardize sustainable economic growth rates. Such a growth may be reached through increasing tax revenues (annual increase of 0.3-0.4% of GDP mainly through improvement of tax administration and simplification of tax systems) and expanding state budget deficit within safe limits. From the perspective of poverty and inequality reduction such a growth is crucial to ensure the increase of social spending share in total public expenditures.
115. Next priority in terms of poverty and inequality reduction is the increase of public investment programs and their targeting to mitigating poverty (including human poverty) and inequality problems. Such programs include, in particular:
- (i) Program of construction and improvement of rural roads, which would enable more efficient agriculture, closer main agricultural markets, will optimize distribution of educational and health establishments and enhance their efficiency;
  - (ii) Program of water supply with the objectives to enhance accessibility of drinking water to the population, ensure, in principle, 24 hours water supply and increase the quality of the supplied water;
  - (iii) Irrigation program that aims at increasing irrigated land areas and regulating irrigation water supply systems.
116. In the area of mitigating rural poverty and inequality the priorities are placed with accelerating growth in incomes from sales of agricultural produce, introduction of insurance schemes co-financed by the government and agricultural farms against nature and climatic risks, increasing access to financial and credit resources, creation of effective land market, introduction of micro-credit facilities for development of cooperatives, self-employment opportunities and small businesses.
117. Promotion of self-employment and small businesses through establishment of micro-crediting facilities is a priority for the most vulnerable groups as well, such as households with woman as its head, unemployed, refugees and displaced persons.
118. In the context of poverty and inequality reduction the main priority in education sector will be the further development of general education system with particular emphasis on increased enrolment in the higher grades of secondary schools. Special attention will be given to affordability issues existing in vocational education sector. Enhancing the efficiency and increasing public financing of the sector are the main directions to reach these targets. In particular, budget expenditures in education sector in 2015 will increase by 1.7 percentage points of GDP compared with 2002 and will amount to 4% of GDP.
119. Accessibility of health services will be enhanced through increased public expenditures apportioned to the sector, relevant intra-sector redistribution of public funds, as well as optimization and administration reforms leading to increased efficiency. It is expected to increase state budget expenditures in health sector to 2.5% of GDP in 2015 up from 1.2% of GDP registered in 2002.
120. The priorities in respect of poverty reduction among refugees and internally displaced people include improvement of residential conditions of people residing in hostels and temporary shelters, including their inclusion in the residence-title distribution system.

## CHAPTER 5. THE PRSP AND THE MILLENNIUM DEVELOPMENT GOALS

121. Target indicators for reduction of poverty, including extreme poverty, set in the PRSP are fully in line with the targets envisaged in the Millennium Development Goals<sup>52</sup>, i.e. reduce the number of people living with less than USD 1 per day at least by half by the year 2015 (compared to 1990). In other words, the number of people living with less than USD 1 per day should be reduced to 14.5 percent of the total population. Armenia will achieve this indicator by 2005,<sup>53</sup> and in 2015 this indicator will be 2.7 percent.
122. According to PRSP projections, Armenia will exceed the MDG projected average indicator for Europe and Central Asia of 8.7 percent of population living with less than USD 2 per day by 2015<sup>54</sup>. In 2015 it will amount to 6.8 percent in Armenia.
123. The mentioned indicators can be achieved only through stable and rapid rates of economic growth. It is planned that in 2003-2015 the annual GDP per capita growth will be 5.1 percent, instead of the 3.6 percent projected for poverty reduction by MDG.
124. Armenia currently is not developing programs for eradication of hunger<sup>55</sup>. Nevertheless, facts pointing to malnutrition are alarming, particularly those indicating the large share of U5 children with below normal weight and height. In 2000 these indicators for Armenia were as follows:<sup>56</sup>
- (i) the share of children with below normal weight was 3 percent on average, with substantial regional variation: from 0.7 percent in Yerevan up to 9.3 percent in Kotayk marz;
  - (ii) the share of children with below normal height was 13 percent on average, with substantial regional variation: from 8 percent in Yerevan up to 32 percent in Gegharqunik marz.

These facts are directly linked to poverty and malnutrition. PRSP targets corresponding to the relevant MDG targets are presented in Table 3.1.

125. The second MDG goal, i.e. universal enrolment in elementary school by 2015, was, in effect, already achieved during the early years of the Soviet Union. In 2001, the enrolment rate of children aged 8-15 in the educational system amounted to 98.7 percent, whereas the literacy rate among the population aged 15-24 was 99.8 percent<sup>57</sup>. According to PRSP projections these levels will be maintained.
126. The third MDG goal, i.e. promote gender equality and women's empowerment is a multi-factor issue. Having formal equality and higher level of education, which is characteristic to Armenia and a number of other CIS countries (in 2001 the ratio of girls to boys in secondary school constituted 1.02, in higher educational system the ratio was 1.2), as well as comparable poverty levels (see Table 2.9), women, nevertheless, lag behind men by average salaries, earning at around 69 percent of men's salaries in 2001<sup>58</sup>. This fact, being combined with the absence of formal discrimination, is explained by the smaller share of women in areas of activity with high incomes and their large share in social services sector, where salaries are notably lower. According to PRSP projections, high level of enrolment in educational system among women will continue also in 2003-2015, while differences in incomes will decline due to increase in salaries of workers in the social sector. On the other hand, the government will promote wider involvement of women in income generating activities, particularly small

<sup>52</sup> *Millennium Development Goals, 2000.*

<sup>53</sup> *In the case, where population's incomes are used as poverty indicator. If expenditures are taken into account, then Armenia has exceeded this indicator already in 1999.*

<sup>54</sup> *Millennium Development Goals, 2000, p. 5.*

<sup>55</sup> *A good approximation of the number of people suffering from continuous malnutrition can be the number of individuals who consume less than 1900 calories per day, which according to FAO is the lower limit for continuous malnutrition. According to the results of the 2001 household survey, the share of such people in the entire population amounts to 14.4 percent. In this regard, the target indicators of PRSP for poverty reduction correspond to the second goal of MDG relating to poverty reduction, i.e. reduce by half the share of people, whose consumption is lower than the minimum energy needs.*

<sup>56</sup> *National Statistical Service (Armenia), Ministry of Health (Armenia), and ORC Macro, 2001, Armenia Demographic and Health Survey 2000, Calverton, Maryland.*

<sup>57</sup> *Human Development Report, UNDP, 2003, p. 200.*

<sup>58</sup> *Human Development Report, UNDP, 2003, p. 311.*

businesses, for example through micro-credit systems. Currently women's participation in the governance system is very low. Here also the government will take measures, up to establishing quotas, in order to substantially increase women's participation in governance.

127. Maternal and infant mortality projections presented in Table 3.3 ensure the achievement of fourth and fifth MDG goals, i.e. by 2015 compared to 1990 reduce the U5 mortality rate by two-thirds, (this indicator amounted to 23.8 in 1990), and also reduce maternal mortality rate by three-fourth, (this indicator in 1990 was equal to 34.8 per 100 000 live births)<sup>59</sup>.
128. The sharp increase in financing of healthcare projected within PRSP will provide for more effective countermeasures against socially dangerous diseases, particularly HIV/AIDS, malaria and tuberculosis, preventing the spread of HIV/AIDS, almost totally eradicating mortalities from malaria and sharply reducing tuberculosis mortalities, thus achieving the seventh and eight targets of MDG.
129. In the environmental sector, it is planned to maintain and increase country's forest resources.
130. Projections of indicators on access to drinking water presented in Table 3.3 are also in line with the relevant MDG target.
131. At present, people living under temporary shelter (earthquake zone and refugees) constitute 5.1 percent of the entire population. According to PRSP projections, by 2015 their numbers will amount to 1-1.5 percent of the population, and the issue will be totally resolved by 2020 (MDG target 11).

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<sup>59</sup> Average for 1988-1990.

## SECTION 3. POVERTY REDUCTION STRATEGY

### CHAPTER 6. ECONOMIC GROWTH PROMOTION AND POVERTY REDUCTION

#### 6.1. PRSP MACROECONOMIC FRAMEWORK

132. The comprehensive solution to poverty and inequality reduction depends mainly on economic growth. High economic growth will in the long run necessarily result in employment expansion and in increase of the wage incomes, the main source of income of the population; at the same time, being the primary source for government revenues it will enlarge the capacity of the government to redistribute incomes.
133. Starting 1994, continuous economic growth has been recorded in Armenia, at an average rate of 6.68% per annum. Nevertheless, it has yet been impossible to restore the income levels pertinent to the first three years of transition as at 2002. Should these rates be maintained, however, in 2005 it would be possible to double the GDP level of 1994, and exceed the 1990 level.
134. Economic developments of the recent years provide grounds to think that stable and favorable macroeconomic environment, microeconomic and structural changes supported by external assistance may ensure high rates of economic growth in the coming decade, at an average of 5.5-6.5% per annum. The baseline scenario for macroeconomic projections is based on SAC-5 and PRGF programs implemented by the Government in cooperation with the World Bank and IMF and calls for consistent and comprehensive implementation of policies and measures agreed therein.
135. The following developments are projected for main macroeconomic indicators:
- (i) Real GDP in the program period will display stable growth trends. GDP real growth rate of at least 7% is projected for 2003. In 2004-2008 annual GDP growth will be 6%, while by the end of the program period it will stabilize at the level of 5% per annum;
  - (ii) Consumer prices will have stable behavior with average annual increase of 3% throughout the program period;
  - (iii) Investments (investments/GDP) in 2015 will grow by 5 percentage points from the level of 2002, reaching 24.3%. At the same time national savings will increase at higher rates (6.6 percentage points of GDP increase compared to 2002) thus narrowing the investment/savings gap. Public investments will stabilize as a percent of GDP in the range of 4%, and government savings will show gradually growing trends;
  - (iv) Total revenues of the state budget, by 2015 will amount to about 20% of GDP, which is by 2 percentage points higher than the level of 2004. At the same time significant changes will take place in the structure of budget revenues due to higher increase in tax revenues (an increase of 3.4 percentage points of GDP within respective period). State budget expenditures will grow at lower rates leading to shrinkage of budget deficit. Deficit-to-GDP ratio during 2005-2010 will stabilize at the level of 2% of GDP, while for 2015 it is projected at 1.6% of GDP.
  - (v) Export of goods and services during 2004-2015 (in dollar terms) will grow at higher rates than imports (average annual of 9.2% and 7.4% respectively). This will serve as the main factor for the improvement of current account; starting 2010 current account deficit/GDP ratio will stabilize at the level of 4.5% of GDP against 6.5% programmed for 2003.
136. Macroeconomic projections for the program period are presented in the Table 6.1 below<sup>60</sup>.

<sup>60</sup> The PRSP macroeconomic framework is projected based on the actual data for Q1, 2003. Given the significantly higher than projected growth rates during H1, 2003, we expect that the annual growth rate would surpass those envisaged under the PRSP projections. For the same reason, there can be differences between the macroeconomic projections done at a later period which are included in the government programs, particularly, the macroeconomic projections within the PRGF (IMF's Poverty Reduction and Growth Facility) program.

**Table 6.1. PRSP macroeconomic framework: projections of main indicators**

	2002	2003	2004	2005	2006	2009	2012	2015
	Actual	Prog.	Projections					
	<i>In percent of GDP, unless otherwise indicated</i>							
<b>National Income and Prices</b>								
Real GDP, year-on-year % change	12.9	7.0	6.0	6.0	6.0	5.5	5.0	5.0
Gross Domestic Product, billion drams	1357.3	1474.1	1609.4	1757.1	1918.4	2485.0	3143.4	3976.3
Gross Domestic Product, million US dollars	2365.1	2514.0	2731.1	2967.0	3223.3	4113.1	5125.7	6387.6
Per Capita GDP, US dollars <sup>1</sup>	786	834	904	980	1061	1338	1640	1999
CPI (average), year-on-year % change	1.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0
<b>Investment and Saving</b>								
Investment	19.5	22.6	20.6	20.4	20.8	21.9	22.7	24.3
General Government	4.7	6.8	5.4	4.5	4.4	4.3	4.1	4.0
Other	14.8	15.8	15.2	15.9	16.4	17.7	18.6	20.3
National Savings	13.4	16.1	14.8	14.9	15.5	17.3	18.5	20.0
General Government	2.6	0.8	1.7	1.3	1.7	2.1	2.1	2.4
Other	10.8	15.3	13.1	13.6	13.9	15.2	16.3	17.6
<b>Fiscal Sector</b>								
Central Government								
Total Revenue and Grants	19.2	19.5	17.8	18.1	18.2	18.7	19.4	19.9
<i>of which: Tax Revenues</i>	14.6	15.0	15.3	15.7	16.2	17.3	18.1	18.7
Grants	3.5	4.1	2.1	1.9	1.7	1.0	0.8	0.7
Total Expenditure	20.1	21.8	20.4	20.3	20.2	20.8	21.4	21.4
Current Expenditure	14.5	15.3	14.7	15.5	15.4	16.1	16.9	17.2
Capital Expenditure	4.6	6.7	5.3	4.3	4.3	4.2	4.0	3.9
<i>of which: Grant-financed</i>	2.2	3.2	1.5	1.4	1.2	0.6	0.5	0.4
Fiscal Balance (accrual)	-0.8	-2.5	-2.6	-2.2	-2.0	-2.0	-1.9	-1.6
<b>External Sector</b>								
Exports	29.6	30.5	30.7	31.0	31.2	31.9	33.2	34.6
Imports	45.8	46.5	46.0	45.6	45.3	44.1	43.2	43.1
Current Account	-6.2	-6.5	-5.8	-5.5	-5.2	-4.6	-4.3	-4.3

<sup>1</sup> Calculations are based on number of de facto population.

137. Developments projected within the macroeconomic framework of the PRSP are presented in Table 6.2 by main sectors of economy.
138. The economy will experience substantial structural shifts in 2003-2015: the share of agriculture in GDP will reduce by 7.7 percentage points, while, due to the rapid growth rates, shares of industry and construction sectors will increase by 2.2 and 6.7 percentage points correspondingly. The following developments in main economic sectors are projected within the macroeconomic framework of the PRSP for 2003-2015:
- (i) the value-added in industry will grow by 114% or at annual average rate of 6%, in the context of average annual GDP growth of 5.6%;
  - (ii) the overall growth in agriculture will amount to 33.1%, which is the equivalent of an average annual growth of 2.2% in the program period;
  - (iii) the value-added in construction will grow by 182% or at annual average rate of 8.3%;
  - (iv) the GDP growth generated in transport and telecommunication sector will amount to 102% or an annual average of 5.5%;
  - (v) in trade and services sectors the corresponding indicators will be 86% and 4.9% correspondingly.
139. The economic growth in non-agricultural sectors in 1994-2001 was mainly the result of labor



productivity growth and declining employment, while the number of those employed in the agricultural sector is relatively stable. It is projected that economic growth will also lead to creation of new jobs: generally, it is projected that 248,000 new jobs will be created in 2003-2015, of which 231,000 jobs in non-agricultural sectors.

140. In 2003-2015, 73% of the GDP growth will be attained through labor productivity growth. Productivity growth will account for 63% of the growth in non-agricultural sectors and 90% of the growth in the agricultural sector.

**Table 6.2. Development of economy by sectors: projections of main indicators**

Indicators	2003	2004	2005	2006	2009	2012	2015
	Prog.	Projections					
<b>GDP Structure by Sectors</b>	<i>in billions of drams, current prices</i>						
Industry	303.7	337.9	372.4	406.5	529.1	682.1	875.3
Agriculture	329.6	348.9	365.1	385.4	453.6	525.9	609.9
Construction	231.8	237.9	262.4	294.4	406.8	549.4	739.0
Transport and Communication	95.1	103.8	113.7	124.1	161.5	210.2	265.9
Trade and Services	373.9	418.6	461.3	501.4	644.4	796.4	978.6
Net Indirect Taxes	139.9	162.4	182.3	206.5	289.7	379.4	507.7
<b>Gross Domestic Product</b>	<b>1 474.1</b>	<b>1 609.4</b>	<b>1 757.1</b>	<b>1 918.4</b>	<b>2 485.0</b>	<b>3 143.4</b>	<b>3 976.3</b>
<b>GDP Structure by Sectors (in 2000 constant factor prices)</b>	<i>in percent of GDP</i>						
Industry	22.9	23.5	23.8	23.9	24.3	24.9	25.4
Agriculture	23.1	22.5	21.6	21.0	19.3	17.8	16.4
Construction	17.7	16.7	17.0	17.5	18.9	20.3	21.8
Transport and Communication	7.5	7.5	7.6	7.6	7.7	8.0	8.0
Trade and Services	28.8	29.7	30.0	29.9	29.8	29.1	28.3
<b>Gross Domestic Product</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Growth by Main Sectors</b>	<i>year-on-year % change</i>						
Industry	6.0	8.0	7.0	6.0	6.0	5.5	5.5
Agriculture	2.6	2.8	1.6	2.5	2.5	2.0	2.0
Construction	25.7	-0.4	7.1	9.0	8.0	7.4	7.0
Transport and Communication	2.8	6.0	6.3	6.0	6.0	6.0	5.0
Trade and Services	3.9	8.5	6.7	5.3	4.5	4.1	3.5
<b>Gross Domestic Product</b>	<b>7.0</b>	<b>6.0</b>	<b>6.0</b>	<b>6.0</b>	<b>5.5</b>	<b>5.0</b>	<b>5.0</b>
<b>Labor Productivity</b>	<i>year-on-year % change</i>						
Industry	2.9	3.8	3.4	2.9	2.9	2.7	2.7
Agriculture	2.3	2.5	1.4	2.2	2.2	1.8	1.8
Construction	11.4	-0.2	3.4	4.3	3.9	3.6	3.4
Transport and Communication	1.4	2.9	3.1	2.9	2.9	2.9	2.4
Trade and Services	4.4	8.0	6.1	3.1	2.4	2.2	2.2
<b>Entire Economy</b>	<b>6.3</b>	<b>4.4</b>	<b>4.6</b>	<b>3.9</b>	<b>3.6</b>	<b>3.3</b>	<b>3.3</b>
<b>Employment</b>	<i>year-on-year % change</i>						
Industry	3.0	4.0	3.5	3.0	3.0	2.8	2.8
Agriculture	0.3	0.3	0.2	0.3	0.2	0.2	0.2
Construction	12.8	-0.2	3.6	4.5	4.0	3.7	3.5
Transport and Communication	1.4	3.0	3.2	3.0	3.0	3.0	2.5
Trade and Services	-0.5	0.5	0.6	2.2	2.1	1.9	1.3
<b>Entire Economy</b>	<b>0.9</b>	<b>0.9</b>	<b>1.0</b>	<b>1.6</b>	<b>1.6</b>	<b>1.5</b>	<b>1.3</b>

141. Maintaining such high growth rates in the long run will require a number of fundamental measures, including those of economic policy, which will focus on ensuring the growth of export, introducing basic structures for functioning of knowledge-based economy and ensuring the above-mentioned improvements in economic efficiency and labor productivity. These issues will be discussed in detail

in the strategy for sustainable economic development of Armenia for 2003-2015, which, in effect, will be a supplement to the PRSP, and its target indicators and macroeconomic framework will be in line with those of PRSP.

142. For this reason, the PRSP discusses issues of ensuring economic growth and the relevant economic policy as far as they are directly or indirectly linked to PRSP goals of poverty eradication and reduction of inequality, in particular increasing opportunities for paid work and self-employment, or, in other words, ensuring substantial improvements in opportunities for receiving incomes from employment or entrepreneurial activities for the population, including its poorer segments.

## 6.2. RURAL POVERTY REDUCTION ISSUES

### 6.2.1. SPECIFICS AND EXISTING PROBLEMS

143. As mentioned in Chapter 1 of the PRSP, the level of poverty in rural areas was lower than the national average in 1996-2001. In 2001, 48.7 percent of the rural population were poor, which included the extremely poor population at 11.3 percent, compared to the national average of 50.9 percent for the poor and 16 percent for the extremely poor (see Table 2.2.). The main reason for this is the notably high level of self-sufficiency through subsistence farming among the rural population. Generally, the produce is consumed by the family and only the remainder, amounting to about 40 percent of the production, is marketed, where a certain share of it is bartered for other products<sup>61</sup>. It must be noted that there is no correlation between the level of poverty and farm size (land area, number of animals). Here the level of poverty is mainly the result of low productivity, while in uplands unfavorable conditions are also a contributing factor, such as non-existent or very limited irrigated land, distance from agricultural markets, small production volumes, as well as limited possibilities for other types of employment. These factors are directly linked to the location of the settlement, as presented in Table 6.3.

**Table 6.3. Rural poverty and location of rural settlements**

Indicators	I level: up to 1300 m above sea level	II level: from 1301 to 1700 m above sea level	III level: 1701 m above sea level and higher	Total rural areas
Share of population, %	39.0	26.0	35.0	100.0
Poor, %	42.35	54.93	57.99	50.76
including extremely poor, %	16.37	24.86	28.28	22.55

Source: ISLC 1998/99.

144. On the other hand, the inequality is much higher in rural settlements compared to the national average. In rural settlements the Gini coefficient for income inequality was 0.583 in 2001, compared to the national 0.535 and 0.466 for urban areas (see Table 2.2). The main reason is that the largest share of incomes is generated through farming (about 50 percent of the total income) and that the incomes received from the sale of produce are extremely unequally distributed<sup>62</sup>. The Gini coefficient for concentration of incomes received from the sale of produce was 0.728 in 1999, and in 2001 it increased to 0.734.
145. One of the main characteristics of Armenian agriculture is the very large number of people employed in this sector. According to official statistics, at present there are more than 334,000 farms in the country, where the total number of workers amounts to 550,000 (43.5 percent of the rural population) or 58.9 percent of rural population above age 15 (937,000 people). The workforce is severely underemployed, and its productivity is very low. The share of those working in the sector the whole

<sup>61</sup> Strategy for sustainable agricultural development in Armenia, Yerevan 2002, p. 23. According to some studies (see Armenia's Private Agriculture: 1998 Survey of Family Farms. WB, 1999, p. 2) this indicator was characteristic to farms with irrigated land areas. Farms without irrigated land plots sold only 22 percent of their product.

<sup>62</sup> According to sampling surveys, in 2001 incomes from the sales of agricultural products amounted to 41 percent of the average total incomes of the rural population.

- year is 36.1 percent. About 40 percent of the workforce is employed only 7-9 months per year<sup>63</sup>.
146. In 2002, those working in the agricultural sector constituted 44.4 percent of the total number of the employed, and the share of agriculture in GDP was 23 percent, i.e. the productivity in agriculture was 1.9 times lower than the average and 3.1 times lower than the productivity in industry<sup>64</sup>.
147. Farms are small; the average land size is 1.37ha, varying from 0.61ha in Ararat marz to 3ha in Syunik marz. Non-cultivated lands amount to 15 percent of the total land area. In 2001, 1.68 people were employed on the average farm, the latter had 1.43 heads of cattle, 1.67 heads of sheep and goat, produced 0.91 ton of grain, 1.29 ton of vegetables, 0.95 ton of potato, 142 kg of meat, 1.38 ton of milk and 670 eggs. The average volume of annual production for one farm was 1.015 million drams, including 614,000 drams of crops production, and 401,000 drams of livestock products<sup>65</sup>. The sale of agricultural products has a seasonal nature. About 80 percent of farms sell their agricultural products commercially<sup>66</sup>. Yields are also very low. For example, the average yield of grain, which covers around 60 percent of the total cultivated area, amounted to 1608 kg per hectare in 1997-2001. This can be compared to data from 1998-2000 on the average per hectare yield of grain which amounted to 2067 kg worldwide, 2407 in European and Central Asian countries, 4000 kg in developed countries and 6067 kg in the EU<sup>67</sup>. The average milk production per cow in 2001 amounted to 1000 liter, which is 4-5 times less than the same indicator in developed countries.
148. The use of credits is extremely inadequate as well. As of 1 January 2002, the total credits provided to the agricultural sector amounted to only 7 billion drams or 2.25 percent of the agricultural GDP in 2001. In 2001, the same indicator for industry was 13.2 percent of the GDP, and 8.1 percent for the entire economy<sup>68</sup>.
149. Agricultural insurance systems against natural disasters and weather are practically non-existent, and this role, to some degree, is carried out by the state budget, which provides partial compensation for damages caused by natural disasters and unfavorable weather conditions. However, this system is ineffective and not flexible enough.

### 6.2.2. MAIN DIRECTIONS FOR ERADICATION OF RURAL POVERTY

150. In 2003-2015, the growth of agricultural production will remain the main factor for rural poverty reduction. According to macroeconomic projections of the PRSP, the average annual growth of value-added in the agricultural sector will be 2.2 percent, or a total increase of 33.1 percent throughout the period. The main indicators of agricultural development are presented in Table 6.4.
151. As presented in tables 6.2 and 6.4, the agricultural growth in the projection period will mainly result from the increase in labor productivity. A total increase in productivity of around 29 percent is projected for 2003-2015 (on average 2 percent per year). At the same time, the number of employed<sup>69</sup> will not change significantly and will increase by about 0.22 percent per year. In 2015, the volume of agricultural production will exceed the level of 1990 by about 40 percent. The share of commercial agricultural production will increase notably from the present 40 percent up to 70 percent in 2015. This will provide for a substantial increase in the volume of financial resources available to agriculture and will allow a large number of farms to leave behind the subsistence economy.

<sup>63</sup> The official statistics considers all working age members of family farms as persons employed in agriculture. Thus, the level of economic activity of these individuals is assumed to be 100 percent. In reality, the number of people employed in agriculture, according to the international experience, should amount to 70-80 percent of the economically active population, which is in line with the above estimations.

<sup>64</sup> Agricultural GDP per capita in 2002 was 45,600 drams per month. Considering the 40 percent commerciality of agricultural production, the net monthly output of one worker will amount to 18,000 drams, which can only support minimum subsistence.

<sup>65</sup> Calculated using data from Armenian Statistical Bulletin 2002, Yerevan 2002, p. 307.

<sup>66</sup> Armenia's Private Agriculture: 1998 Survey of Family Farms. WB, 1999, p. 2.

<sup>67</sup> See 2001 World Development Indicators, p. 136.

<sup>68</sup> Calculated using data from the 2001 annual report of the Armenian Central Bank (Yerevan, 2002, p. 149).

<sup>69</sup> Here we are referring to effective employment, which according to some estimations, amounts to 70-80 percent of those officially employed.

**Table 6.4. Projections of the main indicators of agricultural development**

Indicators	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Planned</i>	<i>Projection</i>					
<b><u>GDP and prices</u></b>								
Value-added in agriculture, % change from the previous year	4.4	2.6	2.8	1.6	2.5	2.5	2.0	2.0
Value-added in agriculture, billion drams	312.0	329.6	348.9	365.1	385.4	453.6	525.9	609.9
<i>% of GDP (prices adjusted to the year 2000)</i>	<i>24.1</i>	<i>23.1</i>	<i>22.5</i>	<i>21.6</i>	<i>21.0</i>	<i>19.3</i>	<i>17.8</i>	<i>16.4</i>
Price indices of agricultural products, year-on-year % change	2.2	3.0	3.0	3.0	3.0	3.0	3.0	3.0
<b><u>Employment and productivity</u></b>								
Number of employed, year-on-year % change	0.0	0.3	0.3	0.2	0.3	0.2	0.2	0.2
Labor productivity, year-on-year % change	4.4	2.3	2.5	1.4	2.2	2.2	1.8	1.8
Labor productivity as percentage of productivity in the entire economy, %	54	52	51	50	49	47	45	43
<b><u>Other indicators</u></b>								
Agricultural credits, billion drams	7.0 <sup>1</sup>	10.1	11.9	13.9	16.5	27.5	45.2	67.1
<i>% of value-added in agriculture share in GDP</i>	<i>2.3</i>	<i>3.1</i>	<i>3.4</i>	<i>3.8</i>	<i>4.3</i>	<i>6.1</i>	<i>8.6</i>	<i>11.0</i>
Share of commercial agricultural production in total, %	40 <sup>1</sup>	43.5	46.5	48.0	51.0	57.0	63.0	70.0

<sup>1</sup> Data of 2001.

152. In order to ensure the described growth, it will be necessary to introduce significant changes in mechanisms for financing in agriculture, particularly a sharp increase in credit provision. According to PRSP projections, it is envisaged to increase the volume of agricultural credits by 10 times, which will amount to 11 percent of the sector's GDP by 2015, compared to 2.3 percent in 2001.
153. The Program envisages an average 3 percent annual growth in price indices of agricultural products, which will be achieved through expansion of internal market for agricultural products, as well as through growth of export of produce and foodstuff, the average annual growth of which is projected to be 10 percent.
154. In order to ensure stable agricultural growth and substantially reduce rural poverty and inequality, it is necessary to take a number of important measures, which will focus on:
- (i) substantial increase in productivity and farm incomes, particularly through resolving problems of irrigation and water use, land use, yields, share of commercial production and volumes of production;
  - (ii) establishment and development of sales markets and institutions;
  - (iii) development of financing and insurance institutions for agricultural production;
  - (iv) providing for wider possibilities for non-farm activities.
155. One of the main reasons for current inefficiency of farms, as already mentioned, is their limited resources and small volumes of production, as well as land fragmentation<sup>70</sup>, which makes the collective use of infrastructures particularly difficult. Thus, enlargement of farms is one of the main preconditions for enhancing productivity. In this regard, in 2004-2005, all the conditions necessary for establishment of a land market will be created, in particular, mechanisms for determining the market value of land and transfer of ownership will be in place, land collateral will be used widely, which is also a necessary condition for substantial increase in bank credits provided to agriculture. Since land resources are scarce, limits will be introduced for farm sizes, which will vary by marzes. In order to

<sup>70</sup> Average farm consists of 3 land plots, one of which is irrigated, and the other two are rainfed (see Strategy for sustainable agricultural development in Armenia, Yerevan 2002, p. 23). Thus, agricultural activities are presently conducted on about 1.2 million land plots each with an average area of 0.45 ha.

- include unused land areas in economic activities an inventory of arable land and perennial plantations will be set up, also legal and other mechanisms will be put in place to prevent cases where land is not used or is used unproductively.
156. Irrigated farming accounts for more than 70 percent of the gross crops production. Irrigation and water supply issues are discussed in detail in "Infrastructure Development" section of the PRSP. However, here it must be noted that in 2004-2005 an inventory of the use of country's water resources will be set up; irrigation norms and volumes of water used for irrigation will be defined. The management structure of the system will be improved, including measures for increasing the effectiveness of activities of water users unions. The technical conditions of networks will be improved through public investment programs and water losses in public networks will reduce substantially. Mechanical irrigation systems will be gradually replaced by gravitational systems and modern irrigation technologies will be introduced.
  157. One of the main causes of rural poverty and inequality is the insufficiency of incomes received from the sale of agricultural products. A large-scale road construction program will be implemented in order to ensure reliable and effective communications with main agricultural markets and to enhance the mobility of the rural population (see "Road Construction" section of the PRSP). Another issue is to promote the establishment and operations of institutions for sales and processing of agricultural products. The international experience shows that such institutions normally function in the form of farmers' cooperatives or associations. Thus in 2003-2004 measures for promoting, as well as financing, the establishment and operations of such institutions will be developed and implemented.
  158. The introduction of reliable financing mechanisms has fundamental importance for increasing the share of commercial production in farms. In order to reach the financing volume levels projected in the PRSP, it is necessary to introduce effective mechanisms for operations of the land market and land collateral, as well as to ensure the link between credit provision and use of modern agro-technologies by farms. For this purpose a network of companies involved in agro-technologies will be established, and mechanisms for their cooperation with farms and credit institutions will be developed and introduced.
  159. Subsidized consulting services for farms will continue in order to promote productivity and the share of commercial production in agriculture.
  160. Establishment of an effective agricultural insurance system is a very urgent issue. The present mechanism of partial compensation from the state budget for damages caused by natural disasters will be replaced by an insurance mechanism by 2005, and the necessary fund will be formed on a co-financing basis through contributions by the state and farms themselves. The specific action plan will be developed in 2003-2004. At the same time, the government will encourage the involvement of private insurance companies in agricultural insurance.
  161. The issue of improving opportunities for non-farm employment will become more urgent with the projected slow changes in employment in the agricultural sector. For this purpose two main mechanisms will be used:
    - (i) micro-credit mechanisms, which will focus on the development of services sector, as well as establishment of non-farm micro-enterprises in rural areas;
    - (ii) targeted credit mechanisms, which will be used for processing of agricultural products and improving their packaging. These will be provided mainly to cooperatives or associations of farmers.
  162. Financing of the mentioned schemes, especially the first one, will be supported by donors or relevant specialized organizations.
  163. Projections for public financing of agriculture for the period of 2003-2015 are presented in the section on the PRSP budget framework (see "PRSP Implementation Financing: Budget Framework").

### 6.3. INSTITUTIONAL REFORMS AND IMPROVEMENT OF BUSINESS ENVIRONMENT

#### 6.3.1. PUBLIC ADMINISTRATION AND JUDICIAL SYSTEM REFORMS

164. Transition difficulties and variety of institutional issues have not allowed for the reforms undertaken in public administration and judicial system to achieve quick and tangible results. In contrast to other sectors, reforms here were launched relatively later and the influence of former centralized governance system was very much implanted in the system.
165. The above had negative impact on the efficiency of public administration system in place. Still inadequately high is the degree of centralization in policy implementation, decision-making processes (absence of transparency, weak accountability, failure to ensure public participation).
166. Efficiency, quality and availability of public administration services still remain unsatisfactory, particularly for poor population. According to the results of sociological survey<sup>71</sup>, population views addressing social problems as a priority among public services rendered by the state. Public services accessibility assessment directly depends on the poverty rate. These are more accessible for non-poor households, whereas completely inaccessible for predominant share of the poor. The same applies to the judicial system in terms of its accessibility and quality. According to the households and business community, judicial system is in the third place among three most unavailable services<sup>72</sup>, especially for the poor population.
167. Deficiency of public administration and judicial systems, aggravated by a number of transition-inherent problems, gave rise to blooming shadow economy and corruption in Armenia. As a consequence of widespread corruption in public administration, public services degenerated into payable ones; essentially taking into consideration the structure of their expenditures, poor people have to pay more than non-poor for acquisition of these services. Given illegal payments and protectionism widespread in business sector, poor people - when embarking on business activities - encounter more complications and hardships than other people. If ever the difficulties of initial period are overcome, the poor are among the first to move to the shadow sector, because this approach is dictated by the prevalent rules; non-acceptance of the latter leads to isolation and deprives of much needed entrepreneurial income.

##### 6.3.1.1. Priorities for Enhancing Efficiency of the Public Administration and Relevant Policies

168. During the recent years, the government has adopted new structural reform strategies with the objective to enhance efficiency, quality and accessibility of public services, transparency and accountability, as well as oversight of public administration system. The strategies are to be implemented along the three main directions:
  - (i) Structural and functional reforms in public administration;
  - (ii) Introduction of civil service systems;
  - (iii) Reforms on financial management systems.
169. Currently, statutory functions of the ministries are streamlined and restructuring of administrative bodies is underway. Reforms result in reduction of the number of ministries, governmental public administration agencies and committees, together with the number of their structural subdivisions, staff-lists are optimized to ensure their adequacy to statutory functions of the institutions.
170. Reforms in civil service have been undertaken pursuant to the Laws on Civil Service, State and Non-State Institutions, Public Administration Bodies, and a number of other legislative acts. In accordance with legislative requirements, political, discretionary and support positions were clearly separated and defined, equality based criteria for admission to and withdrawal from civil service established, as well

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<sup>71</sup> Armenian Democratic Forum, "Public Opinion on Public Services Provided to Households and Private Enterprises", Yerevan 2001.

<sup>72</sup> Armenian Democratic Forum, "Public Opinion on Public Services Provided to Households and Private Enterprises", Yerevan 2001, p. 48.

as professional career opportunities guaranteed together with service stability, job descriptions, definition of responsibilities of civil servants, remuneration and social security, as well as the system of declaring incomes and assets.

171. The legislation regulating civil service has been adopted, yet unsolved is the issue of the number of civil servants. Among others, this is the reason why program estimation of the number of civil servants in public administration is unchanged for the subsequent years (see Table 6.5). Number of employees in public administration system will be finalized upon adjustment of the government structure, number of ministries and governmental agencies, and their functions and will not exceed the existing level. The process has already started to be supported by the relevant credit facility of the World Bank in 2004.

**Table 6.5. Number of public administration employees and average monthly wages (excluding local authorities) in 2000-2004**

	2000	2001	2002	2003	2004
Number of employees	12 060	12 418	12 072	14 247	14 267
<i>of which: Judicial system</i>	<i>1 783</i>	<i>1 869</i>	<i>1 892</i>	<i>1 954</i>	<i>1 954</i>
Average monthly salary, dram	34 976	34 968	61 110	64 548	101 501
<i>of which: Judicial system</i>	<i>40 416</i>	<i>40 131</i>	<i>62 219</i>	<i>76 970</i>	<i>95 535</i>

172. Decentralization of public services is as amongst the priorities for the development of public administration system. To this end, it is necessary to improve the operations and structure of regional administrations.
173. An important direction for enhancing efficiency of public administration is the provision of modern equipment and means of communication in government bodies. Public investment programs will address these issues by virtue of capital investments. In particular, during the period of 2004-2008 when major structural and functional reforms in public administration system are planned, substantial increase of relevant expenditures is envisaged (see Table 6.6 below).

**Table 6.6. Financing of public administration and judicial system in 2002-2015 (% of GDP)**

	2002	2003	2004	2005	2006	2009	2012	2015
<b>Public Administration (excluding Judicial System)</b>	<b>1.41</b>	<b>1.65</b>	<b>1.78</b>	<b>2.13</b>	<b>2.13</b>	<b>2.32</b>	<b>2.64</b>	<b>2.71</b>
Salaries and Payroll	0.75	1.00	1.22	1.50	1.55	1.81	2.17	2.28
Current Expenditure	0.61	0.62	0.53	0.55	0.52	0.45	0.43	0.40
Capital Expenditure	0.06	0.03	0.03	0.09	0.06	0.06	0.03	0.03
<b>Judicial System</b>	<b>0.17</b>	<b>0.27</b>	<b>0.42</b>	<b>0.24</b>	<b>0.16</b>	<b>0.31</b>	<b>0.35</b>	<b>0.36</b>
Salaries and Payroll	0.12	0.14	0.15	0.14	0.12	0.18	0.22	0.26
Current Expenditure	0.03	0.04	0.04	0.04	0.04	0.04	0.04	0.04
Capital Expenditure	0.02	0.08	0.23	0.07	0.00	0.09	0.09	0.06

174. The main prerequisite for successful reforms in the public administration and judicial systems, as well as the most important factor to mitigate corruption in these sectors, is the increase of salaries for the sector employees. This is one of the important measures stipulated in the anti-corruption policy of the government. To this end, PRSP public expenditures program envisages tangible resources for this, as well as other sectors (see Table 6.6). Allocations for salary (ratio to GDP) in public administration and judicial systems during the programmed period (2003-2015) will grow more than three times, while total financing (ratio to GDP) will increase by 94%. Average monthly salaries in nominal terms will increase more than 12 times.
175. According to surveys of the population and businesses<sup>73</sup>, the unpredictability of state policy is one of the main factors limiting economic activity and investments in Armenia, more than in any other transition country. According to some estimates<sup>74</sup>, unpredictability of policies is the second main

<sup>73</sup> See *Investment Climate Around The World*, WB, 2003.

<sup>74</sup> *Investment Climate Around The World*, WB 2003, pp. 110, 128.

factor constraining investments in Armenia after tax and customs regulations and administration (while among CIS countries, this factor was on average the fourth important one). Unpredictability is mainly manifested in frequent changes of legislation. At the same time, the population and businesses are normally not informed about the expected changes in the legislation<sup>75</sup>, which renders the process of opinion exchange between the government and a wide range of stakeholder groups ineffective.

176. Attaching importance to the necessity of enhancing the predictability of state policies, Armenian authorities will take relevant measures. In particular, using modern technologies (e-Governance), all legislative acts and programs will be accessible starting 2003-2004. These documents, as well as the further explanatory notes and comments, will be available to the wide public on the Internet sites of the relevant governmental agencies. Drafts of legislative acts to be amended will be placed in the same sites in advance, and those who would like to comment on the draft will have the possibility to do so, and these comments will be taken into account during the actual decision making process.
177. In 2003-2004, a program ensuring more efficient cooperation between the population and the central and local authorities, based on modern technologies (e-Government) will be developed and implemented. The program will transfer the issuance of permissions for activities and a number of other functions to the Internet and thus will reduce immediate contacts between people and the relevant employees of public agencies and will thus significantly increase the level of control over activities of these employees. This program is important also in the context of the anti-corruption strategy measures.
178. Currently, the participation of civil society organizations, particularly non-governmental specialized organizations and representatives of the private sector, in decision making processes is fairly limited and is not institutionalized. This is a constraint to the development of the civil society and does not allow for a higher level of trust in authorities on the side of the population. Thus, in 2003-2004 a corresponding program will be developed and implemented. It will include:
  - (i) relevant legislative changes, particularly adoption of a law on lobbying, which will allow the specialized non-governmental organizations and the private sector representatives to present and defend the interests of the society and the private sector in various governmental agencies. Also, major amendments will be done in the law on Trade-Industrial Palaces, which will strengthen these institutions making them a central body ensuring cooperation between private sector organizations;
  - (ii) relevant measures for regulating the participation of specialized non-governmental organizations in decision making process and enhancing possibilities for their involvement, as well as relevant measures to transfer certain regulatory functions to representatives of the private sector (for example, issues related to certification of qualifications).
179. In this context, the issues related to the participation of women in the governance system are also important. Armenia has joined the UN 1979 convention on Eliminating All Forms of Discrimination Against Women, where member countries have taken on the commitment to ensure equality between women and men in the development and implementation of state policies, in senior governmental positions, as well as in carrying out public functions at all levels of government. However, not only in governmental structures, but also in political parties and private enterprises the level of involvement of women in leadership and responsible positions is not high at present<sup>76</sup>. Thus, within the framework of governance reforms measures will be taken for improving the situation and ensuring full participation of women in executive and legislative bodies, using, among others, the quota system as well.
180. In the PRSP process substantial role is attributed to enhancing efficiency of budget management, which in the current stage should be carried out along the following major directions:

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<sup>75</sup> 68.55 percent of companies in Armenia mentioned that frequent changes in the legislation are a substantial constraint to investments, 83.87 percent mentioned that the level of unpredictability of legislative changes has risen in the past 3 years, 74.38 percent mentioned that they have not been informed in advance of the expected changes, and 80.83 percent mentioned that their opinion was not taken into account by authorities (see *Investment Climate Around The World*, WB, 2003, pp. 125-130).

<sup>76</sup> In particular, in 1995 women constituted 6.3 percent of deputies in the parliament, in 1999 3 percent and in 2003 4.6 percent.



- (i) The budget should be closely interrelated with the medium-term strategy. To this end, incorporation of the MTEF in budget process is an important step towards this objective.
- (ii) Enhancing publicity of the entire budget process;
- (iii) Expanding budget coverage, i.e. the budget should incorporate each and every cash and non-cash flows of public finance, including extra-budgetary funds and externally financed operations
- (iv) Strengthening supervision in all stages of budget execution. Primary aspect of this is the higher responsibility of the ministries and agencies in respect of management of allocations, budget execution and timely reporting. Enhancing the supervisory role and importance of the Chamber of Control of the National Assembly is crucial, which is also a tangible anti-corruption measure;
- (v) Enhancing predictability of the budget. An important role here is attributed not only to the interactions with the MTEF, but also to ensuring actual execution of all the planned indicators;
- (vi) The budget must also be simple and understandable for all users/consumers, which would allow for budget monitoring by the public at large.

**6.3.1.2. Regional Administration and Improvement of Activities of Local Authorities**

181. Regional development reforms primarily aimed at creating guarantees for normal functioning of regional and local governance systems and setting grounds for regional development. However, shortcomings in regional development policy and the absence of a regional development strategy, appropriate principles and approaches resulted in severe polarization of regional development and in deterioration of social and economic conditions. This fact had a direct and large negative impact on living standards, and contributed to the deepening of poverty, across the nation, particularly in small and medium sized towns.
182. The main directions for regional development in the country should be:
- (i) Optimal administrative-territorial division of the country based on comprehensively justified principles;
  - (ii) Cohesive social and economic development of country's territorial-administrative units;
  - (iii) Development of small and medium sized towns with high levels of poverty;
  - (iv) Improvement of the legal framework regulating the operation, as well as authorities and responsibilities of central, regional and local governments.
183. In the context of poverty reduction, primary role is attributed to communities in respect of rendering public services. Communities in Armenia bear certain specifics and are extremely inhomogeneous in terms of number of population, elevation, geographical location, level of socio-economic development and other features; so poverty is manifested in different ways depending on the community, its size and specifics. Small communities are not in a position to fulfill their powers, as a consequence of which majority of own and delegated powers are doomed to failure. That's why many communal and housing, educational, cultural, sports, health, and social problems of the community population remain unsolved; this directly preconditions poverty problem and community development. In guaranteeing the rights of local governance system, the legislation however did not take into consideration capacity of the communities to enforce and exercise these rights, without which any right would be only declarative in essence.
184. Powers of local governments, as a rule, are exercised through public services rendered to population; these may be classified into two groups free and payable. Free services are funded from the community budget. An important issue thus is fair distribution of budget resources, solution of which depends on publicity, transparency, active involvement of community councils in the budget process and open discussions with the public at large.
185. In respect of payable services an important factor is the protection of the population through defining fair tariffs, fees and local duties to ensure their affordability to poor population, through their utmost possible differentiation by level of neediness. In defining rates of duties, charges and rents it should be taken into consideration that predominant majority of expenditures incurred by local governments is

not compensated because of insolvency and poverty of the population. This is especially attributive to water supply, heating, trash removal, residential stock maintenance and other sectors. Consequently, the process of tariff determination should be open and transparent involving the public at large and considering the interests of the population.

186. It is necessary to differentiate and streamline the authorities vested in village, town and district communities. At the same time, the absence of legislatively defined procedures to exercise the authorities of local governments is a serious impediment for a number of issues, including fulfillment of effective controls over performance and adequate financial resource allocation, evaluation of additional financial needs, etc. Subsequently, in the current stage legislative stipulation of the procedures regulating the exercising of mandatory authorities of local governments will enlarge the potential for development and implementation of comprehensive measures aiming at replenishment of local budgets through expansion of their income base.
187. Maintenance of living standards and poverty reduction in communities may not be efficient without establishment and improvement of rational administration systems. Improvement of community governance is largely dependent upon establishment of community councils, professionalism and capacities of the local government staff, potential to take and implement high quality decisions and human resources. It is necessary to undertake serious measures to enhance professionalism, management skills of more than 7500 employees of local governments and putting them to service the objective of efficient management of the community. The existing legislation does not regulate human resources movements in local governments, i.e. recruitment, career advancement, attestation, training, human resource databases, etc. Thus elaboration of the draft Law on Service in Local Governments and submission to the National Assembly for approval is imperative.
188. In the framework of poverty reduction measures, important role in local governance is attributed to consolidation of communities and reduction of their number, as well as mitigation of problems of small communities through establishment of inter-community associations. In planning appropriations to local budgets to combat problems existing in the area of local self-governance priorities should be attached to inter-community associations and development of their network.
189. In performing their functions local self-governments should ensure accessibility and quality of public services rendered in the relevant community. So extremely important is the transfer of the authority to manage and administer local secondary education, health, and social service functions to the local governments after comprehensive preparatory measures are fulfilled.
190. Identification of administrative and territorial specifics of communities plays crucial role for diversified approach to communities in elaborating relevant public policies. For instance, poverty is manifested differently in earthquake area, bordering, highly elevated, mountainous regions, and small communities. The state should legislatively stipulate and apply a targeted system of privileges, discounts and allowances. In particular, there is a need to review mechanisms of estimation and allocation of state budget subsidies on the basis of financial adjustment principle.

#### 6.3.1.3. Judicial System and Poverty Reduction

191. In order to form an efficient and accessible judicial system, it is necessary to establish a system of guarantees, which are particularly attributed to officials involved in exercise of justice and improvement of legislative framework. In this regard, it is important to ensure the corresponding legal and social guarantees, as well as a more effective application of laws, and also, in particular, adequate technical and staff capacity in relevant expertise centers and better access to their services.
192. **Legal guarantees** include independence of officials exercising justice in accordance with the Constitutional and legislative requirements and clear definition of their rights and responsibilities. In this respect there is a need to make amendments in a number of provisions of the Constitution related to the Council of Justice and Constitutional Court by clearly establishing powers of these institutions, ensuring utmost independence of these institutions and their staff from the authorities, as well as authorizing more entities and individuals to apply to the Constitutional Court and enlarging jurisdiction of the latter. It is necessary to streamline the processes and the principles of exercising justice and of activities of the police and at the same time defining the cases and issues relating to

responsibilities of judges and prosecutor personnel, providing most transparency and public awareness concerning these issues. To this end, it is also important to establish requirements in respect of publication of court resolutions and decisions (web page, bulletins, and other means), which will enable the society to form an opinion on the justice system in the country.

193. In terms of **social guarantees, the** increase of remuneration of judicial officials will be of utmost importance, which will also serve as a tool to mitigate corruption (see Table 6.5 and Table 6.6). Otherwise, bribery will spread further, making it even more difficult to fight against it. The socially vulnerable population suffers the most from consequences of bribery and taking into account the fact that bribery tends to become a habit, the socially vulnerable population avoids applying to judicial authorities a priori recognizing their low chances in such competition. Thus, it is necessary to revise and streamline the rates of judicial fees and consider the option of deferred payments. In this regard, it is necessary to review and amend another very important provision of the Constitution, according to which in case when a defendant lacks sufficient funds for hiring a lawyer or in other cases provided by legislation, the state covers relevant expenses. This provision will allow allocation of public funds for legal defense in civil and administrative proceedings when further amendments in the relevant legislation are made, which will also clearly define the cases and mechanisms of such payments on the basis of properly justified estimations.
194. The existing justice related problems are mainly connected to contradictory, obscure and ambiguous legislative provisions. In terms of clarification and streamlining of legislative provisions it is necessary to establish a standing legal expertise process (independent of the authorized body), which will provide legal expertise on the existing and future legal acts. Legal expertise process should take into consideration the issue of conflict of interests otherwise it may not be efficient. For example, if this process is led by the government it will naturally defend the interests of the government violating the rights of other parties.

### 6.3.2. ANTI-CORRUPTION POLICY

195. Poverty reduction is directly linked to the effectiveness of the efforts for limiting corruption, as well as preventing its new and more dangerous variations. Priority should be given to preventive measures in anti-corruption policy. Despite the fact that these measures are also reflected in various sections of the PRSP, the government is currently developing a comprehensive anti-corruption strategy and the corresponding action plan, which will be approved by the end of 2003. The document will provide a definition for corruption, its causes and the anti-corruption strategy in the following three main directions:
- (i) resolution of economic problems and reduction of shadow economy;
  - (ii) combating political corruption;
  - (iii) elimination of corruption in government, judicial system and city governments.
196. **Economic problems and reduction of shadow economy** Equal legal protection of all types of right of ownership, as well as promotion of economic activity and free competition are important matters in this regard. An important step for reduction of shadow economy would be stronger control over incomes resulting from illegal economic activities (adoption of a legal framework against money laundering), and limiting of cash transactions.
197. Important measures for preventing tax and customs corruption are the elimination of tax privileges, publication of guidelines on rights and obligations of taxpayers, strengthening of tax and customs administration. It is necessary to establish a universal system for income declaration through the introduction of individual taxpayer identification numbers.
198. The administrative involvement in determining the customs value of goods should be reduced to a minimum, and possibilities for arbitrary interpretations should be ruled out from the customs code.
199. An important anti-corruption step in the economic sphere would be the establishment of specialized unions and associations.
200. In order to avoid “dual” accounting and reporting it is necessary to finalize the introduction of the

audit system.

201. For preventing fake and intentional bankruptcies it is necessary to improve the bankruptcy law in order to conduct bankruptcy processes with rapid and simplified procedures.
202. In order to promote a competitive environment, the government will take the necessary measures for improving the regulation of natural monopoly activities.
203. **Political corruption** Preventive anti-corruption and measures in politics are an important part of the anti-corruption strategy. In this regard it is important to fully apply the law on political parties, as well as adopt a law on political lobbying, which will allow all actors in the political field to pursue their interests in accordance with legally defined functions.
204. Improvement of the electoral system has an important role in the eradication of political corruption. In order to bring elections up to the international standards it is necessary that voters' lists be checked and updated not just right before the elections, but periodically at community level, which will also strengthen the institution of observers.
205. The development and implementation of an anti-corruption strategy for **the government, judicial system and community governments** is central to the anti-corruption activities. The main measures in this regard are presented in various sections of this document (see "Reforms of Governance and Judiciary System").
206. The success in implementation of the anti-corruption strategy depends also on the efficiency of implementation and monitoring of the strategy. Particular attention will be given to:
  - (i) analysis of the causes of corruption at all levels;
  - (ii) development of specific short and long term programs within the framework of the anti-corruption strategy;
  - (iii) active cooperation with the civil society in prevention of corruption;
  - (iv) co-ordination of activities of individual ministries in developing and implementing anti-corruption programs, as well as coordinated collaboration between law-enforcement authorities.

### **6.3.3. IMPROVEMENT OF BUSINESS AND INVESTMENT ENVIRONMENT**

#### **6.3.3.1. Current situation and development objectives for 2004-2015**

207. The business and investment environment, the quality of which is a decisive factor in job creation and attracting investments, has improved significantly in recent years. A survey of 200 companies operating in Armenia conducted at the end of 2001 reveals that:<sup>77</sup>
  - (i) the average time needed for official registration of companies reduced from 27.3 days in 2000 to 21.1 days in 2001;
  - (ii) the average cost of official registration reduced from the equivalent of USD 109 in 2000 to the equivalent of USD 92 in 2001;
  - (iii) the time needed for obtaining official license for operations reduced from 23.5 days in 2000 to 18.5 days in 2001;
  - (iv) the average annual number of inspections of companies reduced from 6.6 in 2000 to 6.4 in 2001;
  - (v) there was an increase in the overall confidence in the business environment, economic policies of the state and the administrative conduct from 3.3 in 2000 to 2.57 in 2001 (confidence is measured on a 6 point scale, where 1 corresponds to total lack of confidence and 6 corresponds to full confidence);
  - (vi) the cost of transporting a standard sized container from Yerevan to Poti (Georgia) reduced by almost 25 percent in 2001-2002 compared to 1999.

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<sup>77</sup> See IDA, *Program Document for a Proposed Fifth Structural Adjustment Credit to the Republic of Armenia, February 2003*, p. 2.

208. Nevertheless, the business and investment environment in Armenia needs substantial improvements, which is evident when compared to EU membership candidate countries in transition<sup>78</sup>.

**Table 6.7. Assessment of transition economy in Armenia and a number of CIS and East European countries in 2001**

Country	Private sector share in GDP, %	Enterprises			Markets and trade			Financial organizations		Infrastructural reforms
		1	2	3	4	5	6	7	8	
Armenia	70	3+	4-	2+	3	4	2	2+	2	2+
Azerbaijan	60	2	4-	2	3	4-	2	2+	2-	2-
Georgia	65	3+	4	2	3+	4+	2	2+	2-	2+
Russia	70	3+	4	2+	3	3	2+	2	2+	2+
Ukraine	65	3	4-	2	3	3	2+	2+	2	2
Moldova	50	3	3+	2	3+	4+	2	2+	2	2+
Estonia	80	4	4+	3+	3	4+	3-	4-	3+	3+
Bulgaria	70	4-	4-	2+	3	4+	2+	3+	2+	3-
Poland	75	3+	4+	3+	3+	4+	3	3+	4-	4-
Slovenia	65	3	4+	3	3+	4+	3-	3+	3-	3+
Hungary	80	4	4+	3+	3+	4+	3	4	4-	4-
Czech Republic	80	4	4+	3+	3	4+	3	4-	3	3

Note: Column numbers: 1 – privatization of large and medium sized enterprises; 2 – privatization of “small” businesses; 3 – corporate management and structural reforms at enterprise level; 4 – price liberalization; 5 – trade and exchange system; 6 – anti-monopoly policy; 7 – banking reforms and interest rate liberalization; 8 – financial market and non-bank financial institutions.

209. The above data show that while Armenia, as well as the other CIS countries included in the table, are more or less comparable to EU candidate countries in respect of privatization, price liberalization, trade and exchange rate regulation, they are significantly behind in respect of all other indicator related to the business and investment environment.

210. The following targets for the main quantitative and qualitative indicators characterizing the business and investment environment are set by the PRSP for 2004-2015 (Table 6.8). These developments will allow Armenia to surpass the current indicators of EU candidate countries by 2015.

**Table 6.8. Target indicators for the development of business and investment environment in Armenia, 2001-2015**

Indicators	2001	2004	2005	2006	2009	2012	2015
Private sector share in GDP, %	70	73	74	75	77	80	80
Index of confidence in economic policies and administrative conduct of the state (min: 1, max: 6)	3.33	3.75	3.9	4.1	4.5	4.75	5.0
Average time needed for official registration of enterprises, days	21.1	15.0	11.0	9.0	7.0	5.0	3.0
Average time needed for obtaining licenses, days	18.5	15.0	13.0	11.0	9.0	7.0	5.0
Number of commercial organizations per 1000 people	15.9 <sup>1</sup>	17.0	18.0	19.0	22.0	26.0	30.0
Privatization of large and medium sized enterprises	3+	3+	3+	4.0	4.0	4.0	4.0
Privatization of “small” businesses	3.7	3.9	4.0	4+	4+	4+	4+
Corporate management and structural reforms at enterprise level	2+	3-	3-	3.0	3.0	3+	3+
Price liberalization	3.0	3.0	3.0	3+	3+	4	4.0
Trade and exchange system	4.0	4+	4+	4+	4+	4+	4+
Anti-monopoly policy	2.0	2.2	2.3	2.4	2+	3-	3.0
Banking reforms and interest rate liberalization	2.3	2.6	2.7	3-	3.0	3+	4.0
Financial market and non-bank financial institutions	2.0	2.1	2.3	2.5	3.0	3+	4-
Infrastructural reforms	2.3	2.4	2.5	3-	3.0	3+	4-

<sup>1</sup> Data for 2003.

Source: 2001 IDA, Program Document for a Proposed Fifth Structural Adjustment Credit to the Republic of Armenia, February 2003, 2002 Transition Report, EBRD, 2003, 2004-2015, PRSP projections.

<sup>78</sup> See 2002 Transition Report, EBRD, 2003.

**Box 6.1. Economic Assessment Indicators System**

Indicators presented in Table 6.7 reflect qualitative assessments of development, which can be used to compare countries by the depth of implemented structural reforms, as well as by the level of development in business and investment environments.

Numeral 1 in the table indicates insignificant changes compared to the central planning system, and 4+ indicates that the situation is comparable to standards of developed countries.

**Reforms of enterprises**

**Privatization of large and medium sized enterprises.** 2: the privatization plan is ready, some enterprises are sold; 3: 25 percent or more of the stock of large and medium sized enterprises are privatized; 4: 50 percent or more of the stock is privatized; 4+: 75 percent or more of the stock is privatized and an effective corporate management system for enterprises is introduced.

**Privatization of "small" businesses.** 2: a fairly large part is privatized; 3: almost the entire program is implemented, 4: privatization is finished with the possibility for sale of property; 4+: there is no public ownership, land sale is allowed.

**Corporate management and structural reforms at enterprise level.** 2: moderately strict budgetary limitations, inefficient application of bankruptcy laws, corporate management norms followed inadequately; 3: strict budgetary limitations and corporate management norms, active application of bankruptcy laws; 4: substantial improvement of corporate management, large private investments at enterprise level, 4: effective corporate control through local financial institutions and markets.

**Markets and trade**

**Price liberalization.** 2: state regulation of prices for some goods, state purchases by non-market prices are common; 3: substantial progress in price liberalization, absence of state purchases by non-market prices; 4: total price liberalization, utility prices reflect the costs; 4+: utility prices reflect the needs for improving efficiency.

**Trade and exchange system.** 2: some liberalization of import/export regulations, multiple exchange rates for foreign currencies are allowed; 3: removal of almost all administrative restrictions for import/export, almost full current account convertibility; 4: removal of all administrative restrictions for import/export (except for the agricultural sector), elimination of export customs duties, absence of large differences between customs duties for non-agricultural items, full current account convertibility; 4+: removal of the majority of tariff restrictions, membership in WTO.

**Anti-monopoly policy** 2: adoption of anti-monopoly legislation, establishment of anti-monopoly bodies, removal of a number of restrictions to the formation of new market players, application of some compulsory measures vis-à-vis monopolist enterprises, 3: removal of almost all restrictions to the formation of new market players, break up of individual monopolistic enterprises, 4: wide-ranging anti-corruption activities and support to competition; 4+: efficient anti-monopoly policy, removal of all restrictions to the formation of new market players.

**Financial organizations**

**Banking reforms and interest rate liberalization.** 2: substantial liberalization of interest rates and credit provision, limitation of the directive practice for defining credit provision and interest rates setting; 3: substantial progress in bank consolidation, introduction of banking control and regulation, full liberalization of interest rates, large volumes of credits for private enterprises, large number of private banks; 4: substantial harmonization of banking control and regulation norms with Basel standards, effective control system and genuine competition in banking system, substantial consolidation of the financial system; 4+: total harmonization of banking control and regulation norms with Basel standards, comprehensive provision of competitive banking services.

**Financial market and non-bank financial institutions.** 2: establishment of stock exchanges, formation of stock brokers, limited trade in state bonds, incomplete legal framework; 3: large number of stocks issued by private companies, establishment of independent stock registry, reliable protection of mutual accounts, certain protection of small shareholders' rights, establishment of non-bank financial institutions and creation of the corresponding legal framework; 4: stocks and financial market legislation in essence corresponds to international standards, adequate liquidation and capitalization capacity of financial markets, effective control system; 4+: stocks and financial market legislation fully corresponds to international standards, developed system of non-bank financial intermediation.

**Infrastructural reforms.** Average assessments of reforms in the communications, energy, water, sewage roads and railroad sectors.

*Source: 2002 Transition Report, EBRD, 2003.*

6.3.3.2. Business and investment environment development policy 2004-2015

211. The major share of Armenia's non-agricultural economic growth in recent years has been coming from the private sector, mainly the newly formed small and medium sized enterprises (SMEs). As a result of the collapse of the economic system inherited from the former Soviet Union where large enterprises were predominant, in today's Armenia unlike developed countries, both production

volumes and labor productivity are noticeably higher in SMEs than in large enterprises<sup>79</sup>. The transition experience of European countries shows that there is a direct link between economic growth and the number and production volumes of the newly formed (not privatized) SMEs<sup>80</sup>. In Armenia, the growth in the number of newly formed enterprises, the majority of which are SMEs, lags substantially behind economic growth rates. In 2001 the number of registered commercial organizations increased by 2,818 or 4.7 percent, in 2002 by 2,613 or 4.1 percent, while economic growth rates were 9.6 and 12.9 percent respectively. As of 01.01.2003 there were 48,069 commercial organizations<sup>81</sup> registered in Armenia or 15.9 enterprises per 1000 people, which is far behind the levels of this indicator in developed countries<sup>82</sup>.

212. Since 1999, the pattern of private sector formation in Armenia has changed significantly. In 1994-1998, the non-agricultural private sector was formed mainly through wide-ranging privatization, while after the end of the voucher privatization stage the development of the private sector and generally the entire economy was due to the increase in production volumes in existing SMEs and establishment of new commercial entities.
213. Considering that the macroeconomic framework of the PRSP aims at creating 248,000 additional non-agricultural jobs in 2003-2015, the development of the private sector becomes one of the main preconditions for reducing poverty and inequality and increasing labor incomes of the population. In order to ensure this development the government intends to take wide-ranging measures, which will aim at achieving the target indicators in Table 6.8.
214. These measures intend to:
  - (i) simplify procedures for registration and licensing of companies and reduce the time and money spent on such procedures;
  - (ii) promote the establishment of new companies and develop and introduce effective schemes for financing new businesses;
  - (iii) regulate labor relationships;
  - (iv) effectively protect private ownership (including intellectual ownership) and introduce effective mechanisms of responsibility for economic violations;
  - (v) ensure significantly wider access to financial resources;
  - (vi) promote competition, in essence eliminate monopolies;
  - (vii) regulate inspections, substantially improve tax, customs and other administrative regulation, as well improve the quality of services provided by the state;
  - (viii) promote export and innovation;
  - (ix) develop micro-entrepreneurship;
  - (x) reduce the shadow economy.
215. Although certain reduction in the amount of time and money necessary for official registration and licensing was achieved, these do not yet correspond to the requirements for a modern business environment and are substantial factors limiting the entry of new enterprises and new investments<sup>83</sup>.

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<sup>79</sup> According to *Growth Challenges and Government Policies in Armenia, WB 2002, p 43*, the newly established industrial enterprises produced 40 percent of the total industrial output in 1999, employment in these companies constituted only 7.7 percent of the total employment in industry, while productivity was on average 5.2 times higher.

<sup>80</sup> Kontorovich, V. "Has new business creation in Russia come to halt?" *Journal of Business Venturing, Vol. 14, N 5/6, 1999*.

<sup>81</sup> *Socio-economic situation in Armenia 2002 January-December, Yerevan, 2003, p. 113*.

<sup>82</sup> *In Germany at the end of 1990s, the corresponding indicator was 37 registered enterprises per 1000 people, in Slovenia 45, in the USA 74 (Growth Challenges and Government Policies in Armenia, WB 2002, p. 42)*.

<sup>83</sup> According to *Investment Climate Around The World, WB 2003, p. 114*, 21.6 percent of respondent companies considered official registration and licensing procedures as constraints to the development of the private sector, compared to the average of 23.4 percent for CIS countries. However, countries characterized by rapid development of the private sector and high level of investment attraction have much lower indicators: Estonia 11 percent, Poland 8.7 percent, Singapore 9.3 percent.

- Thus, in 2004-2006 the number of activities subject to licensing will be reduced, licensing procedures will be simplified, computerized official registration and licensing systems will be introduced (e-Government) and some specialization qualification functions will be transferred to relevant private associations.
216. In order to promote the entry of new companies, especially in manufacturing and high technologies sectors and in order to improve their access to financial resources:
- (i) Establishment of manufacturing zones and industrial parks using the territory and equipment of unviable public and private enterprises, as well, will be promoted, including with state participation. For this purpose the bankruptcy process for such enterprises will be made faster and simpler and organizations specializing in their restructuring will be established<sup>84</sup>.
  - (ii) Establishment of venture financing mechanisms for new products will be promoted, the government will also support the formation of other organizations for financing new businesses and a legal framework for regulating their operations will be set up.
217. Presently Armenia is characterized by a high level of shadow employment. According to a household survey conducted in 2001, the number of self-employed individuals was 3 times higher than the number of officially registered individual proprietors. The number of people employed in trade and services sector is greatly underestimated<sup>85</sup>. Incomplete declaration of salaries is also very common. In order to improve the registration of the labor force, the Government of Armenia has initiated a number of measures in 2003, which will continue further in coming years. The new Labor Code will be adopted by 2004 in order to adapt labor relationships to today's conditions and to protect the interests of hired employees.
218. Mechanisms for protection of property rights, execution of contracts and ensuring economic responsibility are the main preconditions for the development of the private sector. The current situation in this area is characterized by low financial discipline: as of October 2002 the total debt of Armenian organizations was 535 million drams, or 39.3 percent of GDP, of which 359 million drams or 26.4 percent of GDP was the debt to suppliers and contractors, and arrears amounted to 98 million drams (7.2 percent of GDP)<sup>86</sup>. This situation is mainly the result of ineffective application of bankruptcy legislation, as well as ineffective, protracted and monopolized mechanisms for liquidation of seized property. Thus, in 2004-2006, it is planned to simplify and clarify the law on bankruptcy, ensure its broad application, remove the monopoly power of judicial enforcement officers in liquidation of seized property, substantially reduce the duration of proceedings for bankruptcy and seizure, as well as sale of property. In the light of these issues, substantial improvements in the effectiveness of and access to the court system become fundamentally significant.
219. Better access to external financing for enterprises, particularly SMEs, is one of the most important factors contributing to the development of the private sector. Financing issues, were classified as major constraints to development by 60.7 percent of respondent enterprises in Armenia<sup>87</sup>. As presented in Table 6.9. Armenia's enterprises finance their development mainly by their own investments or funding through informal channels, the total sum of which provides for 89 percent of the total financing, which is the highest share among the countries presented in the table. Funding received through formal channels constitutes only 11.4 percent of total resources, compared to 55.5 percent in Estonia, 24.6 percent in Georgia and 56 percent in Poland. Financial and commercial markets provide only 6.5 percent of the resources, where 3.2 percent is provided by the banking system, compared to 54.6 percent in Poland and 53.5 percent in Estonia. This indicates that financial markets are underdeveloped, and levels of financial discipline and mutual trust in the business environment are fairly low. This can be a serious constraint to the development of the private sector in the near future.

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<sup>84</sup> Currently two projects financed by WB credits are being implemented: establishment of IT technological park and reconstruction agency.

<sup>85</sup> *Growth Challenges and Government Policies in Armenia*, WB 2002, p. 40.

<sup>86</sup> *Socio-economic situation in Armenia 2002 January-December*, Yerevan, 2003, p. 78.

<sup>87</sup> *Investment Climate around The World*, WB 2003, p. 110.



**Table 6.9. Financial resources for investments in the main assets of enterprises in Armenia and a number of other countries, 2001, % of total**

Country	Own resources	Stocks and shares	Banking system	Non-bank financial institutions	Public resources	Lease	Suppliers' credits	Other
Armenia	67.3	1.0	3.2	0.4	4.9	0.9	1.0	21.3
Georgia	69.6	0.7	7.2	1.3	6.8	3.4	5.2	5.8
Azerbaijan	63.4	0.2	1.9	0.4	14.4	0.8	3.4	15.5
Russia	69.6	0.9	5.6	1.3	4.0	3.5	8.7	6.4
Ukraine	69.1	2.2	6.4	1.7	4.9	1.1	7.0	7.6
Estonia	35.5	15.9	20.0	2.0	2.3	8.5	6.8	9.0
Poland	39.6	30.5	13.1	2.9	1.4	4.3	3.8	4.4
Hungary	52.1	6.0	15.1	2.0	4.2	2.4	4.1	14.1
Czech Republic	62.6	0.8	10.2	0.9	7.0	3.4	3.5	11.6
Bulgaria	58.2	1.4	6.4	1.6	4.4	3.6	5.5	18.9

*Source: Investment Climate Around The World, WB 2003, p. 122.*

220. In 2003, in order to improve access to bank financing for SMEs, a public guarantee fund for SMEs, was established with 100 million drams allocated in 2003. Insufficient financing for enterprise available from financial and commercial systems is also due to the poor quality of their management, lack of information on their activities and the large share of shadow economy, which significantly reduces country's attractiveness for investors. In this regard, efforts to improve corporate management will aim at protecting small shareholders and investors, regulating and simplifying company management systems, enhancing the reliability of information and broadly introducing modern accounting standards. To this end changes will be introduced in the legal framework regulating activities of companies, namely the Civil Code and the Law on Companies. Measures will be taken to improve access to consulting services, to allow for developing of more reasonable and acceptable financial and investment proposals.
221. In the last 12 years the competition environment in Armenia has been and is taking shape influenced on one hand by the open nature of the economy and on the other hand by the limited internal market. . As a consequence, monopoly powers have emerged in the sectors of import of certain basic consumption goods, and their wholesale sales. The entire telecommunication sector will remain monopolized until 2013, following the relevant privatization agreement. The main anti-monopoly and competition promotion law was adopted in 2000 and a regulating body, the State Committee for Protection of Economic Competition, was established. The mentioned sectors, more than any other area of the economy, are characterized by a lack of reliable information on markets, by higher levels of corruption and patronage, by large volumes of shadow operations and growing unfair competition, as well as by closer ties between businesses and central and local authorities (administrative monopoly). In order to address these issues, a state program of De-monopolization of Economy and Competition Promotion will be developed in 2003-2004, which will be implemented in accordance with the following priorities:
- (i) de-monopolization of economy, aimed at redistribution of control of monopolies in goods markets and creation of economic conditions for competition;
  - (ii) creation of a favorable competitive environment and promotion of competition, which is in line with both de-monopolization and anti-monopoly policies;
  - (iii) anti-monopolistic regulation of economy;
  - (iv) unified tariffs systems in cases of natural monopoly;
  - (v) improvement of the legal framework for anti-monopoly policies.
222. Efficiency of the state regulation of the private sector and effective and accessible public services are essential conditions for the development of the private sector and improvement of the investment environment. Despite some improvements in state regulation and provision of public services in

recent years, their quality still remains rather low. State regulation and public services were considered ineffective by 84 percent of respondent companies in Armenia, compared to 43 percent in Estonia and 48 percent in Poland. 86 percent of companies in Armenia mentioned that the judicial system is unfair. Customs services were rated as ineffective by 61 percent of companies, and tax administration was mentioned as a constraint to development by 74 percent of companies<sup>88</sup>. Measures for improving the quality and effectiveness of state regulation are presented in the PRSP sections on reforms of governance and judiciary system and tax policies.

223. In 2001-2002, for the first time in independent Armenia's history, increased exports were a main factor driving the economic growth. Exports grew by more than 50 percent in these two years. For 2003-2015, ensuring export growth will be one of the main priorities of economic policy (the PRSP macroeconomic framework projects an annual increase of 9.2 percent). Ensuring a stable economic growth driven by exports will require the implementation of comprehensive measures for export promotion. These measures will be included in **Strategy for Sustainable Economic Development in Armenia**, which will be approved by the government by the end of 2003.
224. Micro-enterprises (the self-employed and small family businesses) play a significant role in Armenia's economy<sup>89</sup>. Micro-enterprises are labor-intensive businesses and are one of the most important sources for family income growth. According to the results of the household survey conducted in 2001, 174,000 people had incomes from self-employment, amounting to 9.8 percent of the total incomes (10.7 percent for the poorer segments of the population). Thus, promotion of micro-enterprises and their development have a direct impact on poverty reduction. The international experience shows that micro-credit systems<sup>90</sup> are an effective tool in developing micro-enterprises; credits of USD 500-1000 provide the opportunity for establishing new micro-businesses mostly in services, primary processing of agricultural products and craftwork sectors. In Armenia's conditions micro-credits are especially important in rural areas and small towns for promotion of non-farming activities. This will also reduce regional differences in economic development. Thus, starting in 2004, comprehensive micro-credit systems for promoting non-farming employment will be introduced in Armenia, which will be accompanied by the relevant consulting services.
225. According to the most common definition of shadow economy, it involves activities and transactions of a commercial nature, which are not included in the official accounts of GDP and generated incomes are not recorded by tax authorities<sup>91</sup>. The shadow economy includes activities prohibited by law, as well as legal economic activities, which either are not officially registered or are totally or partially hidden from official statistics and tax authorities. There are a number of estimations of the shadow economy in Armenia, according to which it reaches to 45-50 percent of the official economy. According to F. Shneider's estimation the volumes of shadow economy in 2000 were 46.3 of GDP in Armenia, 67.3 percent of GDP in Georgia, 60.6 percent of GDP in Azerbaijan, 46.1 percent of GDP in Russia, compared to the average 38 percent for transition countries and 18 percent for developed countries<sup>92</sup>. According to PRSP estimations, shadow economy is almost equally divided into non-registered activities, which are prevalent in services sector, and incomplete declaration of incomes and volumes of activities by officially registered businesses, while the share of illegal activities is quite small. The main type of illegal activity relates to the widely spread smuggling.
226. Cross-country analysis of shadow economy shows that it is influenced by two main factors: country's level of economic development and effectiveness of the government, improvements in both factors lead to reduction of the shadow economy. Based on Armenia's specifics (high level of poverty and inequality, limited employment, importance of incomes from self-employment for poor families), the strategy for reducing the shadow economy within the framework of the PRSP in 2003-2015 will focus

<sup>88</sup> *Investment Climate Around The World, WB 2003.*

<sup>89</sup> *According to Growth Challenges and Government Policies in Armenia, WB 2002, p. 141, non-farm micro-enterprises produce 1.1 percent of Armenia's GDP.*

<sup>90</sup> *See The Microfinance Handbook, vv. 1-3, WB, 2001:*

<sup>91</sup> *F. Shneider, Size and Measurement of the Informal Economy in 110 Countries around the World. 2002, p. 3.*

<sup>92</sup> *F. Shneider. Size and Measurement of the Informal Economy in 110 Countries around the World. 2002, pp. 11, 13.*

on reducing the volumes of undeclared incomes and activities of registered businesses. Regarding the non-registered self-employment, it is envisaged that after the system of income declarations will become operational, the requirement for official registration will be abolished for types of activities not needing special qualifications. Thus, the strategy for reduction of shadow economy will include:

- (i) reforms of tax and customs systems, improvement of tax and customs administration and simplification of tax and customs systems;
- (ii) separation of the shadow economy from the political power and measures to prevent state capture;
- (iii) improvement of labor market regulation and introduction of labor registration mechanisms;
- (iv) improvement of money flow regulation and control.

#### 6.3.3.3. Enhancing financial intermediation

227. Adequate financial intermediation is a very important factor for poverty reduction. The ratio of banking system assets to GDP is only 17 percent in Armenia. There is a large excess liquidity in the banking system (as of April 1, 2003 the excess liquidity in the banking system amounted to about 26 billion drams), while the capital adequacy ratios, both by total and core capital, exceed the required minimums by 27 and 29 percentage points correspondingly. This situation is not conducive to poverty reduction in the country and expansion of credits has become an urgent issue. Another characteristic of Armenia's financial system is the predominant position of the banking system vis-à-vis the insurance and pension systems, which hampers the formation of long-term financial resources. Prerequisites for development of insurance and private pension companies need to be created.
228. There are a number of constraints hindering larger volumes of credit provision, particularly some provisions in the legal framework encourage borrowers not to repay their loans, which negatively affects the volumes of credits provided by the banking system. The following legal constraints need to be addressed:
- (i) "Rules of the game" in terms of court decision enforcement, in effect, inefficient, especially as far as the economic disputes are concerned it may take unreasonably long time. As a result, the creditors may be unable to compensate their losses;
  - (ii) Presently, property registration procedures are very costly and time consuming, which hinders the development of housing credits;
  - (iii) Currently it is not possible to evict third persons from a property (house) serving as collateral, the ownership of which has been transferred to a bank (according to the current practice children living in the house cannot be evicted, although the ownership of the property has been transferred to the creditor);
  - (iv) The application of laws regulating credit relationships is currently insufficient. For example creditors can sell the credit they have provided against a collateral to a third person, without the consent of the borrower and the person providing the collateral, but the current practice requires the consent of the person providing the collateral for selling and buying credits. Or, the current legislation allows for rights (as well as future rights) to be used as collaterals. But this is not possible in practice because of a number of purely technical problems.
229. Special attention needs to be paid to housing credits, since it will help solve a number of other problems at the same time. Here both social and economic positive results can be expected: in particular, those in need of housing will have the opportunity to acquire it, stocks and insurance markets will develop, better financing opportunities will be created for the construction sector (the latter is particularly important since volumes of foreign financing of construction are expected to fall in the near future).

#### 6.3.4. TAX POLICY

230. As mentioned in the chapter “PRSP Goals and Main Policy Directions”, increase of financial capacities of the state is one of the major strategic priorities. Improvements in tax (customs) policies and administration will create grounds for ensuring tax revenue growth of 0.3-0.4% of GDP per annum. Thus, potential for sustainable high economic growth may not be hampered because growth of tax revenues will be ensured through improvement of tax administration and simplification of the tax system.
231. According to the World Bank<sup>93</sup>, tax policies efficient from the poverty reduction perspective should be guided through establishment of a tax system with simplified administration, wider tax base and low tax rates. In a transition country like Armenia it is difficult to create a tax system, that would be efficient and at the same time have redistribution impact on incomes of the population. Consequently, selection of tax policy in the coming years should be between (i) a tax system that is simplified and efficient but with low redistribution impact, or (ii) a tax system that is progressive and has higher redistribution impact but low efficiency, with complicated application and monitoring rules.
232. It can be stated that as a result of reforms taken place during the several recent years a tax system with a wide tax base and minimum exemptions and allowances as well as basically with low rates has been established in Armenia. However, collection rates of existing taxes is yet low, as a consequence of which total tax and social contributions in 2002 made about 18% of GDP. Laws on some taxes still contain complicated, sometimes even contradictory provisions for assessment and payment.
233. The need for enhancing financial capacity of the state to be used for implementation of coordinated social and economic policies targeting poverty reduction dictates that growth of tax revenues becomes the priority for the medium term period. This should be implemented primarily through diminishing shadow segment of the economy. Simplification of tax laws should be continued, contradictions removed, and tax assessment and payment procedures and mechanisms made simple and understandable for predominant majority of the taxpayers. Tax administration efficiency should be increased and lead to reduced taxpayer payments related to meeting of tax obligations (accounting and statements) and for oversight of tax payments by tax authorities.
234. Wide tax base for value added tax has been established in Armenia with unified 20% rate, which is not substantially higher than the rate established in the region. Existing privileges are of extremely limited application (mainly financial services, charity, and local agricultural produce). The same procedures apply to taxation of domestically produced and imported products. The only exception is the sales of local agricultural produce with defined privileges to be in force until 2009.

Poverty reduction objective requires that taxation of value added in agriculture did not impede the economy and maintain maximum neutrality towards the output in this sector. A number of principal issues await resolution. First of all, this pertains to the problem of assessment and accounting of tax liabilities. Running of tax accounting for small agricultural farms by tax authorities could be considered as a possible solution. In this case, the accounting would be similar to that applied to land tax, the main tax paid by agricultural farms. At the same time an alternative taxation procedure could exist for those subjects, who export their own produce or sell it to processing industry, in order to preclude decline in the competitiveness of the produce of small agricultural farms.

235. Excise tax is applied only to tobacco, alcoholic beverages and oil-products. The tax rate is predominantly presumptive. Excise tax is paid only in the stage of production or importation. Same rates apply to products of domestic origin and imported goods. With the objective to enhance administration efficiency excise stamps are applied to alcoholic beverages and tobacco.

Excise tax should continue to be simple and very restricted in scope of application.

236. The unified rate of profit tax (20%), as well as absence of essential differences in tax and accounting reporting make the tax predominantly neutral in terms of investment decisions. Depreciation periods for tangible and intangible assets are predominantly unified for all the sectors. Very limited is the scope of application of the few existing exemptions and these are envisaged for attraction of foreign

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<sup>93</sup> PRSP Sourcebook. Overview, WB, 2001.

investments within limited time frame. The loss carry forward procedure is applicable during the following 5 years.

Application of profit tax should be simplified. To the utmost degree possible discrepancies between tax assessment and accounting systems should be lifted. Approaches should be instituted and enforced, which will simplify interrelations between tax authorities and taxpayers. Tax evasion should be minimized if necessary with application of alternative methods of profit tax evaluation (including minimum tax collection on the basis of estimation of real profitability).

237. Low rates of income tax and social contributions (the sum of the two taxes is 28% at all levels of income) are to ensure neutrality of these taxes towards expansion of employment. Existence of exemption from income tax at the minimum of consumer expenditures serves the interests of people with extremely low level of income. Both taxes have only two-layer schedule. Tax collection and payments in case of the both taxes are made by tax agents. Tax amount paid in this way is considered final and not subject to later reassessment.

Assessment procedure for income tax and social contribution should be further simplified. Progressive income tax and regressive social contributions schedules should be replaced by fixed rates, maintaining the aggregate sum of the two at the current level. In addition to simplification, changes in rates is equally important from the perspective of poverty reduction; namely individual numbers will be instituted effective 2004 for social insurance contributions, which will enable consideration of actual social contributions in addition to years of employment when defining pensions at later stages. Replacement of regressive schedule for social contributions with the flat one (fixed rates) will promote fairness of the system laying grounds for higher pensions all other conditions equal.

238. Property taxes are restricted in application. Property tax is applicable only to buildings and vehicles. Rates are not high (building related rates are progressive with the maximum of 1%), exempt threshold is three million drams, which essentially means tax exemption in cases of minimum residential needs. Limitation of the scope of property tax application has minimized impact of this tax on investment decisions. Land tax rates are low, and people involved in agricultural activities are exempt from other income taxes.

From the point of view of poverty reduction an important issue is the fairness in application of property tax. The major challenge will be removal of internal conflict. Currently progressive schedule is applied, but separate pieces of property belonging to one person are not consolidated for taxation purposes. It is necessary to consolidate total value of property belonging to one person or replace the progressive schedule with flat tax (fixed rates).

239. In addition to main types of taxes, simplified methods of tax assessment and collection are enforced for small businesses. Agents with annual turnover of below dram 50 million are entitled to pay tax on sales turnover instead of profit (personal income) and value added taxes. There are types of economic activities where presumptive tax is applied. In such cases particular objective is simplification of the tax accounting/assessment procedures, and reduction of tax expenses for relevant economic agents.

Targeting of simplified tax assessment mechanisms should be enhanced. It is absolutely mandatory to preclude cases whereby application of simplified or presumptive taxes is a way for economic agents to avoid performance of tax obligations. The tax assessment/accounting of people with restricted economic potential should be extremely simplified thus reducing business risks preconditioned by existence of taxes.

240. In general, the tax base of Armenia has huge unused potential in terms of increasing tax revenues through inclusion in the tax framework, including the possibility to avoid raising tax rates or instituting new taxes. In the framework of poverty reduction strategy, particularly the following issues are to be resolved:

- (i) Increase in the share of taxes in GDP;
- (ii) Development of tax systems promoting investment activities and employment and maintaining maximum neutrality towards sustainable economic growth;
- (iii) Refraining, to the utmost extent possible, from raising tax rates;

- (iv) Improvement of tax administration, qualitative improvement of interrelations between tax and customs authorities and taxpayers;
  - (v) Further simplification of tax systems, consolidation of existing tax laws into the tax code.
241. Taking into consideration the above goals, priorities of the state in tax policy in the medium term will be as follows:
- (i) Simplification of tax (customs) legislation and development of effective mechanisms for supervision of compliance with the legislative requirements;
  - (ii) Improvement of tax administration efficiency and tax oversight system;
  - (iii) Institution of equality in tax payments;
  - (iv) The redistribute function of taxes will have a minimal application, until the principle of horizontally fair taxation is fully in place (the principle of vertically fair taxation can be used widely only after the horizontally fair taxation principle is fully established).
  - (v) Stability of principles stipulated by tax policies and continuity in improvement of tax payment mechanisms.

## **CHAPTER 7. HUMAN DEVELOPMENT**

### **7.1. SOCIAL PROTECTION SYSTEM**

#### **7.1.1. DESCRIPTION OF SOCIAL PROTECTION SYSTEM AND MAIN POLICIES**

242. The social protection policy is aimed at protecting and realizing of economic, social and legal guarantees of human rights and liberties. The essence of social protection policy is the management of social risks by the state with the objective of their reduction. Ideology of social risks management derives from the judgment, that living conditions of individuals, families and communities are exposed to a number of risks emerging from various sources, both natural (earthquake, flood, diseases et cetera) and human (unemployment, deterioration of environment, wars and so on)<sup>94</sup>. Poor people who lack adequate resources for confronting social risks are far more vulnerable than non-poor. This factor incites people to elaborate and apply self-protection mechanisms, such as resource accumulation in a “rainy day fund”, diversification of income sources, reduction of expenditures, creation of informal networks of family and/or community assistance, and so on. Often and especially in case of the poor, these mechanisms are not efficient, their capacity is very low and they do not enable sustainable risk combat. These realities represent fundamentals for the state involvement in social risk management area.
243. State policies in social risks management should target risk prevention, reduction and regulation. To this end, three major spheres of social risks management by the state are<sup>95</sup>:
- (i) Social assistance, which enables the state to minimize the social risks of income reduction or persisting low level of incomes among vulnerable groups of population, as well as to ensure minimum living standards for them;
  - (ii) Pensions and other social insurance, which enable prevention of certain social risks, such as risks related to the old age or disease, through allocation of adequate resources throughout entire working period of individuals;
  - (iii) Employment and remuneration regulations, which regulate social risks related to employment and salary.
244. The social protection system of Armenia currently includes:
- (i) State social assistance programs, such as family benefits, disability, age and other social

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<sup>94</sup> *Social Protection Sector Strategy. From Safety Net to Springboard, WB, 2001.*

<sup>95</sup> *Balancing protection and opportunity. A strategy for social protection in transition economies, WB, 2000.*

- pensions, one-time child birth allowances, and child allowance (up to two years old);
- (ii) Social assistance programs for handicapped, veterans and children, in particular, medical and social rehabilitation programs, in-house social service to elderly and disabled, maintenance of internates, orphanages and boarding schools;
  - (iii) State social insurance programs, consisting of age and disability pensions, as well as allowances for temporary disabilities and pregnancy;
  - (iv) Employment programs, including unemployment benefits, retraining of unemployed as well as public and similar works;
  - (v) System of privileges for certain target groups of population, which in 1999 underwent significant reduction and currently comprises a few privileges, primarily for veterans of the World War II (and equivalent groups) established in the framework of CIS international agreements. These privileges are mostly funded by service providers. No new privileges are planned in the 2003-2015 period.
245. The above programs are currently funded from the state budget (family and other benefits, pensions of military servicemen, social assistance programs and public works, and starting 2003, also social pensions) and State Social Insurance Fund (state pensions, unemployment benefits, as well as temporary disability and pregnancy allowances). Donors' involvement is substantial in a number of social programs, particularly in public works and social security programs, nevertheless it is extremely complicated to evaluate and forecast the financial aspect of this involvement.
246. Given the importance of economic growth, in the framework of PRSP social protection policy:
- (i) Should not hamper high rates of economic growth and stability, in other words, objectives of the social protection policies and the volume of the relevant state resources should be derived from the priorities of ensuring high rates of economic and investment;
  - (ii) Should ensure efficient utilization of the limited state and public resources, i.e. be very targeted and address the prevention, reduction and regulation of social risks of clearly defined categories of population; in other words, it cannot try to ensure social protection, employment and income guarantees for the entire population, from the birth to death, as it used to be in the Soviet times.
247. The above taken into account, priorities of the social protection policies by spheres are presented below:
- (i) **In the sphere of social assistance:** use of the family benefit system to reduce poverty among the most vulnerable people through substantial enhancement of targeting extremely poor households and ensuring that their consumption level is not below the food poverty line. In later periods, provided increase of allocations to family benefits and poverty reduction generally, the aim should be to raise the consumption level of the poorest population above the food poverty line;
  - (ii) Another important priority of social assistance is rendering high quality targeted services to categories of population in need of special protection, such as the handicapped, orphans, refugees and displaced people in view of substantially meeting demands for such services;
  - (iii) **In the sphere of social insurance:** reduction of the number of poor pensioners and increase of pensions to bring them above the general poverty line, rating pensions on the basis of pension contributions and period of employment;
  - (iv) Comprehensive reform of mandatory social insurance system, including enhancing its efficiency, substantial review of principles of appointing pensions and ensuring financial stability and sustainability of the system;
  - (v) **In the sphere of employment policies:** replacement of the currently existing inefficient policies of unemployment insurance and transition to proactive employment policies;
  - (vi) **In the sphere of income policies:** ensuring accelerated increase of salary rates in budget and social infrastructures so as to ensure a level at least twice higher than the general poverty line, also to set the legislatively defined minimum salary rate equal to the general poverty line.

248. Main financial indicators of the social security system of Armenia in 2001-2015 are presented in the Table 7.1 below:

**Table 7.1. Main financial indicators of the social protection system of Armenia in 2001-2015**

	2001	2002	2003	2004	2005	2006	2009	2012	2015
<b>Social security, total, in billion drams</b>	<b>57.4</b>	<b>60.3</b>	<b>69.6</b>	<b>79.5</b>	<b>90.7</b>	<b>103.3</b>	<b>141.9</b>	<b>173.2</b>	<b>215.5</b>
<i>% of GDP</i>	4.9	4.4	4.7	4.9	5.2	5.4	5.7	5.5	5.4
State budget, in billion drams	17.7	23.5	28.8	33.0	38.1	43.8	57.0	65.5	78.8
<i>% of state budget expenditures</i>	7.1	8.7	9.0	10.0	10.6	11.3	11.0	9.7	9.3
State Social Insurance Fund, in billion drams	39.7	36.7	40.8	46.5	52.6	59.5	84.9	107.8	136.7
<i>% of total social security expenditures</i>	69.2	60.9	58.7	58.5	58.0	57.6	59.8	62.2	63.4

*Source: National Statistical Service, PRSP projections.*

## 7.1.2. SOCIAL ASSISTANCE SYSTEM

### 7.1.2.1. Family Benefits

249. Prerequisites of state allowances were established back in Soviet times by introducing “Allowances for Children from Less Secure Families”. The system of allowances has undergone manifold modifications, including monthly allowances paid to children under 17, privilege related compensations to certain categories et cetera, all these and others were replaced in 1999 by the system of family benefits.
250. According to the 2002 Integrated Household Survey, social transfers (mainly pensions and family benefits) constituted the largest source of income of poor families, i.e. 57.8% for the poorest 10% of families; 45.5% for the next 10%; and 52.9% for the third decile.
251. Family benefits and pensions are an efficient tool for poverty and inequality reduction. Some 45% of the reduction in the share of very poor households from 22.9% down to 16% was preconditioned by the increase of the volume of social transfers.
252. On the other hand, family benefits represent the most efficient tool for eradication of income inequality. To this end, according to 2001 data, one percent growth of family benefits at the national level reduced the income inequality (Gini coefficient of income concentration) by 0.67 percentage points, of which 0.4 percentage points in rural areas, 0.25 percentage points in Yerevan and 1.14 percentage points in other cities.
253. The volumes of family benefits and number of eligible households (see Table 7.2) envisaged in the framework of PRSP reflect the imperative of reducing the number of very poor households, which is the main reason for introducing the system of family benefits. On the other hand, reduction in the number of very poor families leads to a reduction of beneficiaries, which, in turn allows for significant increase of the average benefit rate.

**Table 7.2. Family benefits in 2001-2015 (in current prices)**

	2001	2002	2003	2004	2005	2006	2009	2012	2015
<b>Total expenditures, in billion drams</b>	<b>17.66</b>	<b>12.08</b>	<b>12.75</b>	<b>16.09</b>	<b>20.21</b>	<b>24.94</b>	<b>29.82</b>	<b>33.01</b>	<b>39.76</b>
<i>% of GDP</i>	1.5	0.9	0.9	1.0	1.2	1.3	1.2	1.1	1.0
Number of beneficiaries, thousand households	173.3	149.0	139.0	139.0	139.0	132.4	112.5	87.0	87.0
Average monthly benefit, dram	8 500	6 760	7 640	9 649	12 115	15 697	22 096	31 597	38 066

*Source: Ministry of Finance and Economy, Ministry of Social Security, PRSP projections.*

254. Despite the fact that introduction of family benefit system has substantially, i.e. twice, improved the targeting of social protection measures towards most needy categories, nevertheless in 1999-2001 the targeting efficiency of the family benefits has diminished (see Table 2.3). Tightening of the eligibility criteria in 2000-2002 (additional provisions were introduced in the formula, such as benchmarks for electricity consumption and telephone conversations, import and export customs declarations,



acquisition of real estate leading to improvement of housing conditions, etc) have led to substantial reduction of budget allocations as well as of the number of beneficiaries. Aiming at improvement of benefit targeting, starting January 2002 another change in the formula of family benefit calculation was introduced: additional benefits were earmarked only to children up to 18 in eligible families. The reasoning was that families with many children are among the most vulnerable groups. However, above-mentioned changes did not allow for improvements in targeting as compared to 1999.

255. Taking into consideration the fact that family benefits are an efficient tool for increasing the well-being of very poor families (who, have extremely restricted sources of permanent income, apart from social transfers), while improvements in living standards of poor families<sup>96</sup> should mostly result from policies of promoting their “primary” incomes (wages, pensions, income from self-employment), the 2003-2015 state policies in the family benefits envisages:
- (i) The number of beneficiary households should be periodically revised to be consistent with the number of very poor households. The ratio of the number of beneficiary households to the number of very poor households is to be used for this purpose. In projections, starting 2006 this ratio is maintained at the level of 1.15<sup>97</sup>. Taking into account the dynamics of the number of poor people assumed under the PRSP, the number of beneficiary families is also decreasing, reaching 108.5 thousand in 2010 and 42.3 thousand in 2015 (against 139 thousand in 2003).
  - (ii) Effective 2004 one-off allowances will be completely removed and the saved allocations will go to family benefits. The reasoning for removal one-off allowances is that these are not a permanent source of income (payment period is up to three months and the rate of payment is 4000 drams, which is equal to base allowance).
  - (iii) The above-explained regular reduction of the number of beneficiaries<sup>98</sup> should be based on a substantial enhancement of targeting in the system. The program envisages increasing targeting efficiency from 55.3%<sup>99</sup> in 2001 to 80%, and for the poorest 10% to 40%<sup>100</sup> by 2007, and maintaining this level up to 2015.
  - (iv) In order to enhance the targeting of family benefits, effective 2005 transition from currently existing indirect system of household evaluation (scoring) will commence to the direct one (whereby the criterion for evaluating household standing will exclusively be incomes<sup>101</sup> of the household members), which will be appropriate to pilot in one of the territorial social assistance services in Gyumri<sup>102</sup>. If the integrated surveys prove higher degree of targeting reached under the regression analysis on the basis of income evaluation, in 2005-2007 this will replace scoring system nationwide.
  - (v) A matter of concern is low degree of inclusion of very poor families in the family benefit system. Partially this is due to insufficient awareness about the scheme among the poorest population. This requires that regional social centers themselves identify the poorest rather than

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<sup>96</sup> The concept of “poor household” here applies to households, whose own incomes are above the food poverty line, but below the general poverty line.

<sup>97</sup> This ratio corresponds to the average value recorded in 1999-2003. Maintaining this value is necessary to account for the need to minimize “unavoidable inclusion” (i.e. including in the system households, not belonging to the very poor) and exclusion errors (i.e. leaving out very poor households from the system).

<sup>98</sup> Technically the reduction may be carried out not on a yearly basis but rather biennially, thus maintaining the above described ratio during each such reduction.

<sup>99</sup> According to the 2001 Integrated Survey, 40% poorest population received 55.3% of total family benefits (65.6% in 1999). In 2001 10% of the poorest population received only 6.5% of total family benefit funds.

<sup>100</sup> Strengthening of targeting is envisaged along the flowing lines: 20 and 60% in 2003; 25 and 65% in 2004; 30 and 70% in 2005; and 35 and 75% in 2006.

<sup>101</sup> Regression analysis of the formula based on evaluation of household incomes was successfully tested in 2001 in Aragatsotn marz for a sample of 2000 households, which displayed higher degree of targeting.

<sup>102</sup> Gyumri has been selected in view of the highest share of poor and very poor households, as well as due to the fact, that according to the data of the Ministry of Social Security, distribution of households in the regional social assistance centers is the most disproportionate in the republic in terms of scoring. The number of households, who scored 36-37 are respectively 9 and 16.5% more than those who scored 35-36. Currently, 36 is the minimum benchmark allowing for eligibility for the family benefit.

merely making a selection among applications filed by households.

- (vi) Increase of average benefit rate, which will become possible through reduction in the number of beneficiaries (see Table 7.3).
- (vii) Assessment of the family benefit efficiency on the basis of integrated household surveys, which will be carried out on a yearly basis effective 2004. These surveys will enable evaluation of the family benefit targeting efficiency, changes in the number of poor and very poor households in terms of territorial, social and other groups, including impact of family benefits on poverty. Results of the surveys will become the basis for adjustment of benefit policies, including revision of the number of beneficiaries, as well as territorial distribution of relevant resources. Effective 2005 family benefit programs will be reviewed to incorporate results of annual integrated surveys.
- (viii) Until introduction of regression formula for family benefits, the current scoring formula will be applied, which consists of a base rate and the addition accrued for each child under 18. Increase of benefits will be proportionally distributed between the basis and addition components.

**Table 7.3. Family benefits and poverty, 2001-2015 (in current prices)**

	2001	2002	2003	2004	2005	2006	2009	2012	2015
Average monthly benefit per capita, dram	2 458	1 893	2 140	2 702	3 393	4 396	6 188	8 849	10 661
Poverty food line per capita, dram	7 368	7 576	7 632	7 827	8 002	8 207	8 836	9 469	10 169
<i>Family benefit as % of poverty food line</i>	33.4	25.0	28.0	34.5	42.4	53.6	70.0	93.5	104.8
Average monthly salary rate, dram	24 483	26 488	29 462	32 078	35 048	38 235	48 927	59 609	71 607
<i>Average family benefit as % of average monthly salary</i>	10.0	7.1	7.3	8.4	9.7	11.5	12.6	14.8	14.9
<i>Minimum salary rate, dram</i>	5 000	5 000	5 000	12 767	13 053	13 387	14 414	15 446	16 588
<i>Average family benefit as % of minimum salary rate</i>	49.2	37.9	42.8	21.2	26.0	32.8	42.9	57.3	64.3

Source: National Statistical Service, PRSP projections.

256. Per capita family benefit will reach poverty food line in 2013 and exceed that thereon. Comparison of family benefits with the minimum salary rate and average salaries shows that substantial increase in the benefit rates in 2004-2015 may not affect the labor force participation negatively, since the benefit does not exceed 15% of average salary and does not exceed 65%<sup>103</sup> of minimum salary, which since 2004 will be equated to general poverty line.
257. The following measures are envisaged under the family benefit policy:
- (i) Adoption of the Law on the State Benefits aiming at improvement of public benefits system, which will regulate all issues related to public benefits currently administered by various government decrees;
  - (ii) Enhancement of information accessibility, creation of national information network on social services;
  - (iii) Reformation of the appeals system, creating a simplified, understandable, transparent and fair system;
  - (iv) Elaboration of effective mechanisms of monitoring family benefit selection and payment system, prevention of corruption and potential arbitrariness.

#### 7.1.2.2. Other Social Assistance Programs

##### 7.1.2.2.1. Maternity Allowances

258. There are three types of allowances currently existing in Armenia in respect of birth of a child. The

<sup>103</sup> Drastic growth of family benefits will be recorded in 2014-2015 because of relevant reduction in the number of very poor families projected at the level of only 4.11% by 2015.

first is the one-off maternity allowance<sup>104</sup>. The objective is partial compensation of costs related to birth of a child and it is currently paid by State Social Insurance Fund. Next is the monthly payment to people that are taking care of children (up to 2 years old) and are on partially paid leave; these are paid from the state budget<sup>105</sup>. In addition, the existing legislation provides for one year unpaid leave following two years of partially paid maternity leave. After this three-year period, the employer must ensure the same or adequate job to the person, returning from such leave. The third is pregnancy and delivery allowance (maternity benefits) payable to employed women for a period of 70 days preceding the delivery and 70 days thereafter. This allowance is equal to the average salary received during the three months preceding the leave (on a daily basis<sup>106</sup>).

259. The above allowances are extremely important for promoting birth rate, for material support to families and for family planning purposes. Taking into account that poverty risks for families with 0-7 years old children and multi-children families are higher than that of average families (see Tables 2.10 and 2.12), these allowances may serve the goal of poverty and inequality reduction as well. However, carrying a legacy of the social security system operating in the Soviet Union, neither the rates nor eligibility criteria are compliant with the current realities and requirements.
260. With the objective to encourage a higher birth rate and to enhance the efficiency of allowances related to birth of children, it is envisaged to:
- (i) Substantially increase the rate of one-off allowance so as to cover a larger share of relevant expenses and effective 2005 pay those from the state budget<sup>107</sup>;
  - (ii) Cut the duration of the partially paid leave for taking care of children to 1 year<sup>108</sup> effective 2004.
  - (iii) Maternity benefits (pregnancy and delivery benefit) are common almost worldwide. However, duration of this allowance in Armenia, given the current realities is long<sup>109</sup>. Effective 2004 the duration will be curtailed to 112 days (126 days for complicated deliveries and 156 days in case more than one child is born). Effective 2005, maternity benefits will be financed from the state budget, because they are not of insurance nature.

#### 7.1.2.2.2. Other Allowances

261. **Temporary incapacity benefit:** Hired employees making mandatory social contributions are entitled to temporary incapacity benefit in cases of incapacity or professional disease and industrial injuries. The rate of allowance depending on the period of employment varies within 80-100% of the salary. In contrast to many other countries where temporary incapacity allowance is partially paid by the employer (as a rule, during the first two weeks of the disease), in Armenia it is entirely paid State Social Insurance Fund. Partial payment by employer would allow for higher efficiency in monitoring these allowances. Bearing this in mind, effective 2004 first two weeks of temporary incapacity benefits will be paid by employers. Relevant legislative amendments will be made in 2003.
262. **Recreational treatment** is paid out of the resources of the State Social Insurance Fund according to a number of legislative acts, in particular, to the "Law on Social Protection of Disabled People in Armenia". Around 150 thousand citizens are entitled to free recreational treatment in sanatoriums, including 110 thousand handicap people. Dram 480 million was spent for this purpose in 2002 (1.2% of the State Social Insurance Fund revenues, or 14% of resources spent for handicap employment pensions). On this purpose dram 550 million will be spent in 2003. These expenditures in essence contradict the priority of "primary" income policies in social protection, particularly, the strategy to increase pensions. Thus the provision of free recreational treatment in sanatoriums will be

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<sup>104</sup> In 2001 this allowance made 5900 drams.

<sup>105</sup> Average monthly rate of this allowance in 2002 was around 5400 drams. In 2002 around 5400 people received this allowance.

<sup>106</sup> Around 6000 women received maternity benefits in 2001; total allocation was dram 435.2 million.

<sup>107</sup> This allowance is not related to social insurance contributions, it is related to social assistance programs and, subsequently, must be paid from the state budget.

<sup>108</sup> Duration of this allowance in Armenia is much longer than in other CIS countries (average 18 months).

<sup>109</sup> In the Soviet Union maternity benefits were paid during 56 days prior to delivery and another 56 days thereafter.

discontinued from 2004. Relevant amendments in legislation will be introduced in 2003.

263. The rates of allowances envisaged in the framework of PRSP and required financial resources are presented in the Table 7.4 below:

**Table 7.4. Child birth and other allowances, 2002-2015 (in current prices)**

	2002	2003	2004	2005	2006	2009	2012	2015
Monthly allowance during partially paid maternity leave, drams	4 050	4 340	4 520	4 700	9 820*	11 200	12 350	13 960
Number of beneficiaries, thousand	5.4	5.4	5.7	6.0	3.1*	3.6	4.1	4.6
Financing, million drams	260.8	283.2	309.2	337.6	368.6	477.5	604.0	764.0
Maternity benefit (pregnancy and delivery), dram	57 620	61 820	51 420**	53 530	55 860	63 700	70 290	79 430
Number of beneficiaries, thousand	6.0	6.1	6.4	6.7	7.0	7.9	9.1	10.2
Financing, million dram s	345.7	375.4	327.9	358.0	390.9	506.3	640.5	810.2
Temporary incapacity benefit, million drams	335.8	364.7	199.1***	217.4	237.3	307.4	388.9	491.9
Recreational treatment allowance, million dram	480.0	550.0	0.0****	0.0	0.0	0.0	0.0	0.0

\* The cut results from reduction of allowance payment period (from two years to one year).

\*\* Due to reduction of the allowance payment period (from 140 days to 112 days).

\*\*\* Since the first two weeks of temporary incapacity allowance will be covered by employers.

\*\*\*\* Recreational treatment allowances will stop effective 2004.

Source: Ministry of Social Security, PRSP projections.

#### 7.1.2.2.3. Social Security Programs

264. **Social assistance to elderly and handicapped:** Social assistance programs for elderly and handicapped people are derived from the legislative requirements stipulated in the Law on Social Protection of Handicapped People in Armenia. These include prevention of disability, medical and social rehabilitation and prosthesis, in particular, prosthesis and orthopedic assistance to handicapped, provision of rehabilitation accessories, social service to lonely elderly and handicapped. In 2004-2015 the state budget will finance:

- (i) Provision of free prosthesis and orthopedic accessories to handicapped and repair of these devises. Taking into consideration that the number of beneficiaries of this program is relatively stable, budget financing of this item in 2003-2015 will stay at the level of dram 395.5 million (at 2002 volume and prices);
- (ii) Program of maintenance of internates and in-house social services to lonely handicapped and elderly people. In-house social services to lonely handicapped and elderly people is carried out by “Republican Center for in-house Social Services to Lonely Handicapped and Elderly People”, which renders services to 1200 pensioners in Yerevan only. Currently around 900 pensioners are living in six public and non-public internates, of which 450 are at two internates under the auspices of the Ministry of Social Security. Financing of the program in 2003-2015 will amount to dram 762 million per annum in 2002 prices, maintaining the level of financing of 2002.

265. Donors are making substantial investments in social programs for handicapped and elderly people. Taking into account the lack of financing and the large needs in this sector (e.g. there are 600 people registered in the Ministry of Social Security to get wheel-chairs, including 100 children, while around 2000 people are registered to get otoscopes, including around 150 children), the government will take relevant measures to coordinate the activities of the state and donors starting in 2003.

266. **Social assistance to children:** There are 8 orphanages in the jurisdiction of the Ministry of Social Security (with around 900 children), including two for children with restricted abilities (300 children). In addition, there are also three non-public orphanages, currently serving 150 children. Currently there are 55 thousand female-headed households, in Armenia, where the number of children is more than 63.7 thousand. These households are classified among the socially vulnerable categories. 23.8 thousand of these children (37.4%) have single mothers, 11.1 thousand (17.4%) have divorced parents, and 28.8 thousand (45.2%) children have lost their male heads of households. Thus the predominant

majority of the children in orphanages come from single-parent families; however, in the recent years in orphanages the number of children from complete, but socially vulnerable families tends to increase. Per child expenditures in the orphanages are dram 50 000 per month. Effective 2004, upon adoption of the Family Code and relevant legislative framework, children will move from orphanages to “sponsoring” families and will receive annual 600 000 dram financial aid from the state. In addition to the positive moral aspects of being in these families, which is evident from international experience, this will also be economically efficient and it will also address the problem of housing for the children after graduation from orphanages. Total allocations for maintenance of orphanages in 2003-2015 are projected at the level of dram 366 million, maintaining the level of 2002 in 2002 prices. Except for a few special boarding schools (for children with mental and physical disabilities, minor criminal and special occupation institutions), the other children at boarding schools are the ones from very poor families. It is necessary to place these children in general schools, providing them with the necessary financial resources for food, clothes and school accessories. The issues of social protection of graduates from orphanages and their integration into the society are also important and since 2003, the Government has been implementing the program State Assistance to Orphanages’ Graduates aiming to resolve these issues.

267. **Programs of social assistance to refugees:** Refugees as a socially vulnerable category have the following specifics: most of them are residing in temporary shelters, they have insufficient or no furniture or other necessities, the level of poverty or extreme poverty is much higher than average indicator, conditions of women refugees are especially tough, they have insufficient or no representation in national, regional or community authorities, they lack domestic animal or land ownership in rural areas, they face difficulties with regard to social and cultural integration and so on.
268. Taking into account the above, social protection policies for refugees should target creation of equal opportunities for refugees and local residents and mitigate the eye-striking differences, between them. To this end, the problem of housing is the most painful impediment to refugee integration into the society. The program of provision of housing to refugees from Azerbaijan in 1988-1992 approved by the government on December 14 2000 pursues resolution of this problem. In particular, it targets completion of construction works on half-finished multi-apartment residential buildings and individual residential units located on house-adjacent lands, renovation of the hostels inhabited by refugees into residential buildings, acquisition of apartments for refugees residing in emergency buildings, and construction of residential units (boarding houses for elderly people) for lonely elderly refugees. As the result 11 thousand families will be provided with flats and more than 1500 elderly people will be placed in boarding houses. In 2003-2004 the government will undertake measures to improve housing conditions for refugees residing in temporary shelters. An alternative approach in this respect is the implementation of housing certificate program with involvement of donor organizations.
269. Next priority is providing opportunities to extremely poor rural refugees to get involved in animal breeding and crop growing. This program envisages equal opportunities for refugees and extremely poor local people. Taking into consideration the fact that a substantial portion of currently rural refugees used to be urban residents, the program should provide for a relevant training component as well.
270. **Program of social assistance to internally displaced people:** Among the near-border regions, the hardest conditions are in the ones that suffered from military actions or the so-called “post-conflict” areas. 132 out of 170 near-border settlements are ruined, residential stock, roads, drinking water communications, sewage systems are destroyed health, education and household services are in extremely poor conditions. 72 000 people were forced to leave their homes, some 40% of which later returned and the rest, are the so-called internally displaced. A substantial part of agricultural lands is mined. In order to carry out post-conflict rehabilitation, promote return of the population and improve living standards of the population, the government has elaborated three programs;
- (i) The program of “Post-conflict Rehabilitation in Near-border Regions of Armenia”, which exclusively targets internally displaced people;
  - (ii) “Initial program of improving residential conditions for residents of near-border regions damaged by bombing”;

- (iii) “Comprehensive development program in near-border regions” provided by the Law of Armenia on Adoption of the Comprehensive development program in near-border regions.

To implement these programs it is necessary to carry out a survey to collect new data, which has already started with the support of the government of Norway.

271. One of the very important issues in post-conflict rehabilitation is the return of locally displaced people (39 000 people, 9 300 families) and ensuring minimum living conditions through provision of minimum means of existence, opportunities for income-generating activities (farming) and ensuring the availability of minimum social infrastructures in the initial stage. One of the major components of the program is addressing the needs of those, who returned to their initial settlements themselves (28 000 people) and those who never left the region. Mine clearing is extremely important; should this be fulfilled it is expected that cultivated lands will increase by 25% and the panic will subside. In case mines are not cleared from the area, out-migration will persist.
272. The post-conflict rehabilitation program should be complemented with sub-programs targeting cultural rehabilitation, including restoration of cultural centers with the emphasis on library and information assets and restoration of the community life.

### 7.1.3. PENSION SYSTEM

#### 7.1.3.1. Existing Pension System

273. The pension system of the Republic of Armenia consists of state pension insurance and state pension security systems.
274. State pension insurance system includes:
- (i) Age pensions (392 thousand people receiving pensions in 2001 constituted 71% of total pensioners). The Law on the State Pensions enacted on April 10, 2003, set unified retirement age for men and women at 63, and minimum 5 years employment requirement. Meanwhile, the schedule of gradual increase in retirement age for women defined in the previous law has been maintained, according to which retirement age for women will increase by six months per year reaching 63 by 2011<sup>110</sup>. Currently, retirement age for men is 63 years, and for women it is 59<sup>111</sup>.
  - (ii) Protracted service pensions (total of 19.1 thousand beneficiaries i.e. 3.4% of total pensioners in 2001): Currently, the eligibility criteria for protracted service pensions are regulated by the Law on State Pensions<sup>112</sup>.
  - (iii) Disability insurance pensions: (the number of beneficiaries in 2001 was 66.7 thousand, or 12% of total pensioners). The requirements on minimum number of years worked for different age groups to be qualified for this type of pension are defined in the Law on the State Pensions. In particular, for the age group 30 and above it is set at 5 years.
  - (iv) Insurance pensions to families who have lost the head of the household. In 2001 their number was 14.4 thousand, or 2.6% of total pensioners.

The above pensions are based on the mandatory social insurance contributions and constitute the labor (insurance) pension system.

275. State pension security system includes social pensions, as well as pensions paid to public servants in defense, national security, interior and emergency situations management department. Pensions to military personnel are estimated at 70% of their financial remuneration and include a number of supplements. Pensions to veterans of World War II and equivalent persons, as well as pensions paid to military personnel handicapped during the service, and to families of died military personnel are also paid from the state pension security scheme. The number of beneficiaries in this category was 22.3

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<sup>110</sup> The previous law regulating pensions provision was enacted on January 1, 1996, which constituted gradual increase in retirement age for both men and women from 60 to 65 and from 55 to 63, respectively.

<sup>111</sup> The Law on the State Pensions defines also eligibility criteria and rights for early retirement.

<sup>112</sup> According to the Law on the State Pensions only employees of civil aviation are eligible for protracted service pensions, while some categories of people employed in the education and culture sectors are eligible for partial pensions.

- thousand people in 2001. In 2001 the number of people receiving social pensions was 47 thousand.
276. Social pension system includes:
- (i) Age social pensions (these are provided to people non-eligible for age pensions insurance starting at age 65);
  - (ii) Social pensions for disability (these are provided to handicapped people non-eligible for disability insurance pensions, as well as to disabled children);
  - (iii) Pensions paid to families who lost the head of the household with non-sufficient employment record.
277. Current pension system is mainly financed from mandatory social contributions. Pensions of the personnel serving in military, national security, interior and emergency situations management department are financed from the State budget. In 2000 these pensions were on average 6 times higher than the age pension rate, and in 2002 more than dram 7.9 billion was allocated from the state budget for this purpose. Starting 2003 allocations for social pensions are also made from the state budget (dram 2 billion for 2003).
278. Mandatory social contributions are the source of financing for a number of other social programs as well (state employment programs, including unemployment benefits, partial compensation of funeral costs to pensioners, disease and maternity benefits). Since 2001 the progressive-regressive three-layer scheme is in place, according to which employers pay 5000 drams +15% (for salaries between 20 000 drams and 10 0000 drams) or + 5% (for salaries higher than 100 000 drams), while employees pay 3% of the salary. Mandatory social contributions paid by individual entrepreneurs and landowners in 2000 totaled dram 429.2 million, or 1.4% of social payments, in 2001 the amount was drams 537.6 million, or 1.5% of social payments.
279. During the recent decade, both branch structure of the economy and the proportion of the formal and informal segments thereof have undergone tangible changes. As a result, both the number of payers of mandatory social contributions and volumes of payments have substantially decreased. The latter is, inter alia, due to substantial underreporting of actual salaries. Thus, while in Soviet times 1.6 million people employed in various branches of economy were all practically payers of mandatory social contributions, out of 1.37 million employees in 1997 only 570 thousand paid relevant amounts (in 2000 these indicators were 1.27 million and 490 thousand respectively).
280. This factor, accompanied with the substantial payments of allowances not related to social insurance from the budget of the State Social Insurance Fund<sup>113</sup>, became the main reason why development of the Armenian pension system in 1999-2002 lagged behind the GDP and average salary growths. While the GDP in 1999-2001 grew by 18.8% (in current prices), average salaries by 18.7%, the average pension rate grew by only 3.4%, and the average retirement pensions by 2.9%.
281. Pensions in Armenia are very low, currently the lowest in the CIS countries. Other sources of income absent, all the pensioners in the country should have been considered as poor in 1999-2001, with their 94% very poor, since average pension rate had not guaranteed availability of even the minimum food basket.
282. An important feature of the existing pension system of Armenia is the reduction of age pensioners over each subsequent year; in 1999-2001 number of pensioners declined by 16.4 thousand, or 2.9%, and the number of age pensioners by 21.7 thousand, or 5.2%. Reduction in the number of age pensioners, which will persist in 2003-2015, is attributed to:
- (i) Gradual increase of the retirement age, 6 months per year, with its impact felt up to 2011, when women reach the retirement age of 63 years old, but the tension will fade a bit in 2003 when men reach the retirement age of 63;
  - (ii) Those entitled to age pensions in the current and near future were born in 1941-1945, when the growth of population was extremely low because of the War;

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<sup>113</sup> In 2001 State Social Insurance Fund expended 63.8% of its revenues for payment of retirement pensions.

- (iii) Migration: according to estimations based on official and sampled data<sup>114</sup> around 25% reduction in the number of pensioners is a consequence of migration in 1991-2001.

The above factors affect also other types of pensions, such as pensions related to military service. The number of occupational disability and social pensions is relatively stable and dependent on number of targeted handicap, whose average indicator in 1996-2001 was 3.2% of population in Armenia.

### 7.1.3.2. Objectives, Directions and Major Measures of Pension System Reform in 2003-2015

283. Developments in the pension system in the framework of PRSP are presented in the Table 7.5 below:

**Table 7.5. Pension system in Armenia, 2003-2015\***

	2002	2003	2004	2005	2006	2009	2012	2015
Number of pensioners, total, thousand people	553.1	531.7	528.2	496.0	494.8	457.1	438.2	439.5
Employment pensioners, thousand people	483.7	462.0	458.4	426.0	424.5	386.0	365.9	365.6
Including: age pensioners, thousand people	392.6	370.7	367.0	334.3	332.5	292.9	271.3	268.8
Disability pensioners, thousand people	66.8	66.9	67.1	67.3	67.5	68.3	69.4	71.0
Social pensioners, thousand people	47.1	47.3	47.4	47.5	47.7	48.3	49.1	50.2
Military pensioners, thousand people	22.3	22.4	22.4	22.5	22.6	22.8	23.2	23.7
Average monthly pension rate, dram	5 148	6 365	7 407	8 939	10 138	15 755	20 994	26 714
Employment pension, dram	4 979	6 382	7 397	9 082	10 374	16 564	22 260	28 338
Age pension, dram	5 118	6 588	7 645	9 432	10 786	17 377	23 482	29 945
Disability pension, dram	3 989	5 049	5 825	7 103	8 087	12 747	17 072	21 728
Social pension, dram	4 079	3 523	4 800	5 115	5 437	7 151	9 361	12 186
Military service pension, dram	11 062	12 013	13 116	14 320	15 635	20 252	25 618	32 406
Average monthly salary rate, dram	26 488	29 462	32 078	35 048	38 235	48 927	59 609	71 607
Average pension average salary ratio, %	19.4	21.6	23.1	25.5	26.5	32.2	35.2	37.3
Pension expenditures, billion drams	34.2	40.6	47.0	53.2	60.2	86.4	110.4	140.9
<i>Pension expenditures/GDP, %</i>	2.5	2.8	2.9	3.0	3.1	3.5	3.5	3.5
Average pension/general poverty line, %	41.7	51.1	58.0	68.5	75.7	109.3	135.9	161.0
Social pension/poverty food line, %	53.8	46.2	61.3	63.9	66.2	80.9	98.9	119.8
Number of de facto population in Armenia**, thousand people	3 008.6	3 013.8	3 020.5	3 028.4	3 038.1	3 074.2	3 125.7	3 196.0
<i>Pensioners/de facto population, %</i>	18.4	17.6	17.5	16.4	16.3	14.9	14.0	13.8
<i>Age pensioners/de facto population, %</i>	13.1	12.3	12.1	11.0	10.9	9.5	8.7	8.4

\* Note: The Table does not contain pension paid to military, national security, interior and emergency situations management department personnel, which are entirely paid from the state budget; nor the number of beneficiaries is estimated here.

\*\* Note: Projections of the number of population in Armenia are based on the preliminary data of the 2001 Census and does not taken into consideration migration factor.

Source: NSS data, for 2002-2005 - 2002 approved budget data and Medium Term Expenditure Framework projections; PRSP projections.

284. Reduction trends in the number of pensioners will enable maintaining financial stability of the pension system up until 2015, if the existing rates of social contributions are preserved and the number of contributors to the State Social Insurance Fund does not diminish from the level of 2000, i.e. 490 thousand people.

285. At the same time, current and future reduction trends in the number of pensioners and related financial stability of the system provide a unique opportunity to implement fundamental reforms in the pension system of Armenia in 2003-2005. These reforms target:

- (i) Increase of pensions so that the average employment pensions in 2005-2006 exceed per capita poverty food line, and the per capita general poverty line by 2008;
- (ii) In 2003-2005 social and other pensions, which are not based on mandatory social contributions

<sup>114</sup> Armenian Statistical Yearbook (1997, 1998), p37, Yerevan, 2001; Armenian Statistical Yearbook (1999, 2000), p39, Yerevan, 2001; Armenian Statistical Yearbook (2002), pp43-47, Yerevan, 2002, pp. 43-47.



- to be financially separate from employment pensions;
  - (iii) Streamlining of collection mechanisms in respect of mandatory social contributions;
  - (iv) Radical increase in the degree of differentiation between age pensions on the basis of employment period;
  - (v) Certain tightening of eligibility criteria for pensions;
  - (vi) Development of legislative and organizational measures to start transition to three-layer pension system in 2006 (mandatory social insurance, social pensions and voluntary pension insurance system).
286. Table 7.5 shows that in 2003-2015 substantial improvement of living conditions of the pensioners will take place, i.e. effective 2005 age pensions will be above poverty food line, while disability pensions will approach it. Poverty line will be overcome effective 2008. Social pensions will exceed the poverty food line in 2013. Such developments will materialize given financial stability of the pension system, which is, in turn, preconditioned by economic growth and unprecedented reduction in the number of pensioners, especially age pensioners, up until 2015. The proportion of average pension to average salary will also improve reaching 37% in 2014-2015 up from 19.4% in 2002.
287. Despite the shrinkage of financial basis of the existing pension system over each subsequent year (in 1997 each employee financed 1.03 pensioners, or 0.92 employment pension, or 0.75 age pension; in 2000 these proportions made 1.14, 1.02 and 0.81 respectively; in 2002 these were 1.15, 1.01 and 0.82), in 2003-2015 it will significantly expand given the reduction of the share of pensioners and tangible increase in the number of population of working age. The latter are also preconditions for financial stability of the pension system.
288. In addition to demographic developments favorable for the financial stability of the pension system, there are three available types of policies to strengthen financial stability, including (i) increasing the number of payers of mandatory social contributions; (ii) increasing of the rates of contributions; and (iii) checking and adjusting the number of beneficiaries receiving pensions from State Social Insurance Fund. The combination of the first policy with the third policy has been identified as the key policy direction for 2003-2015. It will aim at limiting the coverage of pensions paid from the State Social Insurance Fund to employment (insurance) pensions only, while transferring the burden of financing of other pensions to the state budget and, at the same time tightening the eligibility criteria to be qualified for insurance pensions. In particular, as a result of transferring payment of social pensions under the jurisdiction of the state budget in 2003, each employee finances 1.03 pensions, and as a result of transferring the function of payment of pensions for military service under budget financing in 2005 each employee will finance 0.96 pensions.
289. Increase in the rate of mandatory social contribution may not be considered efficient for a number of reasons. First of all, being the lowest in the CIS countries, mandatory social contributions however are in principle quite high (for example, in the US these payments constituted 12.4% of average salary rate in 1997). On the other hand, increase in the rate of these contributions will significantly complicate introduction of voluntary pension insurance scheme, as well as other insurance schemes (for example, medical insurance); nor it will contribute to reduction of shadow economy. Nevertheless, it is envisaged to simplify the existing payment mechanisms and shift to unified assessment scale.
290. Increase in the number of payers and their share is one of the priorities of the pension system development, but being long-term in nature, its PRSP related impact would be palpable only in 2012-2015.
291. The long-term essence of the issue lies with the currently existing pension system characterized by very weak differentiation of pensions, as well as weak eligibility criteria. Five years of employment period is sufficient to be eligible for age pension. On the other hand, there is essentially no linkage between the salary and related social contributions and rates of pensions to be entitled to in later periods; this state of affairs is far from promoting engagement in mandatory pension insurance system, rather it induces shadow activities. The existing pension system is constructed on internal "cross" subsidies, i.e. people having longer employment period subsidize those with shorter employment,

while people with high salaries subsidize those with low salaries. This in addition to high degree of shadow economy is the explanation to the fact that less than 40% of the officially registered employees make social contribution payments (for example, this indicator in Slovenia in 1997 was 84%, and in United States it was 91%).

292. Thus addressing the issue of increasing the number of contributors lies with transition to individualized pension schemes whereby the rate of pension will be directly dependent upon actual salary and social contributions made. With the view of enactment of this approach in 2006, the following measures are to be undertaken in 2003-2005:
- (i) New Labor Code will be enacted to lay grounds for regulating labor relations as relevant to a market economy;
  - (ii) Individual registration system will be introduced: It will enable proper accounting of the contributors' payments and obligations (salary rate of each employee, social contributions by employers and employees, period of insurance payments, etc) and appointing pension on the basis of data contained in respective individual accounts and in accordance with the pension legislation;
  - (iii) Upon introduction of this system the minimum benchmark for pension eligibility will be raised in 2005 to reach 10 years (from the current 5);
  - (iv) In 2003 the mechanisms and relevant measures for the introduction of individual registration system will be designed. Measures toward improvement of legislative basis for introduction of voluntary pension schemes will be taken;
  - (v) In 2004 the Law on Pension Funds will be adopted to create legislative framework for introduction of voluntary pension schemes and state regulation of their activities;
  - (vi) Defining new rate of minimum salary corresponding to general poverty line. This issue is to be solved already in 2004. It will minimize rates of shadow salaries at the same time increasing the volume of collectible indirect taxes, as well as eradicate degree of remuneration inequalities and contribute to poverty reduction.
293. Effective January 2003, employees of agricultural farms are exempt from mandatory social contributions. The financial implications (losses) of this measure are small: in 1999 contributions by agricultural farms totaled dram 289 million or 0.8% of revenues of the State Social Insurance Fund (excluding budget transfers); in 2001 these were dram 207 million or 0.5%; respectively. Thus, effective 2003 accrued employment period for employees of agricultural farms will not be recorded. The positive impact of this measure on the pension system will materialize in the long-term. On the other hand, legislative regulations for voluntary participation of agricultural farms' employees in the state (mandatory) pension scheme will be considered for introducing voluntary social insurance scheme on a contractual basis.
294. Effective 2004, the procedure for disability pension appointment will be modified:
- (i) The current approach with three categories of handicap will be replaced by the functional disability approach and establish two relevant groups, i.e. industrially incapable and with limited capability;
  - (ii) From 2004 no new pensions to the third category of handicap will be provided;
  - (iii) In order to ensure financial sustainability of disability insurance, an amendment to the Law on the State pensions will be made to separate (fix) the share of financial resources to be allocated for disability pensions at around 10% of contributions;
  - (iv) In order to supply legislative fundamentals for the above challenges, new Law on Social Protection of Handicap will be adopted in 2003.

The above measures will enable around 25% decrease in newly set disability pensions and expand the pensions for the first and second categories already in 2005 so that they exceed the general poverty level by 2010.

295. Prior to introduction of individual registration system, differentiation of employment pensions will be implemented at the expense of incremental funds paid for employment period with the base pension rate unchanged. For each year of employment unified accretion will be 100 drams in 2003; in 2004 it will be 150 drams; and 190 drams in 2005, which provides for tangible improvement of pension differentiation on the basis of employment period.

#### **7.1.4. EMPLOYMENT PROGRAMS**

296. Employment programs include unemployment benefits, support in search and finding jobs, retraining of unemployed, as well as financial assistance to unemployed. These, as well as public works programs are implemented by Regional Unemployment Centers, maintenance costs of which are funded from the state budget, while the implemented programs (except public works funded from the state budget) are funded from the State Social Insurance Fund.

297. Currently those people are entitled to unemployment benefits, who have paid mandatory social contributions for at least 12 months. Period of entitlement depends on the employment period of the applicant and may last from 5 to 12 months. The amount of benefit also depends on the employment period but may not exceed 3900 drams per month. The benefits are paid out of the social contributions and other resources, which employers must transfer to the State Social Insurance Fund if an employee is dismissed. Upon completion of the period of entitlement to unemployment benefit the relevant unemployed person has the right to receive monetary assistance of 1300 dram per month.

298. As of end 2002, there were 133.7 thousand unemployed (9.58% of economically active population)<sup>115</sup> registered with the Republican Unemployment Center, who received the status of unemployed. The number of unemployed receiving unemployment benefits was 6 thousand people as of December 2002. Average rate of unemployment was 3214 dram. In December 2001 there were 5.8 thousand beneficiaries with the average rate of 3187 drams.

299. Taking into account widespread unemployment whereby according to the official data registered unemployed people constituted 32% of people paying social contributions (70-80% if real unemployment rate is taken into account), the unemployment insurance system is not in a position to insure unemployment risks in an efficient manner.

300. An unemployed registered with Unemployment Center is entitled to participate in free training courses held by such Centers and funded from the resources of State Social Insurance Fund. According to 2001 data, only 989 unemployed participated in training courses and 855 acquired new professions. In 2002 8.5 thousand people were provided with jobs. These data witness extremely inefficient system of training and addressing unemployment issues. Existing scarce financing of training and retraining system does not ensure compliance of quality of trainees with labor market requirements.

301. Bearing the above in mind, the following measures are to be undertaken in the area of employment programs effective 2004:

- (i) Unemployment insurance will be discontinued together with the payments, which employers have to pay to State Social Insurance Fund in case of dismissal of an employee. Legislative basis for such entitlement will be enforced through relevant amendments in the legislation;
- (ii) The share of mandatory social contributions used for unemployment insurance (2% of total payments) will be earmarked for disability insurance.
- (iii) Effective 2005 financing of employment programs will be performed from the state budget;
- (iv) State training programs will be suspended, training of unemployed will be undertaken by labor services on the basis of tendered state orders for certain groups of unemployed to get retrained in specialties enjoying high demand in the labor market. The above groups will contain refugees, handicap and people with limited capacities, as well as for people uncompetitive in the labor market, which will also contribute to development of training institutions;

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<sup>115</sup> These figures are substantially lower than the reality. According to the 2001 Integrated Household Survey, real rate of unemployment in Armenia was around 25%.

- (v) Unemployment benefits will be replaced by monetary unemployment support, larger in volume but with shorter entitlement period, to be provided under stricter eligibility criteria than the existing benefits. The rate and eligibility criteria will be determined by the government in 2004;
  - (vi) Effective 2004 financial assistance to unemployed for getting involved in business activities and job creation will be discontinued and so released resources will be earmarked for professional training and retraining of unemployed.
302. **Public works:** State budget of Armenia has been financing “benefit for work” programs since 2001 (dram 500 million in 2001 and 2002). The goal of this program is provision of temporary employment to families enrolled in family poverty benefits and unemployed in search of job. Programs works are in the domain of social infrastructures, area improvement, tiding monuments and architectural structures, sanitary cleaning, etc. Since the beginning of 2001 around 9051 people took part in public works, in 2002 the number increase to 11.7 thousand, each paid 800 dram per day. In order to expand this program:
- (i) The enrollment procedure will be simplified in 2004. There will be no limitations for people of working age. Resources of the Armenian Social Investment Fund will also be used to finance unskilled labor to be performed by local residents registered in the list of applicants for public works with regional unemployment centers;
  - (ii) Large volume of public works is currently funded from international, donor and non-governmental organizations (“food for work”, etc). The format of cooperation with such organizations will be developed by 2004, in particular, the procedure of involving applicants in public works.

## 7.2. INVESTMENT IN HUMAN CAPITAL

### 7.2.1. HEALTH

#### 7.2.1.1. General Overview

303. The PRSP pursues the objective of turning backwards the negative trends observed in the path of development in the health sector in the recent years and enforce the constitutional right of the people in respect of maintaining health through substantial increase in accessibility and quality of health care services guaranteed by the state (for the poor people of the country in the first instance). Measures suggested for implementation in the health sector are particularly intended to meeting the target indicators for infant and mother mortality declared by the UN within the Millennium Developments Goals framework.
304. As a result of socio-economic transformations during the recent years, indicators describing health conditions of the population displayed negative trends. In parallel, consumption of health care resources by population substantially contracted. Analyses show that affordability of services for certain groups of population widely differs depending on the type of service. The Table 7.6 reflects the structure of public expenditures in health sector in 1990 by types of services and consumption groups.

**Table 7.6. Distribution of public expenditures in health sector by consumer quintiles (%)**

	Consumer quintiles					Total	Coefficient of concentration	Quintile 5/ Quintile 1
	1	2	3	4	5			
Hospital	13.4	12.2	13.4	18.4	42.7	100	0.276	3.20
Polyclinic	15.6	18.0	17.9	20.0	28.5	100	0.114	1.83
Diagnostic centers and other	8.2	22.4	14.3	12.3	42.8	100	0.276	5.22
<b>Total</b>	<b>13.3</b>	<b>14.8</b>	<b>14.6</b>	<b>18.1</b>	<b>39.2</b>	<b>100</b>	<b>0.180</b>	<b>2.95</b>

*Source: 1998/99 Integrated Household Survey; 2003 –2005 MTEF of the Republic of Armenia*

Results of the 1998/99 integrated household survey show that consumption of health services in 1999 by the 20% richest population is 3 times higher than the consumption by the 20% poorest groups provided that in case of hospital services the discrepancy is even larger (3.2 times), while polyclinic and out-patient services have been far more equally (1.8 times) distributed and affordable by the poor population.

305. Expenditures channeled from the state budget to the health sector are rather low (see Table 7.7). In 1998-2002 the highest indicator was 1.4% of GDP (for comparison: in countries with average income level, this indicator is 3%). The severity of the situation would not alleviate even if the significant role of humanitarian aid in financing health sector received in the recent years is taken into consideration. The difference becomes more eye striking if the basis for comparison were selected to be the per capita public expenditures in the sector: in the countries of Europe and Central Asia in 1997 per capita expenditures were USD 123, while in Armenia these made only USD 7. At the same time, predominant portion of budget allocations were channeled to hospital services instead of redistributing these to primary health care more accessible for poor population.

**Table 7.7. Public expenditures in health sector**

	1998	1999	2000	2001	2002
Total, in billion drams	13.7	13.6	9.8	15.7	16.0
<i>% of GDP</i>	<i>1.43</i>	<i>1.38</i>	<i>0.95</i>	<i>1.34</i>	<i>1.18</i>
<i>% of state budget expenditures</i>	<i>6.7</i>	<i>5.6</i>	<i>4.4</i>	<i>6.4</i>	<i>6.0</i>
Per capita of population, in US Dollars	8.9	8.4	6.1	9.4	9.3

Source: Ministry of Finance and Economy, NSS.

#### 7.2.1.2. Priorities and Targets

306. In the context of poverty reduction and increasing targeting of publicly funded health care programs for the poor population, a priority for the sector is the enhancing of accessibility of health services with the major emphasis on primary health care system.
307. With the objective to maintain and improving health conditions of the population, as well as enhancing accessibility of health services it is necessary to ensure participation of all public and civil institutions and their coordinated activities. This implies active and immediate involvement of both public and private sectors, including non-governmental organizations, in implementation and monitoring of the programs underway.
308. Enhancing accessibility will become possible by virtue of increased public funding, relevant redistribution of intra-sectoral allocations, optimization and efficiency increased as a result of sector management and administration reforms.

#### 7.2.1.3. Public Expenditures in Health Sector and Increased Accessibility of Services

309. Increase in public funds allocated to health sector is one of the priorities in improving the situation therein. Throughout the program period public expenditures will display growth trends (2004-2015, with average of 14% per annum). In the period between 2004-2006 growth rates will be higher (average 19% per annum) with further stabilization in the range of 11% in 2010-2015.
310. Main sources of such growth in public expenditures in the sector will be collection of revenues from domestic sources and project financing from foreign sources. It should be mentioned that within the context of important international cooperation projects (such as vaccinations, etc) the Government is intended to take the main part of financial burden, while donor (specialized) organizations mostly will concentrate on technical support side of cooperation projects.

**Table 7.8. Program indicators of state budget expenditures in the health sector**

	2003	2004	2005	2006	2009	2012	2015
<b>Total, billion drams</b>	<b>21.0</b>	<b>24.9</b>	<b>30.8</b>	<b>35.5</b>	<b>52.7</b>	<b>73.3</b>	<b>101.1</b>
<i>Of which:</i>							
<i>Current expenditures, % of total</i>	<i>95.3</i>	<i>93.9</i>	<i>92.0</i>	<i>92.0</i>	<i>94.0</i>	<i>94.0</i>	<i>94.0</i>
<i>Capital expenditures, % of total</i>	<i>4.7</i>	<i>6.1</i>	<i>8.0</i>	<i>8.0</i>	<i>6.0</i>	<i>6.0</i>	<i>6.0</i>
<i>% of GDP</i>	<i>1.4</i>	<i>1.5</i>	<i>1.8</i>	<i>1.9</i>	<i>2.1</i>	<i>2.3</i>	<i>2.5</i>
<i>% of state budget expenditures</i>	<i>6.5</i>	<i>7.6</i>	<i>8.6</i>	<i>9.2</i>	<i>10.2</i>	<i>10.9</i>	<i>11.9</i>
<i>Year-on-year % change</i>	<i>31.2</i>	<i>18.6</i>	<i>23.5</i>	<i>15.4</i>	<i>12.4</i>	<i>11.5</i>	<i>11.2</i>

311. Throughout the program period growth rate of the public expenditures in health sector will exceed growth rates of total public expenditures leading to an increase in the share of health expenditures in the state budget. It is envisaged to increase the share of health expenditures in the state budget to 9% in 2006, 10% in 2008, and 11% in 2012, with the end-period indicator as high as 12%. The behavior of health sector share in GDP is programmed to be consistent with the dynamics of nominal indicators as above. In 2015 (compared to 2003) public expenditures in health sector-to-GDP ratio will increase by 1.1 percentage points to reach the program target indicator of 2.5% of GDP in 2015. According to the program, envisaged changes will predominantly be ensured during the first five program years (0.6 percentage points increase in 2008 from 2003), thus reaching the target indicator of public expenditures in the health sector-to-GDP ratio of 2% in 2007.
312. Increase in budget allocations particularly addresses increase of wages for doctors and middle medical personnel, supply of medicines and medical materials, improvement of buildings and supply of modern equipment. Both in terms of wages and capital expenditures, improvement of conditions in primary health care institutions is prioritized (especially in rural areas). With the objective to meet these targets, the state will control salaries for primary health care system employees and allocations for capital spending, while other apportions will be made on the per capita normative bases.
313. Should the required levels of funding be impossible to ensure, the authorities will stand ready to undertake even more substantial inter-sectoral redistributions than envisaged herein in view of the priority they attach to the health sector.
314. Intra-sectoral redistribution of public expenditures will be carried out along the following priorities:
  - (i) Taking into consideration higher rate of accessibility of primary health care (out-patient and policlinic) and its territorial closeness to population, the share of state budget financing primary health care will increase reallocating fund from appropriations to hospital care;
  - (ii) Both hospital and primary health care systems (including family doctors) will have the priorities of mother and child health and mitigating diseases of special social significance.

#### 7.2.1.4. Program Priorities in the Health Sector

##### 7.2.1.4.1. Primary Health Care (out-patient and policlinic)

315. It is programmed to increase the share of primary health care in total health expenditures to 40% in 2006, 45% in 2008, and channel 50% of the sector expenditures in 2015.
316. Introduction and coverage of family doctor system should continue and expand in the entire country. Family doctor and primary health care systems should gradually receive independent status based on per patient (properly registered) financing, independent resource management and decision-making systems. In the context of primary health care for the poor it is necessary to ensure accessibility of diagnostic services. To this end, targeted use of diagnostic equipment procured under the World Bank project to regional policlinics and placing stat orders with off-hospital diagnostic centers for expensive diagnostic examinations are prioritized. In addition, strengthening ambulance service is important to be implemented through creation of a fleet of reanimation vehicles with special equipment.
317. In the context of poverty and inequality reduction the authorities will attach special importance to accessibility of primary health care service including family doctors for population in rural areas.

##### 7.2.1.4.2. Mother and Child Health Care

318. Attaching relevant importance to women and children health care, including reproductive health issues, is of principal significance in terms of ensuring healthy generations and, subsequently, improvement of health conditions of the population and poverty reduction. It is necessary to reiterate the priority of women and children health care at national level through ensuring continued improvement of health conditions of pregnant and nursing women and nutrition of children in the age of 0-5 years old, encouragement of breast feeding, as well as provision of prenatal and postnatal quality medical service.
319. Special importance is attached to fulfillment of the above issues, and millennium goals announced by the United Nations in respect of infant and mother mortality, to be enforced through improvement of

the quality of obstetrician and gynecological medical aid and enhancing equipment of obstetrician hospitals (see Box 7.1).

320. In terms of medical aid to children special attention is attached to quality improvement and disease prevention measures, including vaccinations and programs on healthy growth and development of children. An importance also attached to the introduction of the WHO's strategy of integrated management of childhood diseases.

**Box 7.1. Financing of Obstetrician Medical Aid**

In the framework of maintaining mother and children health it is envisaged to substantially increase public expenditures for obstetrician medical aid both in hospitals and primary health care network. In particular, in the framework of out-patient and polyclinic medical aid per patient expenditures for obstetrician services will be increased by average 40% per annum in 2004-2006 thus ensuring the per patient indicator of USD 55 (in 2003 prices). These indicators for 2007-2008 and 2009-2015 constitute 20% (and USD 80) and 9% (and USD 150) respectively. Expenditures per patient in hospitals are also to increase by average of 8% per annum in 2004-2006 reaching USD 100 in 2006 (in 2003 prices). In 2007-2008 average annual growth of this indicator will be 10% and in 2009-2015 it will make 3%; as a result of these accretions per patient expenditures in hospital health care system will reach USD 120 and 150 in 2008 and 2015 respectively. According to preliminary estimates, such an intra-sectoral redistribution will result in share of total expenditures for obstetrician care in total health sector expenditures increased to 11% in 2008, and 13% in 2015 (in comparison with the 2003 programmed 7.6%).

*7.2.1.4.3. Contagious Diseases and HIV/AIDS Prevention*

321. Poverty is closely related to such contagious diseases as tuberculosis, sexually transmitted diseases and AIDS. Given the drastic proliferation of these diseases in the recent decade (including twice in case of tuberculosis, three times in case of syphilis, etc), it is necessary to strengthen prevention measures, carry out early diagnosis and identification and thorough treatment. Redistribution of budget resources will particularly contribute to implementation of the above measures.

*7.2.1.5. Enhancing Efficiency and Accountability of the Health Sector*

322. Currently there is a substantial gap between the demand and supply of health sector services. Despite the fact that in recent years some reduction of the doctor/per 1000 people indicator (10% reduction from 1997 to make 3.8 in 2001), as well as hospital beds per 1000 people (-36% and 5.4 respectively) have been recorded, but international comparisons prove that Armenia is close to (in many cases is above) countries having medium and high income levels. As a result insufficient budget resources are allocated to health sector, often channeled to maintenance of substantially exaggerated network of medical institutions exceeding demands of the population, which led to undue duplication health services in the environment of scarce budget allocations.
323. Priority directions in enhancing efficiency are optimization and management reforms. As a result of sector optimization, service provision should shift towards more accessible and relatively cheap primary health care network away from relatively expensive hospital one.
324. One of the main directions for enhancing the effectiveness of hospital healthcare would be to concentrate the limited public resources as much as possible in the fewest healthcare facilities. Among measures to be implemented to this end, great importance is attached to the consolidation of healthcare facilities in Yerevan through their merger.
325. Special measures should be undertaken to enhance efficiency of planning, budgeting and oversight functions at the level of medical institutions.
326. Within the authorities prescribed by the legislation it is necessary to strengthen the regulatory and supervisory functions of the state in the health care system. In particular, it is necessary to launch the process of elaboration and introduction of quality control standards and reviewed sanitary norms and regulations.

**7.2.2. EDUCATION**

**7.2.2.1. General Overview**

327. Ensuring quality education and enhancing its accessibility in the medium and long run are among the most important factors for economic growth, as well as poverty and inequality alleviation. Further development of the sector is perceived as the utmost priority for economic progress.
328. Transition period has had negative impact on the education system of Armenia as well. In particular, reduction of public spending in education sector gave rise to deterioration of the quality of education services. Despite the fact that during recent years positive changes were recorded in terms of state financing of education, but their level is almost twice lower than the average level recorded in OECD countries (the 2002 expenditures of consolidated budget constituted 2.2% of GDP, while average public spending in OECD countries in 1999 was 4.7% of GDP) (see Table 7.9). At the same time, distribution of public resources by various layers of education is comparable with the indicators in OECD countries; during the recent three years some 65% of public funds were channeled to elementary, basic and secondary education and special general education, while 16% was allocated to financing of professional education. The respective indicators of the OECD countries in 1999 were 72% and 20%.

**Table 7.9. Public expenditures in education (% of GDP)**

	1997	1998	1999	2000	2001	2002	Average for OECD countries (1999)
<b>Total</b>	2.0	2.1	2.3	2.9	2.5	2.2	4.7
<i>of which:</i>							
Elementary, basic and secondary education and special general education	1.4	1.3	1.5	2.1	1.8	1.5	3.3
Professional educational programs <sup>1</sup>	0.3	0.4	0.4	0.5	0.4	0.4	0.9

<sup>1</sup>Includes expenditures for preliminary professional (vocational), secondary, higher and post-graduate professional educational programs.

Source: Ministry of Finance and Economy, *Education at a Glance: OECD Indicators (2002): Tables B2.1a and B2.1b.*

329. Analysis of enrollment indicators in various levels of education silhouettes the following picture (gender specifics of enrolment at the different levels of education are presented separately in the Box 7.2):
- (i) Despite the trends of declining observed in the recent years, enrollment in basic general education is quite high and, essentially, is not a basis for serious concerns. Such a conclusion is a result of analysis of both gross and net indicators of enrollment. In particular, results of 2001 integrated household survey witness that although enrollment of 7 years old pupils is low (around 47%, which may be interpreted as a result of kids attending schools at later age, 8 years old, for example), but net enrollment in the group of 8-15 years old (which may be accepted as closest approximation of the general education period) constitutes 98.7% (see Figure 7.1).
  - (ii) Enrollment in the senior school (including preliminary professional (vocational) education) has not substantially changed and in the recent years fluctuated in the range of 70-75%. The same stability is pertinent to the professional education as well, i.e. in 1997-2001 around 22% of 17-24 year old children were covered in professional education programs. It should be emphasized that in the program period authorities will undertake measures promoting enrollment both in the senior school and professional educational programs with particular attention allocated to equality issues.
330. Efficiency of education system is far from being satisfactory. It refers both to labor force and utilization of physical capital. However, efficiency issues are especially acute in terms of their utilization. In particular, pupil/teacher and pupil/non-teacher ratios in the secondary education system in 2002 were 11 and 18, respectively. For comparison, in 2000 average indicator of pupil/teacher ratio in OECD countries was 14.3, which, in turn, is evaluated as inefficient. Workload of teachers is also below OECD indicators. A matter of concern persists to be the low remuneration of teachers; average salary of a teacher/GDP per capita ratio in 2002 was 0.41 (0.96-1.45 in 2002 in OECD countries



depending on experience).

**Box 7.2. Enrolment in Educational Institutions by Gender**

The analysis of both the official statistics and results of sampling surveys reveals that the problem related to the enrolment at various levels of educational system by gender, in effect, does not exist in Armenia. In this context it must be noted that one of the issues raised within the framework of the Goal 3 of the MDG declared by the UN (support to gender equality and women's empowerment) namely elimination of gender discrimination at various levels of education (at elementary and secondary education levels preferable by 2005 and at higher education level by 2015) has long been resolved in Armenia. Equal rights of women and men defined in the Soviet period has been protected and implemented in various areas of life. Characteristically, the tradition of equal enrolment of girls and boys in elementary education comes already from the 19<sup>th</sup> century.

By reviewing the statistical data the following conclusions can be drawn regarding the enrolment by gender indicators at various levels of education.

**1. Secondary education.** It can be stated that at the basic education level (grades 1-8) the enrolments of girls and boys are almost equal, and the small differences are mainly the results of demographic factors. This balance, however, has been disrupted in recent years, as a rule, in senior grades in favor of girls.

For example, in 2001-2002 academic year, girls constituted around 54 percent of 9<sup>th</sup> graders and 56 percent of 10<sup>th</sup> graders (see table). Analyzing the same data by marzes, we can conclude that deviations from the national average are not substantial (the prevalence of girls in senior grades is more underlined in Syunik and Tavush marzes). Such manifestations are a result of a number of factors, including also tradition. Although the poverty factor also has a role (for example, boys leave the school earlier, so that they can participate in income generation for the family), nevertheless, the share of this factor, most probably, is not predominant.

**2. Tertiary education.** Women also form the majority in the enrolment structure at this level of education. Data from 2001-2002 academic year reveal that differences were particularly notable in secondary vocational educational institutions, where women constituted 66 percent of the enrolled. The overall larger share of women in universities is a result of their larger numbers in private universities. As regards to smaller share of women enrolled in post-graduate studies, the main reason is the enrolment structure in doctorate courses where men constituted about 63 percent of those enrolled, while women were the majority in pre-doctorate post-graduate courses (around 53 percent).

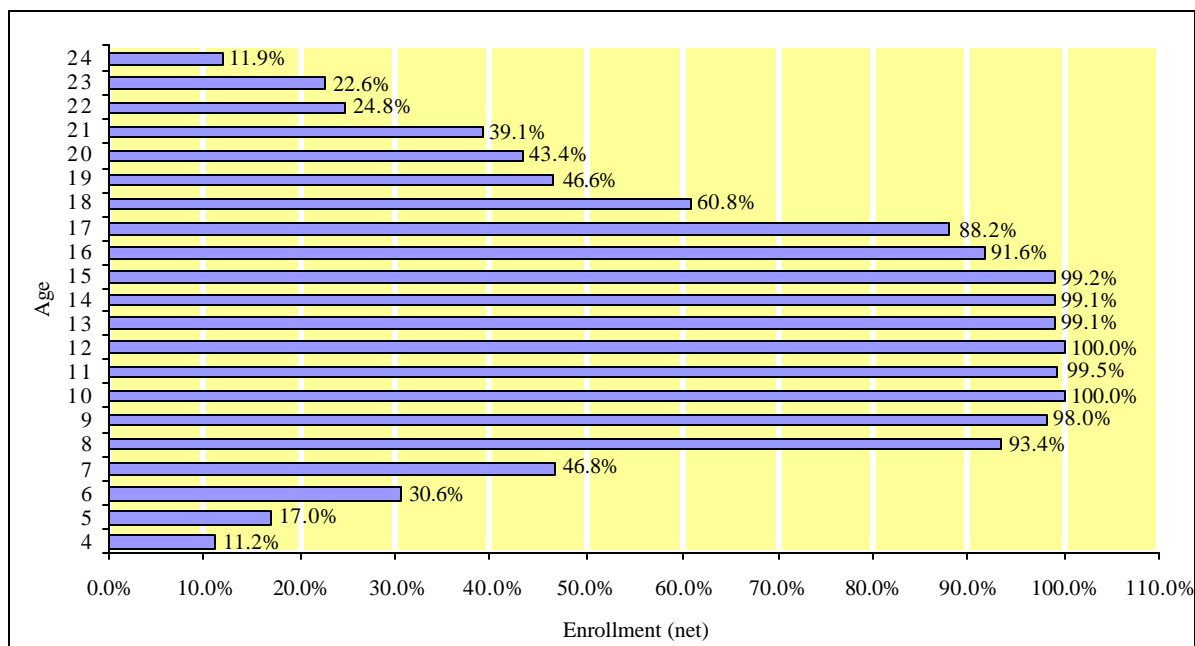
**Table B 7.1. Enrolment structure in various levels of education by gender, 2001-2002 academic year**

Education level	PUBLIC			NON-PUBLIC			TOTAL		
	Total	Girls	Boys	Total	Girls	Boys	Total	Girls	Boys
<b>1. Secondary education</b>	<b>100.0</b>	<b>50.2</b>	<b>49.8</b>	<b>100.0</b>	<b>44.3</b>	<b>55.7</b>	<b>100.0</b>	<b>50.2</b>	<b>49.8</b>
Basic education	100.0	49.3	50.7	100.0	44.4	55.6	100.0	49.2	50.8
1 <sup>st</sup> grade	100.0	48.4	51.6	100.0	43.5	56.5	100.0	48.3	51.7
2 <sup>nd</sup> grade	100.0	48.9	51.1	100.0	51.0	49.0	100.0	48.9	51.1
3 <sup>rd</sup> grade	100.0	49.0	51.0	100.0	45.0	55.0	100.0	49.0	51.0
4 <sup>th</sup> grade	100.0	49.6	50.4	100.0	46.9	53.1	100.0	49.6	50.4
5 <sup>th</sup> grade	100.0	49.1	50.9	100.0	39.0	61.0	100.0	49.1	50.9
6 <sup>th</sup> grade	100.0	48.7	51.3	100.0	43.9	56.1	100.0	48.7	51.3
7 <sup>th</sup> grade	100.0	49.8	50.2	100.0	40.8	59.2	100.0	49.8	50.2
8 <sup>th</sup> grade	100.0	50.4	49.6	100.0	42.2	57.8	100.0	50.3	49.7
Senior grades	100.0	54.8	45.2	100.0	44.2	55.8	100.0	54.7	45.3
9 <sup>th</sup> grade	100.0	53.7	46.3	100.0	42.9	57.1	100.0	53.6	46.4
10 <sup>th</sup> grade	100.0	56.1	43.9	100.0	45.1	54.9	100.0	56.0	44.0
<b>2. Tertiary education</b>	<b>100.0</b>	<b>55.8</b>	<b>44.2</b>	<b>100.0</b>	<b>68.1</b>	<b>31.9</b>	<b>100.0</b>	<b>58.3</b>	<b>41.7</b>
Secondary vocational	100.0	66.0	34.0	100.0	72.6	27.4	100.0	66.4	33.6
University	100.0	50.2	49.8	100.0	67.7	32.3	100.0	55.0	45.0
Post-graduate <sup>1</sup>	100.0	45.8	54.2	...	...	...	100.0	45.8	54.2

<sup>1</sup> Pre-doctorate, doctorate, post-doctorate.

Source: National statistical service

Figure 7.1. Enrolment by age



Source: 2001 Integrated Household Survey.

7.2.2.2. Priorities and Targeting

331. In the framework of the program a priority is further development of general education system from the perspective of improving quality and efficiency of the rendered services. Equally accessible and high quality general education system is an important precondition for (i) education of the society and improvement of literacy ratio; (ii) ensuring initial knowledge necessary for entering labor market; and (iii) furthering education.
332. By solving enhancement of the quality of general education, the state will thus create sufficient fundament for increasing enrollment rate in the senior school and professional education systems particularly in view of children from vulnerable families.
333. In the framework of this program secondary vocational as well as higher education sectors are viewed as the second level of its objectives. Nevertheless, primary policy objectives in this area include: (i) correspondence with market economy rules; (ii) enhanced quality and compliance with international standards; and (iii) improved accessibility and equality.
334. In the area of higher education, the government will pay special attention to equality and targeting issues by creating conditions for increasing the enrolment of all gifted young people willing to receive higher education. One of the alternative approaches to resolving this problem is the development and introduction of a student loan system, where loans will be granted based on success in studies and the level of well-being. Although the possibilities for inter-sectoral redistributions to the benefit of higher education in the first years of the program period are fairly limited, nevertheless resources can be allocated for the operation of the loan system by relevant redistributions within sectors, for example by relinquishing the stipendium system in its current form, which is inefficient and, in fact, not well-targeted.
335. The state will attach special attention to educational and training programs with the objective to smooth the gap between the job opportunities (supply) and requirements of labor market.
336. The objectives inherent to the program will be pursued through increase of allocations to the education sector and enhancement of efficiency of the system.

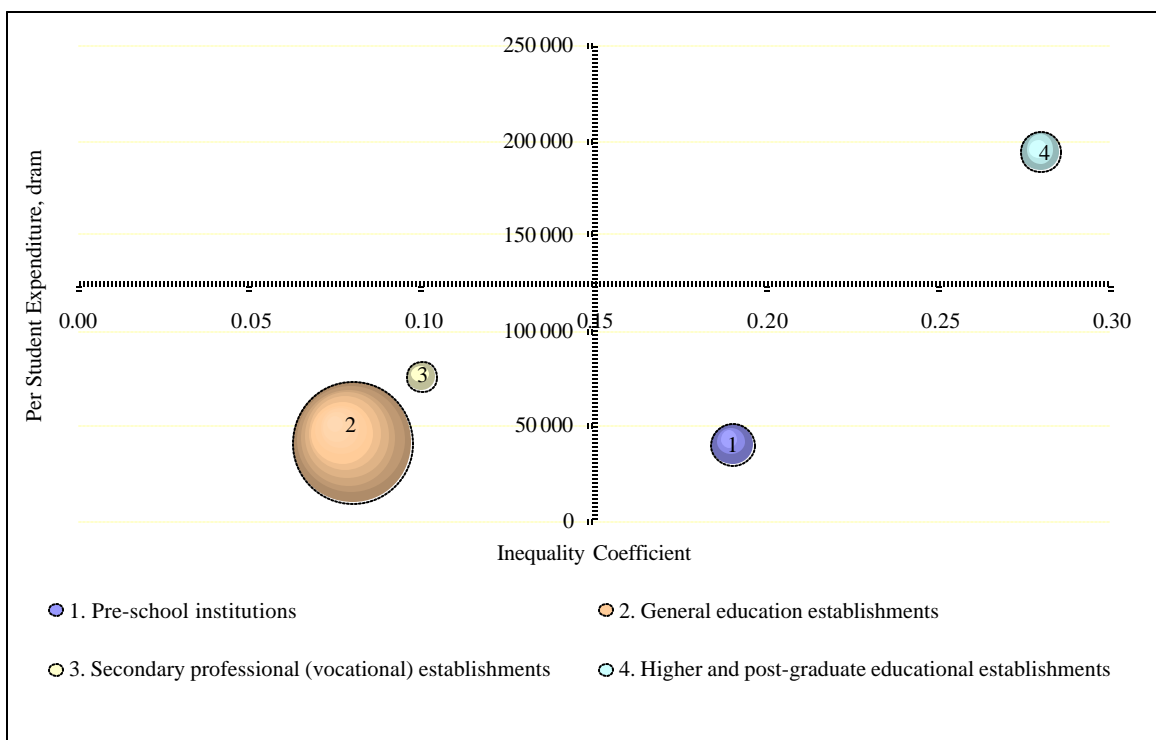
**Box 7.3. Priority Determination**

Determination of priorities is particularly preconditioned by the following factors (see Figure B 7.1):

- (i) The largest group of beneficiaries belongs to the general education sector and essentially education services in this level are almost equally accessible for all consumer groups;
- (ii) However, there is a substantial gap between per pupil expenditures in the general and professional programs (especially, in higher education system). Per student expenditures in professional education system are 4-5 times more than per student expenditures in the general education system (in OECD countries this indicator was in the range of 2 during the recent years).
- (iii) At the same time, average inequality with regard to secondary professional educational establishments is relatively low, but the per pupil expenditures are substantially lower than per student expenditures in the higher education system.

Taking into consideration the above factors, the top priority of the state in the area of education is the general educational system. Public expenditure policy targets alleviation of the gap between per pupil expenditures in various levels of education thanks to faster (than in professional education sector) growth rates of per pupil expenditures in the general education system. On the other hand, huge importance will be attached to secondary and additional education systems.

**Figure B 7.1. Expenditures per pupil and accessibility by levels of education**



Source: Ministry of Finance and Economy, 1998/99 Integrated household Survey.

**7.2.2.3. Public Expenditures in Education Sector**

337. Increase of public financing of education sector and improvement of situation will be considered a priority for the entire program period. In 2004-2015 education expenditures of the consolidated budget will increase by average of 13.5% per annum in nominal terms. In the first five years of the program period (2004-2008) growth rates of around 4.5 percentage points will be over and above average indicator, while in 2009-2015 will be stabilized in the range of 10% per annum (see Table 7.10).

**Table 7.10. Program indicators of the consolidated budget expenditures in education sector**

	2003	2004	2005	2006	2009	2012	2015
<b>Total, in billion drams</b>	<b>35.2</b>	<b>42.8</b>	<b>52.0</b>	<b>59.0</b>	<b>88.7</b>	<b>118.8</b>	<b>158.7</b>
<i>Including: Current expenditures as % of total expenditures</i>	92.5	92.2	91.8	92.2	92.0	92.0	92.0
<i>Capital expenditures as % of total expenditures</i>	7.5	7.8	8.2	7.8	8.0	8.0	8.0
<i>% of GDP</i>	2.4	2.7	3.0	3.1	3.6	3.8	4.0
<i>% of consolidated budget expenditures</i>	9.4	11.0	12.3	12.8	14.4	14.9	15.7
<i>Year-on-year % change</i>	21.5	21.6	21.4	13.6	10.8	10.2	10.1
<i>Memorandum items:</i>							
Expenditures of state budget in education sector, in billion drams	32.0	39.4	47.9	54.8	83.5	112.1	150.1
<i>% of GDP</i>	2.2	2.4	2.7	2.9	3.4	3.6	3.8
<i>% of state budget expenditures</i>	10.0	12.0	13.4	14.1	16.2	16.7	17.6

338. Public spending on education will increase as a share of total consolidated budget expenditures. This will result in inter-sectoral redistribution of budget expenditures towards the increase of expenditures in the sector of education. It is programmed to increase the share of education expenditures in total consolidated budget to around 13% in 2006; 14.5% in 2009 and around 16% by the end of the program period. At the same time, inter-sectoral redistributions towards increasing the share of expenditures on education in the state budget will be more significant.
339. Such a scenario provides for significant shifts in the dynamics of state expenditures on education/GDP ratio. In 2015 (compared to 2003) public spending in the sector of education will grow 1.6 percentage points of GDP to reach the target indicator of 4% of GDP in 2015. At the same time according to the program, education sector expenditures in 2006 will make 3.1% of GDP, and 3.6% of GDP in 2009.
340. In the first years of the program period accretions of public spending in education will nearly entirely be channeled to general education sector. The share of general education system in the structure of public expenditures in education in 2006 (compared to 2003) will grow by around 8 percentage points to reach 73.5%. Effective 2009, increase of expenditures allocated to professional education will be 2 percentage points above relevant indicator of general education expenditures. As a result, share of expenditures in general education sector in the structure of total public spending in education will stabilize in the range of 72%; the share of expenditures channeled to professional education programs will gradually increase to reach 15% in 2015.

**Table 7.11. Intra-sectoral structure of public spending in education sector (%)**

	2003	2004	2005	2006	2009	2012	2015
<b>Total</b>	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>Including:</i>							
Elementary, basic and secondary education	65.4	70.5	72.2	73.5	72.8	72.2	71.5
Professional educational programs	17.4	13.8	12.0	11.1	12.4	13.6	14.5

*Note: Professional educational programs include preliminary professional, secondary professional, higher and post-graduate professional programs, as well as additional education sector.*

341. Programmed increase of public spending in education sector will result in substantial growth of per pupil expenditures. Within this scenario per pupil expenditures in 2006 (in comparison with the 2003 indicator) will be doubled, and be over and above 4 times more in 2008 (See Table 7.12). However, it is necessary to mention that such a behavior of per pupil expenditures is partially preconditioned by predicted changes in demographic structure of the population; despite improvement of enrollment indicators, the number of pupils enrolled in the general education system will decrease in 2015 by some 25% (from the 2003 indicator).

**Table 7.12. Per pupil expenditures in the general education system**

	2003	2004	2005	2006	2009	2012	2015
Index (2003 = 100)	100	136	176	214	379	505	662
<i>Memorandum items</i>							
Number of pupils (2003 = 100)	100	97	93	88	74	74	74
Public spending in general education system (2003 = 100)	100	131	163	188	281	373	493

342. According to the economic classification of budget expenditures, current expenditures in the structure of spending for education will account for 92% with remaining 8% to be allocated to capital expenditures. Program support from foreign sources will represent an important component of financing capital expenditures in the sector.

**7.2.2.4. Priorities of Public Spending**

343. Priorities in the general educational system are the increase of salaries and training. Measures undertaken to this end are considered a prerequisite for increasing the quality of education services. The state will continue implementation of salary increase policies. It is envisaged to increase average salaries of the teachers to the equivalent of 80 US Dollars in 2005, and ensure an average of 12% increase per annum in each of the subsequent program years (see details in Box 7.4). Although calculations in this particular case are justified through the logic of payback of expenditures incurred on higher education, however, setting such a rate of remuneration is also acceptable from the point of view of ratio to per capita GDP. In particular, in the framework of the suggested scenario average salary of a teacher in 2005 will become equal to per capita GDP, and exceed that indicator by 43% in 2015. In the medium term it is envisaged to introduce also effective mechanisms of salary differentiation based on the experience. Such approaches to remuneration will become effective stimulus for the working teachers, as well as promote replenishment of high quality pedagogical staff in general educational schools in future leading to rejuvenation of staff, as well as softening existing gender disproportions in the staff structure<sup>116</sup>. Issues relating to replenishment of high quality staff in the schools are especially crucial schools in rural and bordering communities, which will be the cynosure of the authorities.

344. Average salary rates of administrative and support personnel of general education establishments will substantially increase as well. In particular, effective 2008 average salary rates of administrative staff will be 2.5 times more than average rate of remuneration of teachers (in 2003 this indicator was 1.3 times).

345. Although during the first years of the program period (2004-2006) funds to be channeled to increase salaries will make 80-85% of current expenditures, they will stabilize in the range of 70-75% of current expenditures enabling the authorities to sufficiently meet of other needs of current expenditures<sup>117</sup>.

346. The state will continue the policies of providing textbooks to children in elementary school.

347. Reconstruction and heating will be on the list of priorities as well. In particular, inadequacy of heating systems and building conditions hamper continuity of education process giving rise to tangible loss in quality. This is the reason why predominant share of capital expenditures will be absorbed to address these problems.

348. In respect to improvement of quality at the general education level, the government will attach special attention to improvement of relevant assets and teaching and learning material basis. In particular, issues related to content of education, curriculum, teaching and learning materials modernization, school library resource upgrading, as well as ensuring availability of modern information technologies

<sup>116</sup> In 2001-2002 academic year, average age of teachers employed in public and private general education schools was near to 55 (6.2% of teachers were in retirement age), and share of women in total teaching staff was 84%.

<sup>117</sup> For comparison we should mention that the share of expenditures for remuneration of work in general educational network of OECD countries in 1990 constituted around 80% of total current expenditures in the sector.

in schools are of high importance, and external project assistance will play a significant role to resolve these issues.

349. Despite the fact that predominant portion of education expenditures will be allocated to general educational establishments, but in view of structural changes in progress in the economy special importance is attached to enhancing quality of vocational and training programs and their compliance with socio-economic development goals of the country. Thus, reforms in vocational and additional training in the program period are prioritized, which will enable training meeting requirements of labor market through envisaging special mechanisms for involvement of people with protracted unemployment status and their re-training.

**Box 7.4. Remuneration of Teachers**

Each graduate from general educational school will make a choice whether to get involved in public activities/works (using the knowledge acquired at school) and receive certain remuneration for such activities, or continue education with some higher educational establishment. When making such a choice, an important factor is financial relevancy of education with higher educational establishment, because education in any of them in Armenia requires incremental monetary expenses (investments). These expenses include preparatory, pre-enrolment costs and expenses during education tenure (tuition, other costs related to education). Thus each graduate of a higher educational establishment will incur incremental investments, which may be covered from both private and borrowed funds.

To this end, projection of minimum salary rate in the beginning of working career becomes an important factor, which will enable the graduate to generate income, covering investments within certain period of time.

The following assumptions underlie relevant calculations:

- (i) Expenses related to preparation to entry exams to higher educational establishments and further studies therein are considered investments and constitute 600 US Dollars and dram 80 thousand (with 3% increment every next year);
- (ii) In all the years of study in higher educational establishments, annual rate of tuition is unchangeable and equals to tuition fee of 2002-2003;
- (iii) A person with secondary education may have been involved in other works rather than studying in a higher educational establishment and receive remuneration for such works, which is viewed as an amount "lost" by the graduates of these establishments or investment made;
- (iv) Initial monthly pay of a graduate from secondary school is dram 23 thousand and the growth of 10% per annum;
- (v) A graduate from higher educational establishment, on graduation, will be employed and start working uninterruptedly;
- (vi) Wages will increase 10% per annum.

The estimations have been made along the two investment discount rates (15%, 20%). Calculations show that depending on the number of years in a higher educational establishment and the value of discount rate, wages of graduates of pedagogical higher educational establishments should be about 73.2-133.1 US Dollars in the early period of working experience.

**7.2.2.5. Enhancing Efficiency of Education System**

350. An important aspect of education sector reforms is enhancement of efficiency. The authorities will continue and deepen rationalization measures in the education sector of the country. The need for rationalization is particularly evident in the general education sector when projected demographic changes are taken into account. The measures target enhancing efficiency of utilization of human and physical resources in the education sector, as well as that of management.
351. The following measures addressing efficiency issues are to be implemented in the general education system:
- (i) Increasing pupil/teacher ratio to reach 16 in 2008;
  - (ii) Increasing workload of teachers to reach 22 hours per week in 2005 (according to some estimations, this indicator may be increased to 27 hours per week)
  - (iii) Increasing pupil/non-teacher ratio to reach 24 in 2005;

- (iv) Increasing density of classes;
- (v) Defining optimal number of pupils in schools, and merger of schools if necessary.

### 7.2.3. POVERTY REDUCTION: CULTURE CONCEPT

352. In this paper culture is perceived as a complex of social groups and structures, world vision, behavior, skills, and cultural heritage, individual sectors of which may impede or help poverty reduction.
353. One of the specific manifestations of culture in the poverty in Armenia is the prominent identity of Armenian culture, a totality comprising traditional, national and Soviet perceptions. Widespread is the perception, for example, that the new era Armenia stepped into after regaining independence is a system founded on exploitation, trampling down human dignity and values, a society for a group of rich and social injustice. Kindness, fairness, pliancy transformed into values of no demand whatsoever. Such generalized perception of the new system reinforces the perception of inevitability of poverty and confidence in complete absence of perspectives, which is one of the major impediments for social progress and poverty reduction.
354. Tough attitude to the poor in the society leads to their isolation and self-isolation. Veiling poverty is perceived as a decent standing, full of dignity. Individual self-establishment strategy orients people towards family, “community”, and neighborhood system of values, while at national level it transformed into countrymanship. The society lives in the system of family-relative dimension with mechanisms and means of existence sought within this system. While in individual cases family affiliation bear decisive role in assisting the poor, at national level further implantation of this system extremely restricts the potential for building civil society. To a large extent community life is construed on the family and friendship groups, and embryos of civil society, such as various NGOs, associations and unions, are very weakly manifested while non-existent at the community level. Transferred clubs and culture houses under the jurisdiction of local governments practically put the end to their existence, leading to dissolution of the general socio-cultural domain, which might otherwise be serve as the place where poor population would participate in general discussions and debates, elaboration of community opinions and preparation of decisions, as well as public hearings of the poor.
355. Armenians have very special attitude to the history. Armenia is considered a country of ancient civilization and throughout centuries this has been viewed as inseparable part of the country image. The last 3-4 decades of the Soviet Union allowed extensive archeological explorations and research investigations, restoration of historic and cultural monuments, which reinforced national pride among population for their country. People want to feel they are a part of global civilization. Maintenance of the image of Armenia as the cradle of civilization is necessary first of all for its own people, and in a number of areas people themselves embark on maintenance and repair of historical monuments located in their communities.
356. The poor category in Armenia, having self-isolated themselves, does not nestle up to the Church rather they join various “sects” seduced not by worship formulations and concepts poured during propaganda measures, but rather by sympathy, sincerity, fairness, justice and mutual assistance. The concept of “poverty is not a vice” has certain level of stabile manifestation in some of the newly imported religious communities, than within the Armenian Apostolic Church. However, more widespread is the perception of the poverty as a vice. Its rehabilitation and proliferation is an indication of the progress of the Armenian society in a direction opposite to the “social” one.

### 357. Poverty Reduction within Cultural Development Concept

- (i) In order to prevent self-isolation of the poor, promote their participation in community life and their access to information, both of general and cultural nature, **creation (rehabilitation) of cultural units in communities** with special attention attached to areas populated by refugees and mixture of locals and refugees. In particular, culture houses and libraries should be repaired and equipped and measured undertaken to enhance access to information in the communities.
- (ii) **Propaganda of promoting savings, initiatives and entrepreneurship, and tolerance as national values** will help proliferate the ideology among the population that these values have

been and will remain the cornerstones of any fair and prosperous society. Radio and television programs, lectures and training, as well as assistance in creation of relevant centers will be among the measures to reach the above objectives.

- (iii) **Participatory excavation, restoration and exhibition of a number of historic and cultural monuments of great civil value** will have significant role in enhancing national identity, image of Armenia as a civilized country, promoting interest to surroundings (particularly, for poor people), as well as propaganda of huge potential of cultural tourism.
- (iv) **Organization and conduct of national celebrations** and festivals will have significant importance establishment of social equality, enhancing of civil participation and social activity, difficult to overestimate. To this end, the planned measures include stipulation and implantation of scenarios for holding national festivals and celebrations in accordance with official calendar, presentation of special productions, national, local and other, during such gatherings assistance in proliferation of fair inherent elements, as well as organization of folk contests and festivals of folk-tale narrators, etc.

#### 7.2.4. ENVIRONMENTAL PROTECTION

- 358. Environmental issues are manifested differently from the point of view of their impact on poverty of rural and urban population. The impact on rural population is largely conditioned by the fact that they are essentially dependent on natural resources. Thus, land and forest degradation has a direct impact on the levels of incomes of the rural population. At the same time, air pollution, as well as non-regulated construction in parks and destruction of green areas have an indirect negative impact on the living standards of urban population. The urban poor, as a rule, live mainly in environmentally unfavorable areas of the city adjacent to industrial enterprises and industrial zones.
- 359. In the period of transition to market economy, the structure of natural resources consumption was disrupted radically, which, in its turn, threatens to turn into an environmental and social disaster. On the one hand natural resources are overexploited without any regulation, which will inevitably bring to the frittering away of natural riches and disruption of the environmental balance. On the other hand, this diminishes economic productivity, as well as the possibilities of the future generations for using Armenia's natural resources.
- 360. From the viewpoint of poverty reduction, environmental issues can be classified into the following groups:
  - (i) efficient management of forest resources;
  - (ii) prevention of land degradation, reduction of impact of anthropogenic factors leading to land desertification;
  - (iii) efficient management and use of water resources, improvement of ecobalance of the Lake Sevan;
  - (iv) issues of municipal and hazardous industrial waste.
- 361. **Degradation of forest resources.** Volumes of legal and illegal tree cuttings for heating and industrial purposes have increased significantly. Nevertheless, there are no realistic estimations on the present volumes of forest resources (as of 1989 forests covered 11.2 percent of country's territory), which is mainly the result of the poor forest inventory and monitoring system. Forest degradation is also caused by the use of forest areas as grazing land in some settlements, as a result of which the natural reproduction process of the forest is disrupted. The impact of shrinking forest areas on water resources, ecosystems and livelihoods can be presented by the following negative phenomena:
  - (i) shortage of irrigation and drinking water, which has a direct negative impact on farming and life in general;
  - (ii) more frequent floods, salinization and low fertility, which reduce the quality of lands;
  - (iii) difficulties for the poorer segments of the population in using forest resources (forest fruits, medicinal herbs);



- (iv) “distancing” of forests from settlements, which brings about a number of other serious problems: women and old men have more difficulties in heating their houses through sanitary cuttings of forest trees and are forced to buy expensive firewood, or not to heat their homes in winter.
362. **Land degradation** In many villages, the poor do not use a significant part of their arable land, because of the lack of investments, as well as machinery, fertilizers and other supplies. As a result, arable lands gradually turn into pastures, become eroded and gradually lose their quality. Inappropriate agricultural practices also have an impact on the degradation of arable lands. According to data from 2000, the total area of such lands in Gegharqunik marz exceeded 1000 ha. In Armenia, with limited land areas, this is gradually becoming a serious threat, and remedies will need much larger investments in the future.
363. In summer, the majority of the poor in rural areas can use only nearby pastures, which causes overgrazing in both the existing pastures and arable lands used as pastures. The poor overexploit their arable lands because of their poverty, and the reduced fertility of overexploited arable lands, in its turn, deepens the poverty.
364. **Lake Sevan problems.** Lake Sevan problems have strategic significance for Armenia. This is due to the following three main factors:
- (i) Lake Sevan is the largest water resource reservoir in Armenia, which provides for a significant part of the drinking water, as well as water for industrial use (irrigation, hydro-power);
  - (ii) Lake Sevan is one of the most important income resources (fish production) for the population living in surrounding settlements; and
  - (iii) Lake Sevan is one of the main recreational areas in Armenia with huge significance for tourism development.
365. **Issues of hazardous industrial waste.** Although no serious studies for assessing the volumes and impacts of hazardous industrial waste were conducted in recent years, it is nevertheless obvious that it can have serious health, social and economic consequences for the population. The inadequacy of legal leverage necessary for protection of the population from pollution poses a potential threat to the health of the population. Lands surrounding the mining industries in the north of Armenia are polluted with cyanide and heavy metals, which are a threat, since in particular they can end up in the drinking water.
366. From the viewpoint of poverty reduction strategy, the environmental policy will focus on:
- (i) development of mineral resource basis of the republic;
  - (ii) contribution to the scientific researches, protection of the natural resources and development of the new methods and technologies in the fields of the rational exploitation, promotion of the energetically economical technologies development, as well as implementation of the projects for the secondary raw materials processing;
  - (iii) improvement of the legal framework for environmental protection and nature use, development of concepts for the development of the sector, improvement of mechanisms for control of the implementation of adopted laws and decisions;
  - (iv) ensuring appropriate nature use payments for various forms of nature use and channeling these funds towards nature protection purposes;
  - (v) creation of an environmental standards and norms system, development of environmental impact assessment system and improvement of control mechanisms;
  - (vi) rehabilitation of Lake Sevan ecosystem, its protection and rational use;
  - (vii) strengthening the forest resources management system, attaching special importance to the introduction of modern inventory and control mechanisms;
  - (viii) improvement of the inventory system for hazardous industrial waste, application of administrative and financial sanctions, improvement of economic instruments for environmental

- protection;
- (ix) research on the volumes and potential hazard of industrial wastes, specially on territories of main mining and chemical industries;
- (x) introduction of municipal waste collection and processing technologies.

### 7.3. INFRASTRUCTURE DEVELOPMENT

#### 7.3.1. WATER UTILITIES

367. The quality, accessibility and availability of basic public utilities provided to the population, including drinking and irrigation water are key factors affecting living standards of population. The results of the studies carried out in recent years witness that the fall of water quality affected the poor families most of all. The same is true with regard to irrigation network, where reduction of irrigated areas had a direct impact on poverty level.
368. The currently existing centralized system of water supply covers all urban areas and 36.5% of rural areas. Centralized water supply is available to 71% of households, including 87% in urban, and 45% in rural areas. In 2001 irrigation network covered 161000 hectares of lands, i.e. 58.8% of irrigated land plots.
369. Investments made in the framework of public investment program basically addressed restoration and maintenance of the network's physical conditions. Despite this, the degree of losses in the system remains very high, in particular, losses in drinking water network in 2001 were as high as 65%, and in irrigation network 30%.
370. Subsidies to the sector enterprises were streamlined to cover financial gaps occurred in their recurrent operations. Parts of the gaps left out of subsidy schemes were financed through accumulation of payables (especially for electricity). However, these were essentially funded from the state budget as well, since budget credits were allocated to the sector companies to cover electricity arrears. Thus the conclusion is that the entire financial gap of the sector companies was financed from the state budget. For the companies supplying drinking water budget financing was around dram 6 billion in 1999-2001, and for irrigation companies budget financing totaled dram 5.5-6.5 billion.
371. Targeting of subsidies allocated to cover financial gaps of the sector companies was fairly unsatisfactory. Calculations of the 1999-2001 data show that only 56% of budget funds allocated to cover financial gaps of the drinking water companies reached the poor, in other words these funds were almost equally distributed among the poor and non-poor.
372. Even less targeted have been the irrigation water subsidies whereby only 45% of them reached the poor population. In reality these indicators were even lower, since the volume of both drinking and irrigation water supplied to the poor had been evidently lower than supplies to non-poor population, while evaluation of the targeting exercise was based on the assumption that equal volumes of water were supplied to poor and non-poor consumers.
373. Taking into account the above, the following issues are prioritized in the public service sector:
  - (i) increase of accessibility, availability and quality of the services;
  - (ii) improvement of subsidy targeting;
  - (iii) enhancing management efficiency in the sector companies; and
  - (iv) improvement of the recording system.
374. From the perspective of poverty reduction strategy, the primary objective of the policies in public utilities will be **provision of accessible, affordable and high quality services to the population.**
375. According to the Human Development Goals declared by the UN, the number of population who do not have access to secure drinking water should be curtailed twice by 2015. In case of Armenia it means that by 2015 centralized water supply network should cover at least 86% of population, which implies water supply secured for additional 120-130 thousand households. The latter will require USD 200-220 million investments, which will amount to 55-60% of total investments expected to be done

in the network.

376. In order to ensure provision of accessible and quality water supply to the population, the state will continue investing in public services sector. Investment policy should target physical maintenance and rehabilitation of the engineering systems, replacement of high energy-absorbing structures, improving accountability of the sector and its modernization.
377. As mentioned earlier, centralized water supply system covers around 71% of households, which is not a poor indicator. However, the degree of reliability of the existing network is not high; thus average daily duration of water supply in urban areas is 8 hours, and 14 hours in rural areas. To this end, investments in the sector should address both expansion of centralized water supply network and upgrading degree of reliability of the system.
378. Sources of investments will be mostly foreign. Currently, in the framework of international loan projects and co-financing by the government, a number of loan projects are already underway (in particular, Municipal Development, Water Supply and Sewage to Communities, Irrigation Network Development, Dam Safety and other projects of the World Bank, KfW loan project implemented in Armavir Marz to rehabilitate regional water supply and removal network, etc).

**Table 7.13. Financing water utilities, 2004-2015, in billion drams**

	2004	2005	2006	2009	2012	2015	2004-2015
<b>Current expenditures (subsidies)</b>	<b>4.4</b>	<b>4.0</b>	<b>2.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>11.8</b>
<i>of which: Irrigation</i>	3.6	3.4	2.6	0.0	0.0	0.0	10.5
<i>Drinking water</i>	0.8	0.6	0.0	0.0	0.0	0.0	1.3
<b>Investments<sup>118</sup></b>	<b>17.2</b>	<b>22.8</b>	<b>28.7</b>	<b>37.3</b>	<b>47.2</b>	<b>59.6</b>	<b>468.6</b>
<i>of which: Irrigation</i>	10.2	12.3	15.3	19.9	25.1	31.8	251.1
<i>Drinking water</i>	7.0	10.5	13.4	17.4	22.0	27.8	217.5
<b>Total</b>	<b>21.6</b>	<b>26.8</b>	<b>31.3</b>	<b>37.3</b>	<b>47.2</b>	<b>59.6</b>	<b>480.4</b>
Investments/GDP, %	1.1	1.3	1.5	1.5	1.5	1.5	1.5
<i>of which: Irrigation</i>	0.6	0.7	0.8	0.8	0.8	0.8	0.8
<i>Drinking water</i>	0.4	0.6	0.7	0.7	0.7	0.7	0.7
Investments/capital expenditures of the state budget, %	19.8	29.1	34.3	35.2	36.2	37.2	34.6
<i>of which: Irrigation</i>	11.7	15.7	18.3	18.8	19.3	19.9	18.5
<i>Drinking water</i>	8.1	13.4	16.0	16.4	16.9	17.4	16.1

379. In order to enhance cost-recovery of tariffs and increase collection rates it is necessary to gradually to abstain from subsidizing drinking and irrigation water companies, since this policy implicitly contains two types of subsidies, including general tariff subsidy and “arrear accumulation” subsidies.
380. The tariff policy should define indemnification of current operational costs incurred by sector companies by the consumers. In respect of capital expenditures, these will remain the responsibility of the state and implemented through public investment programs, although in the long term the issue of their compensation through tariff setting will be placed for consideration.
381. In the irrigation sector it is necessary to define zoning tariff-setting policies on the basis of current operation costs incurred in individual zones. The need for determination of zoned tariff structures lies with the judgment that irrigation water is a means of production affecting pricing; to this end, application of unified tariff structure bearing irrelevancy with costs in individual zones impedes formation of realistic prices for agricultural produce and does not promote efficient use of resources.
382. If tariffs are set according to zones, there will be a need for alleviating its potential social impact in certain regions; thus government may channel budget savings accumulated on suspension of subsidies to these regions (this may be done under the financial adjustment policies or other methods, with the final choice to be further investigated).

<sup>118</sup> Including investment programs currently underway.

383. Budget savings generated on suspension of subsidies may be channeled to implementation of various social programs ensuring utmost level of their targeting.
384. Management reforms in the sector companies should become one of the important components of the implemented policies. The policies, especially in terms of irrigation and drinking water companies, should target their financial viability through enhancing efficiency of operation costs and increasing collection rate of tariffs charged for services. In general, improving collection rates and enhancing operational cost efficiency are the major sources for financial rehabilitation of sector companies. In the recent years, emergence of financial gaps has mainly taken place as a consequence of non-objective factors, i.e. inefficient management and weak administration. Thus it is necessary to carry out tight policies in company management area shifting towards contractual arrangements in company management. Management contracts should clearly define and stipulate stimulation mechanisms and responsibilities of the managers. Main indicators for evaluation of managers' activities are collection rates and operation level, especially in terms of electricity consumption.
385. Water metering systems are of great importance for improving management capacities in drinking water companies. Deficient systems of water metering in this sector does not permit drawing a clear understanding of the water supplies to consumers, which in its turn hampers fee collection process. As mentioned earlier, one of the policy directions in the sector is the improvement and modernization of water metering systems, which, inter alia, implies installation of individual water consumption metering equipment with consumers. Installation of meters with poor consumers will be the responsibility of the government. Installation of metering equipment with the consumers will enable shrinkage of inefficient use of water and will contribute to extension of the duration of water supply to the consumers.

**7.3.2. ROAD CONSTRUCTION**

386. As mentioned earlier (see Chapter 1), poverty in this program is defined as impossibility to meet minimum biological, social, and cultural needs. In addition other factors, having direct impact on capacities to meet the three groups of needs, and important role is attributed to physical isolation of people.
387. This is evidenced in the results of Survey<sup>119</sup> of Most Vulnerable Population in Armenia, undertaken by UNDP in 2002. In particular, according to this Survey, the more remote are communities from regional centers and the capital, the more these communities, and their population, are exposed to poverty (Table 7.14).

**Table 7.14. Community inclination to poverty and distance from regional centers and the capital**

Average distance of the communities (km)	Poverty inclination rates of communities					
	Below 20	20-30	30-40	40-50	50-60	60 and more
From regional centers	11.9	20.9	33.7	47.2	76.6	85.4
From the capital	33.8	46.2	109.2	162.9	226.9	237.6

Source: UNDP 2002 Survey of Most Vulnerable Population in Armenia.

388. Physical isolation of communities is a consequence of not only and not so much of remoteness from regional centers and/or the capital, but rather that of extremely poor condition of the roads between locations, or, in some cases, complete absence of such. To this end, there is a direct correlation between poverty and the condition of road network. Without a normal road network it is not feasible to provide for reliable and accessible transportation services.
389. Impact of road network on the poverty is manifested through the two following factors:
- (i) **As a factor of economic growth:** Quality of the road network affects economic growth in

<sup>119</sup> Social Trends in Armenia, Information and Analytical Study, December 2002

various ways. Good roads have direct impact on transport expenses<sup>120</sup>, promote specialization of various sectors of the economy and territories, which results in downsizing prices of local producers, promote local commerce, market integration and strengthens competition.

- (ii) **As a factor of income distribution:** Quality of the road network has an impact also on income distribution, especially in agriculture. As mentioned in the part on the Evolution of Poverty and Factors Preconditioning Poverty, income inequality in rural areas is much higher than in cities. Main reason is the utmost unequal distribution of the gains from sales of agricultural produce, which is the major source of income for rural households. Improvement of road network, and particularly community roads, will increase opportunities for selling agricultural produce by rural households and may lead to substantial alleviation of income inequality. Taking into account this factor, together with the next, rehabilitation of community road network becomes a priority in terms of poverty reduction.
  - (iii) **As a factor of accessibility of social services:** Good roads promote accessibility of main social services. This problem is particularly urgent in rural areas and small towns, where access to education, health and other social services is very restricted.
390. From the perspective of poverty reduction state policies in road construction sector should target rehabilitation and maintenance of the existing road network<sup>121</sup>.
391. According to the results of the Road Financing Survey undertaken in 2002, total demand for financing maintenance and rehabilitation of the entire road network is estimated around 22.2 billion<sup>122</sup> per annum (USD 38.6 million), i.e. 1.6% of GDP (see Table 7.15).

**Table 7.15. Annual financing requirement for the road network, in million drams**

	Maintenance		Administrative costs	Total
	Annual	Regular		
Main roads	2.0	6.7	0.2	<b>8.9</b>
Local (community) roads	1.8	2.8	0.1	<b>4.6</b>
City roads	1.5	6.9	0.2	<b>8.7</b>
<b>Total</b>	<b>5.2</b>	<b>16.4</b>	<b>0.6</b>	<b>22.2</b>

392. Budget expenditures allocated to road construction sector in the recent years are presented in the Table 7.16. According to the data in the table, budget financing of the road construction was well below the required levels.

**Table 7.16. Budget expenditures in the road construction sector**

	2000	2001	2002
<b>Road construction, in billion drams</b>	<b>1.71</b>	<b>4.99</b>	<b>6.82</b>
<i>% of GDP</i>	<i>0.16</i>	<i>0.42</i>	<i>0.50</i>

393. Policy in this sector should provide for relevant level of financing through gradual growth in financial allocations (Table 7.17).
394. Burden of financing, particularly that for current maintenance should be primarily placed with the consumers (by evaluating poverty and social impact analysis of changes within the sector). Fees paid by users will be enforced directly (annual fees for using the road network and transit fees), and indirectly (taxes and charges for fuel).
395. According to the amendments introduced in the Law on Introduction of Amendments and Additions in

<sup>120</sup> According to the WB Survey of Road Utility Financing, carried out in 2002, losses of transportation means incurred because of the existing road conditions are estimated around USD 110 million (additional fuel consumption, premature wear and tear of vehicles, additional loss of time).

<sup>121</sup> Total length of roads in Armenia is around 10405 kilometers, including main roads of 3360 km, local roads of 4341 km and city roads of 2704 km.

<sup>122</sup> In 2002 prices.

the Law of Armenia on Budgetary System, 10% of the previous year fuel (petrol, diesel and liquid gas) tax revenues should be earmarked for maintenance and operation of republican roads. Calculations for 2004-2015 show that expenditures for current maintenance of the roads will make in average 20%<sup>123</sup> of budget revenues expected from fuel taxation, while total expenditures envisaged for maintenance and rehabilitation of the road network will be around 80% (including capital expenditures).

396. Thus, entire volume of expenditures envisaged for maintenance and rehabilitation of roads will almost be equal to the total fuel tax revenues of the state budget. However, maintenance and rehabilitation of roads are not the only beneficiaries of fuel tax revenues of the budget. Fuel taxation is a tool for income redistribution function. To this end, up to 20% of budget revenues from generated on fuel taxation will serve as the allowable benchmark within which road construction sector may be funded from domestic resources sufficient for current maintenance of the road network.
397. Financing of capital repairs is expected to be funded from external sources equally distributed among grants (including Lincy Foundation) and loan projects. Capital repairs of the roads in 2004-2015 are projected at the level of 0.9% of GDP per annum, which is an ambitious and optimistic benchmark. Should the external financing be lower than programmed, it would be necessary to rehabilitation of community roads as a dominant taking into consideration the particular impact of the latter on poverty.

**Table 7.17. Financing of road construction in 2004-2015**

	2004	2005	2006	2009	2012	2015	2004-2015
Current maintenance, in billion drams	4.3	4.9	5.5	7.8	9.1	10.5	93.3
Capital repair, in billion drams	13.4	15.3	17.5	24.5	28.6	33.2	294.4
<b>Total expenditures, in billion drams</b>	<b>17.7</b>	<b>20.2</b>	<b>23.0</b>	<b>32.3</b>	<b>37.7</b>	<b>43.7</b>	<b>387.8</b>
Annual cost per 1 km of roads, in thousand USD	2.9	3.3	3.7	5.1	5.9	6.8	61.3
<i>of which: Current maintenance</i>	<i>0.7</i>	<i>0.8</i>	<i>0.9</i>	<i>1.2</i>	<i>1.4</i>	<i>1.6</i>	<i>14.7</i>
<i>Capital repair</i>	<i>2.2</i>	<i>2.5</i>	<i>2.8</i>	<i>3.9</i>	<i>4.5</i>	<i>5.1</i>	<i>46.5</i>
Total expenditures/GDP, %	1.1	1.2	1.2	1.3	1.2	1.1	1.2
Total expenditures/Budget expenditures, %	4.6	4.9	5.0	5.2	4.7	4.3	4.9
Capital repair/GDP, %	0.8	0.9	0.9	1.0	0.9	0.8	0.9
Capital repair/budget capital spending, %	15.5	19.5	20.9	23.2	22.0	20.7	21.7

### 7.3.3. ENERGY SECTOR

398. The impact of energy sector on poverty is exercised along the two following main directions:
- (i) Energy services, including electricity supply, heating, etc, are considered as means to meet basic human demands (food cooking, heating of residential units and meeting other household needs, access to information and so on) and have substantial impact on living standards of the population;
  - (ii) Energy sector is viewed as one of the most important infrastructures for economic development. In this respect impact of energy sector on poverty level is manifested through general economic development patterns.
399. Accessibility of electricity services in Armenia is close to 100% with almost all the households connected to electricity supply network. In respect to heating services the accessibility is extremely low. During the recent period central heating is accessible for some districts in Yerevan, Gyumri, Hrazdan, Charentsavan, and Jermuk.
400. Investment policies in the district-heating sector should target increase of accessibility of the services

<sup>123</sup> Selection of the indicator of budget revenues from fuel taxation as the comparative indicator for road construction financing is preconditioned by the fact that this indicator reflects predominant share (90%) of budget revenues related to road construction.

with the emphasis on installation of local heating systems. Not only the availability of heating has substantial impact on household expenses, but also addresses environmental issues. In many populated areas households see stove wood as the only means of heating, which as a rule is obtained from neighboring forests and hence significantly damaging environmental situation in the community.

401. The main emphasis in respect of investments in the sector of electricity supply should be:
  - (i) Rehabilitation and development of electricity transmission and regulation network (ArmEnerg, high-voltage networks). Electricity distribution system is already privatized, while privatization of electricity generation companies is in progress. Thus, electricity transmission and regulation system is a component of the energy sector, which will still remain state owned.
  - (ii) Financial assistance to the energy sector. During the recent years huge volume of payables have been generated in the system (dram 110 billion as at the beginning of 2003), which is a serious impediment to natural course of operation in the sector.
  - (iii) Maintaining and strengthening energy independence through development of the indigenous and alternative energy sources and promoting energy efficiency. In regard to development of indigenous resources, priority should be given to development of renewable energy production. In addition to energy independence, renewable energy will produce significant local and global environmental benefits and will facilitate development of private sector.
402. From the perspective of tariff policies, it is necessary to define that all the operation and maintenance expenses incurred in both electricity supply and heating supply systems must be reimbursed by the consumers.
403. The introduction of an effective management system in multi-storey residential buildings will hugely contribute to enhancing the accessibility and effectiveness of water supply services, as well as all other municipal services. Some steps have already been taken in this direction, in particular the law on Management of Multi-Storey Residential Buildings was adopted in 2002, where the main principles for managing multi-storey residential buildings are stipulated.
404. The main objective of the policy on the introduction of a management system for multi-storey residential buildings is to strengthen the multi-storey residential buildings management bodies (condominiums and owners associations) in market conditions with support from the state. Thus the policy will focus on providing both technical and financial support to multi-storey residential buildings management bodies.
405. The main directions for technical assistance would be: support to the establishment of management bodies, training staffs of management bodies, support to provision of services by management bodies to residents (organizing biddings, developing effective mechanisms for fee collection, etc.). Direction for financial assistance are: renovation of common property, providing opportunities for using credit and grant resources, heat isolation work in buildings, etc.

## CHAPTER 8. EMPLOYMENT ISSUES IN THE CONTEXT OF POVERTY REDUCTION

### 8.1. EMPLOYMENT: TRENDS AND SITUATION

406. Increase of employment is undoubtedly the most socially acceptable and economically efficient means of poverty reduction. In transition, the most significant reason for population impoverishment and deepening inequality was drastic, disproportionate and accelerated decline of the employment rates and the employment income. As a consequence of shrinking employment and incomes, household income structure reflected only 29% of revenues generated on formal employment in 2001 (2.5 times decline from the beginning of transition), and only 38% in sum with self-employment incomes. The same is observed in terms of inequality, where employment income concentration ratio, Gini coefficient, reached 0.44 in 2001, a double increase from the same period.
407. According to the official statistical data, number of economically active population in 2002 was 1416 thousand people, including 90.6% (1282 people) in real sector and 9.4% (134 thousand people) were officially registered unemployed. In reality official integrated survey statistics overestimate both economically active strata and employment rates in quantitative terms (see Box 8.1) at the same time underestimating the unemployment rate for the entire past period.
408. Changes in rates and structure of employment during transition period have shown distinct trends which directly and indirectly have impacted on the reduction of incomes and on the increase of income inequality:
- (i) General employment rate in non-agricultural sector reduced twice reflecting shrinkage of economic activity;
  - (ii) Changes in employment rates during transition period had weak, if ever, correspondence with economic activity in terms of timing;
  - (iii) In the circumstances of general unemployment reduction formal employment reduced at higher rates;
  - (iv) According to official statistics, employment in agricultural sector smoothened general fall in employment rates;
  - (v) In general, sector structure of the economy underwent significant changes, primarily affecting branches with inherent high productivity and rates of remuneration, i.e. industry and construction.
409. Having been officially recognized in 1992, unemployment displayed increasing trends up until 1996 reaching the level of 9.3% of economically active population. Further it fluctuated over the subsequent years with no particular trends observable<sup>124</sup>.
410. In the period of transition, i.e. since 1991 employment rate had consistently decreasing trends, and it was only in 2002 when the number of employed increased 1.3% from the previous year. Thus between 1994 and 2001 economic growth had been accompanied with declining unemployment (the level exceeding even the estimated GDP growth by 74%<sup>125</sup>). Comparison of the employment and economic activity rates for the period 1990-2002 is presented in the Figure 8.1.

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<sup>124</sup> According to the official statistics, registered unemployed in 2002 constituted 9.4% of economically active population. At the same time, according to integrated surveys, real unemployment rate already in 1996 was and persists to be substantially over and above the registered indicator. According to integrated surveys, unemployment rate in 2002 was 38.1% of economically active population. Like in the case of number of employed, such a difference is mainly preconditioned by the definition of unemployment and method of its assessment.

<sup>125</sup> It should be mentioned that already in 2002 the GDP index of 84 (1990 =100) was over and above the employment index estimated on the same basis, i.e. 79.



**Box 8.1. Estimating Economically Active Population and Employment Level Armenia**

The assessment of employment and unemployment rates and their changes in transition period encounters a number of similar difficulties in majority of countries. The most important among those are:

- (i) Predominance of private sector;
- (ii) Expansion of informal sector;
- (iii) Official recognition of unemployment; and
- (iv) Unrecorded migration, including labor migration.

In these circumstances assessment of real rate of unemployment necessitates replenishment of existing statistical methods with tools and expertise of statistical practices in market economies.

As in other transition economies, there are two major methods currently employed in Armenia to assess employment and unemployment rates. The first is based on the data collected from enterprises, organizations and administrative registrars; the second is based on the data generated through integrated household questionnaires, including dedicated labor force surveys (LFS). The experience of countries in transition shows that as a rule, employment and unemployment indicators collected on the basis of the two methods substantially differ.

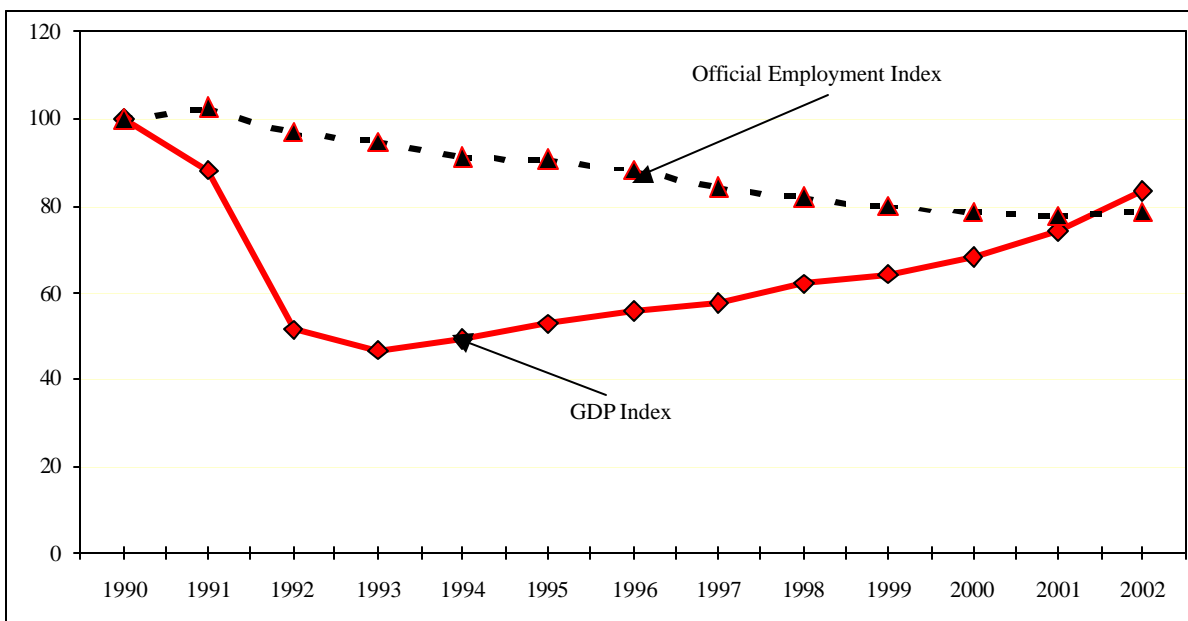
In view of unrecorded huge migration and irregular LFSs in case of Armenia, reconciliation of the two sets of data throughout transition period is a complicated, if not an impossible undertaking. Nevertheless, the preliminary results of the 2001 Census used for expert evaluation it may be stated that the number of 16 years old and above population is 2.2 million people; this indicator is substantially different from the 2002 indicator arrived at on the basis of the above two methods. Thus, according to official statistical data, economically active population in 2002 was 1,415 thousand, including 90.6% employed; on the other hand, according the NSS (LFS Q2 2002), employed population was 61.9% of total population, that is 28.7 percentage points less. Taking into consideration that according to the same survey, economically active population constituted 56.1% of the population of 16 and above hence the estimated number of employed (according to the LFS) will be 710 thousand people or only 55% of the official employment data. It should also be mentioned that similar values are generated if estimations are made for all the years when labor force or households surveys were conducted.

In respect of assessments of economically active population greater deal of trust should be vested in LFS data, according to which this strata constituted around 60% of working age population (in contrast to official data arriving at around 70%). To this end, international experience shows that number of economically active population in a vast majority of countries fluctuates between 50 and 65%. Finally, this indicator is heavily dependent upon degree of economic development of the country, i.e. activeness is higher in developed countries primarily as a result of higher activity of the women.

Taking into consideration the above factors, the top priority of the state in the area of education is the general educational system. Public expenditure policy targets alleviation of the gap between per pupil expenditures in various levels of education thanks to faster (than in professional education sector) growth rates of per pupil expenditures in the general education system. On the other hand, huge importance will be attached to secondary and additional education systems.

	1996	1998	2000	2001	2002
Number of de facto population, thousand people	3 082.1	3 028.9	2 996.6	3 002.6	3 082.1
<i>of which: Population 16 and above</i>	<i>2 072.0</i>	<i>2 075.2</i>	<i>2 112.6</i>	<i>2 152.6</i>	<i>2 072.0</i>
Level of activity	0.53	0.52	0.52	0.52	0.53
Number of economically active population, thousand people	1 094.8	1 083.2	1 098.5	1 110.7	1 094.8
<b>Rate of unemployment</b>					
Officially registered unemployed	0.14	0.12	0.14	0.12	0.14
25% unemployment	0.25	0.25	0.25	0.25	0.25
LFS or ILCS (1996, 1997, 1998/1999, 2001, 2002)	0.37	0.35	0.33	0.33	0.37
<b>Number of unemployed, thousand people</b>					
Officially registered unemployed	147.9	133.8	153.9	138.4	147.9
25% unemployment	273.7	270.8	274.6	277.7	273.7
LFS or ILCS (1996, 1997, 1998/1999, 2001, 2002)	408.4	379.1	360.3	364.3	408.4
<b>Number of employed</b>					
Officially registered unemployed	946.9	949.4	944.6	972.3	946.9
25% unemployment	821.1	812.4	823.9	833.1	821.1
LFS or ILCS (1996, 1997, 1998/1999, 2001, 2002)	686.5	704.1	738.2	746.4	686.5

Figure 8.1. Employment and GDP indices, 1990-2002 (1990 = 100)

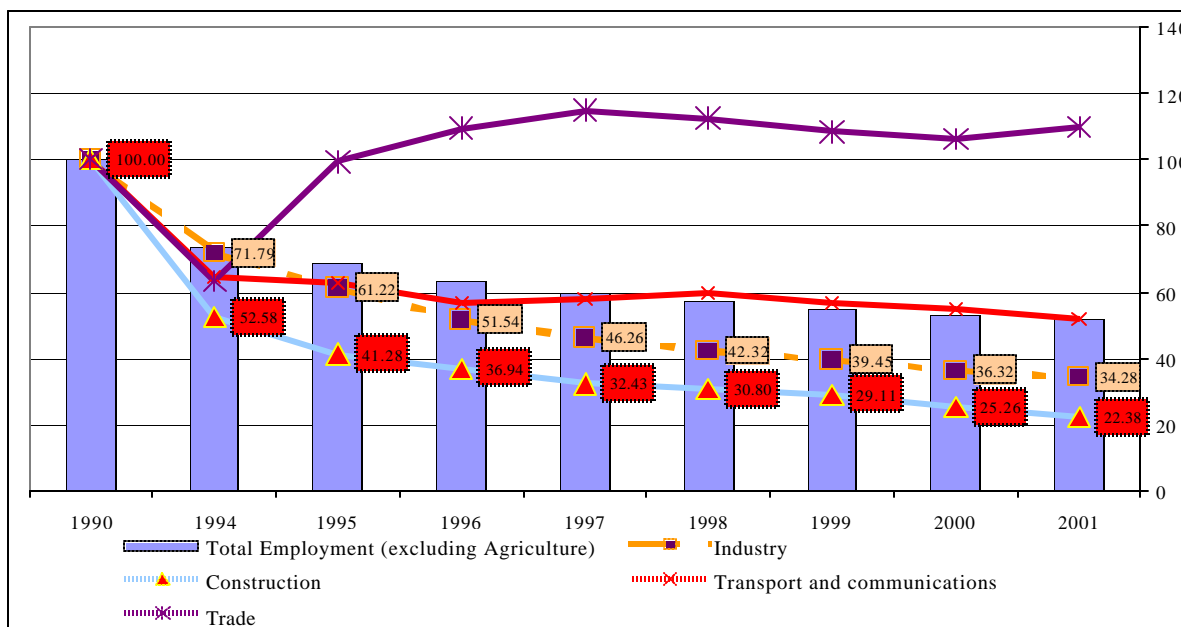


411. In echoing to shrinkage of economic activity and increase of productivity, the general rate of employment has diminished except in agriculture and commerce. Reduction of employment rate in industry and construction dropped in 2001 to 34 and 22% respectively from the level of 1990. Around 60% of reductions in industry were a consequence of diminishing volumes of output and the other 40% were due to increase of productivity.
412. In the first years of transition employment reduction lagged substantially behind the decrease of the production volumes. The low levels of productivity, a legacy from the former times, diminished further in the majority of sectors. It should be mentioned that such a trend was specific to almost all the former USSR republics and in contrast to Eastern European countries where employment rate has reacted to economic decline at more accelerated rates. The policy to contain reduction of employment rate resulted from administrative leaves<sup>126</sup> and shrinkage of salary rates<sup>127</sup> had to resulted and indeed resulted in a situation whereby economic growth between 1994-2001 actually coincided persisting trends of reductions in the employment rate.
413. In the recent decade informal employment established and expanded in Armenia and many other transition economies, i.e. self-employment and unregistered employment. According to various estimations, the rate of informal employment in urban areas fluctuated between 30-38% of total employment. Being one of the major reasons for declining formal incomes, the increase of informal employment at the same time preconditioned the proliferation of income inequality because of higher degree of concentration.

<sup>126</sup> The concept of administrative leave was widespread in 1994 when 16% of employees in industry were on such administrative leaves. Increasing over the years this indicator already in 1996 constituted 40%, after which displayed decreasing trends to reach 17.6% in 2001 (almost the level of 1994). It is symptomatic that the factor of administrative leave taken into account, the number of employees in industry increased by 11 thousand between 1998-2001, which contradicts the substantial decrease of around 40% recorded in the official statistics.

<sup>127</sup> As a result, rate of remuneration in these years underwent unprecedented decline, more than 15 times according to some estimations. Thus, average monthly pay in industry in 1994 was below 10 US Dollars, 5 US Dollars in agriculture, and 3 US Dollars in education.

Figure 8.2. Employment trends by sector (excluding agriculture), 1990-2001 (1990 = 100)



414. In contrast to other sectors agriculture has been the main one to display sectoral employment trends different from other sectors along the two major lines. First, it refers to employment rate, agriculture has been the only sector where substantial increase has been recorded in the transition period. The number of employees in agricultural sector in 1995 doubled from 1990 and remained unchanged since. Thus having increased by 260 thousand the number of employees in agriculture “statistically” smoothed the 300 thousand jobs decline in industry and construction. Second, in view of specifics inherent to employment statistics employment trends in agriculture are in poor correspondence with other indicators of the sector development. In particular, changes in gross agricultural output during the recent 7-8 years has not practically had any impact on the employment rate in the sector.
415. The existing employment structure includes sectors of predominantly low productivity and efficiency branches, such as agriculture, education, health, culture, science and industrial infrastructures, which will become major impediments for increase of employment in future. Despite increasing trends of the recent years, salary rates in these sectors remain below the poverty general line or close to it.
416. Employees in these sectors, who constitute 68% (around 856 thousand people and members of their families) of total employment, definitely replenish the category of poor population, if they lack any other source of income. Trade sector added where the level of declared salaries is also very low, then employment for the three fourth of population is not a sufficient condition for well being. Expansion of employment in these sectors or containment of its reduction by virtue of low salaries may not be considered promising from the perspective of poverty and inequality reduction or development of these sectors.
417. Recent surveys come to evidence that employed and self-employed have better chances of avoiding poverty, and this correlation displays increasing trends in the recent years. At the same time the employment generated income inequality also reduces. Such trends are primarily preconditioned by significant increase of salaries in the republic. Thus average nominal salary in 2002 was twice as high as in 1997. It should be mentioned that this increase was partially a consequence of salary formalization. This is at least reflected in the indicators of economic growth and inflation (1997 = 100) for the period, 144 and 113 respectively.
418. Nevertheless, average monthly salary in the republic, which according to official statistics was 26 444 drams, remains to be very low in terms of any dimension. Thus, a family of four with the income of only one member equivalent to monthly average salary will plunge into the category of extremely

- poor, and into the poor if two receive the same salaries. On the other hand, the current official level of salaries is significantly lower than resources channeled to remuneration indirectly estimated in the system of national accounts. For 2000, the difference between these two indicators constituted some 35%.
419. Among the factors affecting employment, the most important one is its structure by the size of economic agents. Very small and small enterprises, as well as self-employed, usually very extensively deploying available resources are considered to be among the main sources of employment reinforcement. Because of low productivity employment elasticity in this sector is at relatively higher level than the economic activity. Hence, in the countries with large share of employment in small enterprises economic growth leads to higher employment rate. On the other hand, expansion of small enterprise sector with inherent relatively lesser inequality of income distribution between employers and employees has positive impact in terms of reduction of inequality in general terms. Finally, ensuring favorable conditions for small enterprises and self-employment is important also from the perspective of promoting equal business opportunities.
420. From this perspective Armenian realities are difficult to evaluate taking into account the number of employed in agriculture and informal economy. However, according to expert assessments, no less 70% of total employment is located in small enterprises, agricultural livelihoods or self-employment. Like in other countries, high employment rate indicators are recorded in agriculture (95%), trade (90%), construction (60%), and lowest are in industry (26%)<sup>128</sup>.
421. In transition period the demand for labor force and sector structure have drastically decreased together with qualitative changes in the requirements posed to labor force. As a result, discrepancies in demand and supply of labor force resulted in occurrence and deepening of structural unemployment. This is characteristic for all countries in transition. In 2002 the share of unemployed for over one year was 62.4% in Slovakia, 58.2% in Bulgaria, 56% in Latvia, 48.3% in Czech Republic and 44%<sup>129</sup> in Hungary. This indicator for officially registered unemployed in Armenia was 78%<sup>130</sup> in 2002. Such a structural unemployment (protracted), in addition to direct impact on material poverty is an impediment for employment expansion, as international experience states<sup>131</sup>.
422. In developed market economies labor market regulation issues are, as a rule, priority issues in employment sector analyses. The level and methods of labor market regulation may undoubtedly have influence on the employment rate in a country. Nevertheless, influence of these factors on employment in transition period in Armenia was not significant in comparison with others. In future, however, the labor market regulation system may have significant impact on economic activity of the population, i.e. employment and unemployment.

## 8.2. EMPLOYMENT PERSPECTIVES

423. In the years to come increase in employment rate will be dependent on economic growth rates in the first turn. However, according to the analysis, significant impact on employment will have the factor of labor productivity and structure of economic growth. At the same time, in the context of poverty and inequality equally if not more important for employment expansion will be attributed to increase in rates of labor remuneration, formalization of incomes, as well as reduction of unemployment, particularly structural unemployment.
424. 19. The projections for coming 10 years envisage that average 1% of economic growth will result in 0.21% of employment expansion. In the first years of this period this indicator will be lower, i.e. 0.17%, and then increase to reach the level of 0.27%. Such conservative projections are based on forecast of productivity in main sectors of the economy, agriculture in particular, as well as on the

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<sup>128</sup> Share of employees in very small and small industrial enterprises is estimated without self-employment and informal sector (See Socio-economic Situation in Armenia 2002 January-December).

<sup>129</sup> See Labor, Employment and Social Policies in the EU Enlargement Process, The World Bank, 2002.

<sup>130</sup> The same indicator for 2001 estimated on the basis of labor force integrated survey is 73%.

<sup>131</sup> See Economic Survey of Europe, Economic Commission for Europe, 1999 No1, Geneva, 1999.

programs of the government to enhance efficiency social and industrial infrastructures. General index of labor productivity in 2015 will constitute 165% from the year 2002 while the employment index for the same period will be 120% (see Figure 8.3).

Figure 8.3. Projections of GDP, employment and labor productivity indices in 2003-2015 (2002=100)

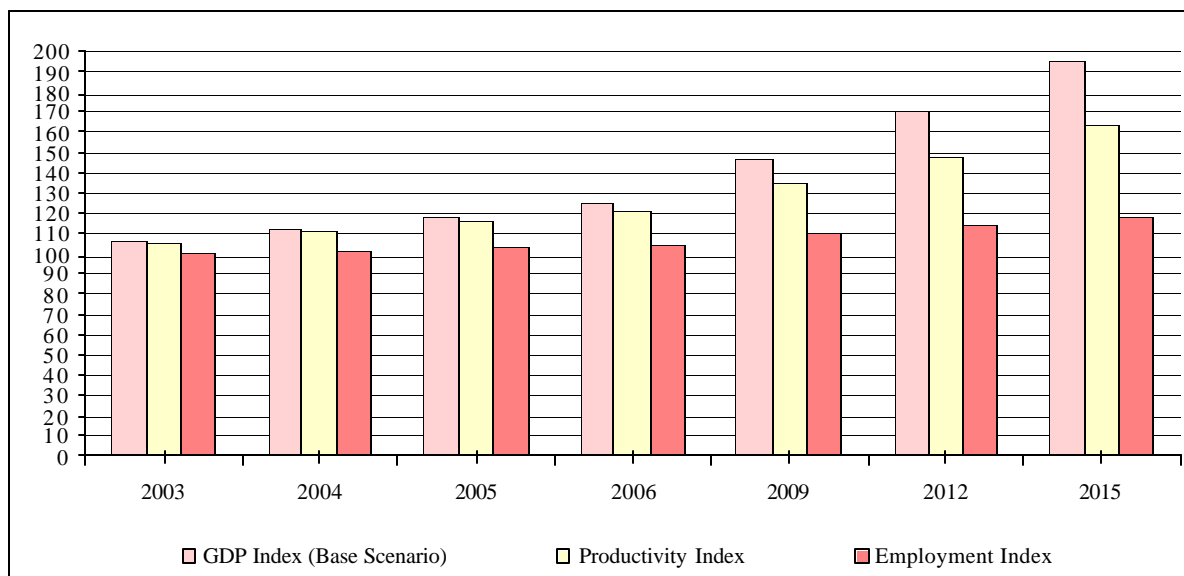


Table 8.1. Projections of changes in employment incomes as share in total monetary incomes of population in 2003-2015 (in percent of per capita monetary income)

	1999	2001	2003	2006	2009	2012	2015
	<i>Actual</i>		<i>Projection</i>				
Employment income	28.7	38.9	40.9	46.1	52.4	56.5	60.7
Hired jobs	20.0	29.1	31.1	35.4	40.4	43.9	47.5
Self-employment	8.6	9.8	9.8	10.7	12.0	12.6	13.2
Gains on sales of agricultural produce	26.2	15.0	15.0	12.5	10.8	9.8	8.9
Social transfers	7.4	12.2	12.4	12.8	12.3	11.7	11.1
Pensions	5.4	9.1	10.5	10.3	10.2	9.8	9.4
Family benefits	0.0	2.8	1.5	2.1	1.8	1.5	1.4
Other allowances	2.1	0.4	0.4	0.4	0.3	0.3	0.3
Transfers by residents of Armenia	4.9	3.6	3.4	3.1	2.9	2.8	2.8
Remittances and incomes from abroad	10.4	17.4	19.2	17.0	16.0	13.3	11.0
Other income	22.4	12.9	9.1	8.5	5.6	5.9	5.5
Total monetary income	100.0	100.0	100.0	100.0	100.0	100.0	100.0

425. Taking into account the sector trends of economic growth and labor productivity, sectoral structure of employment will undergo certain modification in future. In general outline, changes in sectoral structure of employment will be contingent upon shrinkage of social and agricultural sectors towards the enlargement of construction, trade and business services. Quantitative projections of sectoral structure of employment may be of speculative nature in view of significant discrepancies in estimations currently made on the bases of various different sources of employment assessment. However, it should be mentioned that according to projections, predominant share of the 248 thousand new jobs expected in 2003-2015 would belong to non-agricultural sector.

426. From the perspective of poverty and inequality reduction priority will be attached to changes in

incomes generated from employment and self-employment. Taking into consideration the potential for employment expansion, these changes will be dependent on changes in rates of remuneration. Existing salaries and trends recorded in previous years to this end are conducive to thinking that officially registered rates of remuneration will be augmenting quicker than the increase of salaries based on growth on labor productivity. Should the trends of the previous years be maintained one might expect significant accretion of the share of employment and self-employment incomes in total incomes in 2015 reflecting 61% of monetary income of the population, up from 29% in 1999 and 39% in 2001.

427. In parallel with employment expansion and increase of employment incomes, one of the major goal the government faces will be to ensure reduction of unemployment and structural component thereof. Employment expansion in itself may not result in reduction of unemployment if it occurs in parallel with higher rates of economic activity growth or increase of the number of relevant age. According to projections there is high probability of this happening in Armenia in the coming 5-6 years. During this period the number of working age population will grow at higher rates compared to the projected increase in employment, then this trend will be reversed. Thus, in the circumstances of unchanged level of economic activity it is difficult to anticipate reduction of unemployment in the medium-term, after which, however, it will diminish in average by around 1 percentage point per annum.
428. The main way to reduce the existing high rate of structural unemployment is to carry out reforms in the system of vocational and higher education. From this perspective the most important measure is elaboration and implementation of a comprehensive program for rehabilitation and strengthening of currently almost idle system of secondary vocational education.

## SECTION 4. PRSP IMPLEMENTATION FINANCING: BUDGET FRAMEWORK

### CHAPTER 9. DEVELOPMENTS IN CONSOLIDATED BUDGET FRAMEWORK AND POVERTY REDUCTION

429. Measures envisaged under the PRSP predominantly will be financed from the consolidated budget of Armenia, which includes state budget, local budgets and budget of the State Social Insurance Fund. The Table 9.1 below presents projections on consolidated budget indicators drawn on the basis of the PRSP driven macroeconomic framework.

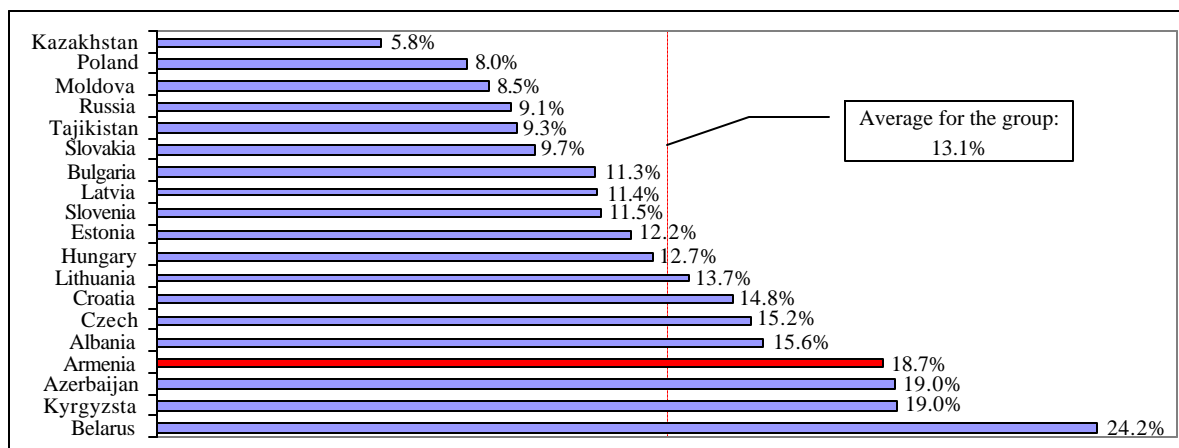
**Table 9.1. Consolidated budget main indicators by economic classification (% of GDP), 2002-2015**

	2002	2003	2004	2005	2006	2009	2012	2015
<b>TOTAL REVENUES AND GRANTS</b>	<b>22.6</b>	<b>23.0</b>	<b>21.5</b>	<b>21.8</b>	<b>22.0</b>	<b>22.8</b>	<b>23.5</b>	<b>23.9</b>
Total current revenues	18.9	18.7	19.4	19.9	20.3	21.8	22.6	23.2
Tax revenues and stamp duties	17.8	18.2	18.8	19.3	19.8	21.2	22.0	22.6
of which: Payroll tax	2.8	2.9	3.0	3.1	3.2	3.5	3.5	3.5
Non-tax revenues	1.1	0.5	0.6	0.6	0.5	0.6	0.7	0.6
Capital revenues	0.19	0.07	0.06	0.04	0.03	0.01	0.01	0.01
Grants	3.5	4.1	2.1	1.9	1.7	1.0	0.8	0.7
<b>TOTAL EXPENDITURES</b>	<b>25.0</b>	<b>26.2</b>	<b>24.1</b>	<b>24.0</b>	<b>24.1</b>	<b>24.8</b>	<b>25.4</b>	<b>25.5</b>
Current expenditures	19.0	18.7	18.3	19.1	19.1	20.1	20.9	21.1
Wages	0.9	1.1	1.4	1.6	1.7	2.0	2.4	2.5
Interest	1.2	0.9	0.8	0.7	0.7	0.6	0.6	0.7
Subsidies	0.6	1.0	0.7	0.7	0.6	0.4	0.4	0.4
Transfers	5.0	5.0	5.1	5.2	5.3	5.5	5.3	5.2
Goods and services	11.4	10.6	10.3	10.9	10.9	11.6	12.1	12.2
Capital expenditures	5.0	7.7	5.4	4.5	4.4	4.3	4.1	4.0
Net lending	1.0	-0.2	0.5	0.5	0.6	0.5	0.4	0.3
<b>DEFICIT</b>	<b>2.4</b>	<b>3.2</b>	<b>2.6</b>	<b>2.2</b>	<b>2.0</b>	<b>2.0</b>	<b>1.9</b>	<b>1.6</b>

As the table shows, while the nominal GDP is projected to increase 2.9 times in 2002-2015, tax revenues in the same period are projected to grow 3.7 times. The share of total revenues in GDP will increase from the actual 22.6% in 2002 to 23.9% in 2015 (+1.3 percentage points of GDP). The structure of revenues by sources will undergo substantial changes. In particular, decreasing official transfers from foreign sources will be accompanied by increasing tax and non-tax revenues. Such trends in domestic revenues will be result from both the projected high economic growth and the measures to improve tax and customs administration.

430. In parallel with the increase in budget revenues, budget expenditures will also grow: in nominal terms the level of expenditures in 2015 will be 2.9 times higher than in 2002. However, taking into consideration the needs of public debt management and budget deficit regulation, expenditures will grow at lower rates compared to revenues, (in 2015 expenditure-to-GDP ratio will amount to 25.5% as compared to 24.1% projected for 2004). The budget expenditures will be characterized by an increased social focus. This is evident in particular from the faster growth of wages and social transfers in total budget expenditures.
431. Together with improvements in the public debt position, the share of interest payments on public debt in total budget expenditures will also decline, and will account for 2.7% in 2015 down from 4.6% in 2002).
432. In comparison with a number of CIS and Eastern European countries in transition the level of public capital expenditures in Armenia is quite high (see Figure 9.1). In recent years the substantial increase in their level has been to a large extent due to capital transfers from abroad (Lincy Foundation).

Figure 9.1. Share of capital expenditure in total public expenditure (%)\*



\* For Armenia 2002, for other countries 1999 data.

Source: Ministry of Finance and Economy, World Development Indicators, WB, 2001.

433. The need for capital expenditures will be more pronounced in the coming years, and on average capital expenditures will stay at the level of around 4% of GDP in 2004-2015. Public capital expenditures will not substitute private investments in terms of their targets or structure; rather they will be complementary. These expenditures will be mainly directed towards rehabilitation and reconstruction of social and productive infrastructures.

434. As in the past, budget formulation and execution in the coming years will have expenditures exceeding revenues, and the deficit will be financed both from domestic and foreign sources. Budget deficit will gradually decrease from 2.6% of GDP projected for 2004 down to 1.6% of GDP in 2015.

### 9.1. PUBLIC EXPENDITURES AND POVERTY REDUCTION STRATEGIES

435. Social and cultural sectors have normally had the largest share in consolidated budget expenditures, followed by allocations to economic services (economic infrastructures). General government services account for a smaller share of expenditures while allocations to economic services are larger in Armenia as compared to other CIS countries (see Table 9.2). The main explanation to this are the numerous foreign funded projects carried out in various sectors of economy.

Table 9.2. Comparisons of the structure of budget expenditures by sectors (functional classification), 2002

	Armenia	Azerbaijan	Georgia	Kazakhstan	Moldova	Tajikistan	Uzbekistan
<b>General Government Services</b>	<b>24.0%</b>	<b>30.4%</b>	<b>40.5%</b>	<b>29.9%</b>	<b>14.4%</b>	<b>34.3%</b>	<b>1.8%</b>
General public services	8.4%	8.5%	24.1%	15.9%	6.6%	17.3%	...
Defense	10.8%	11.7%	5.7%	8.2%	1.6%	8.5%	...
Public order and safety	4.8%	10.2%	10.6%	5.8%	6.1%	8.6%	...
<b>Social and Community Services</b>	<b>42.2%</b>	<b>48.7%</b>	<b>23.6%</b>	<b>51.1%</b>	<b>44.6%</b>	<b>44.8%</b>	<b>48.3%</b>
Education	9.4%	22.0%	5.8%	19.0%	19.3%	6.1%	...
Health	4.7%	5.8%	4.2%	11.2%	12.1%	6.5%	...
Social security and social insurance	18.1%	16.0%	10.6%	14.7%	11.2%	15.6%	...
Housing and utilities	6.9%	2.1%	0.5%	4.1%	0.0%	6.7%	...
Culture, information, sports and religion	3.2%	2.7%	2.5%	2.2%	2.1%	0.0%	...
<b>Economic Services</b>	<b>14.1%</b>	<b>12.4%</b>	<b>4.9%</b>	<b>9.8%</b>	<b>5%</b>	<b>14.2%</b>	<b>8.7%</b>
Fuel and energy	2.4%	-0.1%	2.0%	0.0%	0.0%	1.6%	...
Agriculture, forestry, water and fishing	4.2%	4.4%	2.3%	5.2%	2.2%	3.3%	...
Mining and mineral resources	0.2%	3.8%	0.1%	0.5%	0.2%	1.6%	...
Transport and communications	7.1%	2.9%	0.1%	3.6%	2.1%	7.1%	...
Other economic services	0.2%	1.4%	0.3%	0.5%	0.5%	0.6%	...
<b>Other Services</b>	<b>19.7%</b>	<b>8.5%</b>	<b>30.9%</b>	<b>9.1%</b>	<b>36.1%</b>	<b>6.7%</b>	<b>41.2%</b>
<b>Total Expenditure</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Ministry of Finance and Economy; M. Betley Public Expenditure in the CIS-7, 2003.



436. Directly or indirectly a substantial portion of the consolidated budget expenditures will be attributed to poverty reduction through financing of PRSP measures in various areas of economic activity that aim at increasing the living standards of the people. Expenditures having immediate impact on living standards of population relate to social sectors. In respect of a part of them (education, health) the state will finance basic social services that are directly related to improvement of living standards of the population and to reduction of human poverty. Other social sectors (social security and insurance) cover state assistance directly provided to vulnerable groups and/or disabled people.
437. The Table 9.3 shows that social expenditures for the coming years are characterized by higher growth rates in comparison with other major budget expenditures.

**Table 9.3. Consolidated budget main indicators by functional classification (% of GDP), 2002-2015**

	2002	2003	2004	2005	2006	2009	2012	2015
<b>TOTAL</b>	<b>25.0</b>	<b>26.2</b>	<b>24.1</b>	<b>24.0</b>	<b>24.1</b>	<b>24.8</b>	<b>25.4</b>	<b>25.5</b>
SOCIAL and CULTURAL SECTORS	9.1	10.0	10.2	11.0	11.5	12.3	12.5	12.8
Education	2.3	2.3	2.7	3.0	3.1	3.6	3.8	4.0
Health	1.2	1.4	1.5	1.8	1.9	2.1	2.3	2.5
Social insurance and social security	4.5	5.0	5.2	5.5	5.7	5.8	5.6	5.5
Culture, information, sport and religion	0.8	1.1	0.6	0.6	0.7	0.5	0.5	0.5
Science	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3
DEFENCE, PUBLIC ORDER AND SAFETY	3.7	4.2	4.1	4.2	4.0	3.9	3.9	3.8
ECONOMIC SECTORS	5.2	7.4	5.4	4.4	4.2	4.2	4.0	4.0
Fuel and energy	0.6	0.8	0.8	0.5	0.4	0.0	0.0	0.0
Agriculture, forestry, water and fishing	1.1	1.3	1.1	0.8	0.7	0.8	0.8	0.8
Transport, roads and communication	1.8	2.5	1.6	1.5	1.4	1.3	1.2	1.1
Housing and public utilities	1.7	2.5	1.5	1.4	1.4	2.0	1.9	2.0
Other economic sectors	0.1	0.3	0.4	0.3	0.3	0.2	0.1	0.1
GENERAL PUBLIC SERVICE	1.7	1.9	2.2	2.4	2.3	2.6	3.0	3.1
PUBLIC DEBT LIABILITIES	0.9	0.9	0.8	0.7	0.7	0.6	0.6	0.7
OTHER SECTORS	4.5	1.7	1.4	1.4	1.4	1.0	1.0	0.7
NON-CLASSIFIED ITEMS	0.0	0.0	0.0	0.0	0.0	0.3	0.4	0.4

438. The number of people in need of direct financial assistance will decline with economic growth. In these circumstances, priority will be given to the improvement of quality, efficiency and accessibility of the major social services of health and education: this explains the increase of public expenditures in these sectors, which in particular will be reflected in the structure of social expenditure. While in 2002 expenditures for education, health, social security and insurance in accounted for 26%, 13% and 50% of total social spending, in 2015 they will account for 31%, 20% and 43% respectively.
439. In addition to the above-described budget expenditures for social sector, the budget allocations to state administration will be increasing by higher rates as well (to 3.1% of GDP in 2015, up from 1.7% of GDP in 2002). Such growth basically results from the reforms in state administration structure, civil services and judicial system, which are directly and indirectly linked with poverty reduction, particularly through increased income from employment for civil servants.

**9.1.1. INCREASE OF FINANCIAL RESOURCES IN THE BUDGETS OF 2003 - 2015 AND THEIR DISTRIBUTION**

440. Implementation of poverty reduction measures largely depends on the availability of adequate financial resources. The general picture and main development trends in budget recourses are presented in Table 9.4.

Table 9.4. 2003-2015 budget developments

	2002	2003	2004	2005	2006	2009	2012	2015
1. Revenues and official transfers (billion dram)	306.7	338.4	346.2	383.0	422.9	566.9	737.9	950.5
<i>% in GDP</i>	22.6	23.0	21.5	21.8	22.0	22.8	23.5	23.9
2. Sources of deficit financing (billion dram)	33.1	47.4	41.9	39.2	38.6	50.4	61.1	61.7
<i>% in GDP</i>	2.4	3.2	2.6	2.2	2.0	2.0	1.9	1.6
<b>TOTAL RESOURCE AVAILABLE (billion dram)</b>	<b>339.8</b>	<b>385.7</b>	<b>388.1</b>	<b>422.2</b>	<b>461.5</b>	<b>617.2</b>	<b>799.0</b>	<b>1012.2</b>
<i>% in GDP</i>	25.0	26.2	24.1	24.0	24.1	24.8	25.4	25.5
Increase of resources, (y-o-y, billion dram)	x	45.9	2.4	34.1	39.3	54.1	65.2	74.5
Growth of resources (y-o-y, %)	x	13.5	0.6	8.8	9.3	9.6	8.9	7.9
Increase of resources /GDP ratio (%)	x	3.1	0.2	1.9	2.0	2.2	2.1	1.9
3. Net additional resources freed from the sectors (billion dram)	x	35.0	37.4	9.6	0.5	1.6	0.1	3.3
<b>TOTAL INCREMENTAL RESOURCES (billion dram)</b>	<b>x</b>	<b>80.9</b>	<b>39.8</b>	<b>43.7</b>	<b>39.8</b>	<b>55.7</b>	<b>65.3</b>	<b>77.8</b>
Distribution of incremental resources by sectors (billion dram), of which:	x	80.9	39.8	43.7	39.8	55.7	65.3	77.8
Social and cultural sectors	x	25.0	24.0	27.9	27.5	26.0	31.7	42.8
Defense, national security and public order	x	10.5	5.5	6.6	4.0	7.8	8.7	11.3
Economic sectors	x	38.2	3.1	1.0	3.5	10.4	6.6	8.8
Maintenance of state and local authorities	x	5.4	7.2	6.3	2.2	7.9	7.4	10.0
Public debt service	x	1.6	-	0.0	0.1	1.3	1.7	3.9
Other sectors	x	-	-	1.9	2.4	2.3	2.7	0.0
Non-classified items	x						6.4	0.4

441. The table shows that a consistent growth of budget resources is projected for 2003-2015, as a result of which the level of revenues in 2015 will make more than three times of the actual level of 2002, both in nominal terms and as percent of GDP. In addition, expenditures in some of the sectors will decline thus giving rise to incremental resources to be distributed among other sectors.
442. Substantial portion of incremental budget resources projected for the period under consideration will be channeled to implementation of programs in the social sector, general public service, and infrastructure development. In the program period the average annual increase of incremental budget funds on year-on-year basis is projected at the level of 8.6%. The total amount of incremental revenues expected in the period of 2002-2015 over the actual level of 2002 will be dram 777 billion. Predominant share of the above incremental revenue, i.e. 51%, will be allocated to social and cultural sectors; 13% to military, national security and public order expenditures; 17% to economic sectors; 13% to state administration, and 6% to other sectors.
443. Thus, expenditures channeled to poverty reduction in 2015 will make dram 760 billion, or 75% of total expenditures (60% in 2003), including dram 471 billion to finance direct measures of poverty reduction (or 47% of total expenditures), which will thus be 4.3 times more than in 2002.
444. In particular, significant additional allocations (dram 395 billion, or 63% of the incremental resources channeled to poverty reduction) will be made in the social sector of which around 32% (or dram 127 billion), is projected to for financing of educational programs.
445. The additional budget allocations to health and social security and insurance sectors will be substantial. For the health sector these will be 22% (or dram 85 billion) of the total social sector allocations with the emphasis on primary health care development and capacity building in the sector.
446. Additional resources to be allocated to development of social security and insurance sector will make

dram 156 billion (or 40% of incremental resources earmarked for social sector). Predominant share of these additional resources will be allocated for pensions, i.e. dram 111 billion or 73% of the total incremental funds earmarked for social protection and insurance. Additional allocations will be earmarked also for poverty family benefits and other allowances, for the protection of orphans and employment programs, as well as for strengthening and development of social services to specific segments of population.

- 447. Additional dram 238 billion will be allocated for financing of measures having an indirect impact on poverty reduction (30% of incremental resources channeled to poverty reduction). In particular, additional investments in the areas of culture and sports will make dram 17 billion to support the activities of cultural and sports organizations.
- 448. Additional allocations of around dram 113 billion will be earmarked for road building, house construction, water utilities, environment protection and agriculture. In particular, additional resources of dram 22 billion will be earmarked for maintenance and renovation of roads, and dram 91 billion for house construction, environment protection, water utilities and agriculture.
- 449. Financing of public expenditures in 2004-2015 will be contingent upon the level of state revenue collection, as well as on level of the budget deficit and availability of sources of deficit financing<sup>132</sup>.

## 9.2. CONSOLIDATED BUDGET DEFICIT AND SOURCES OF FINANCING 2003-2015

- 450. Since mid 90-ies the deficit of the consolidated budget of Armenia has had a declining trend. Being financed mostly from external sources, fluctuations of the deficit were an outcome of expansion of projects funded from foreign loans. For recent years, the level and structure of budget deficit was basically comparable with the indicators in other transition countries (see Table 9.5).

**Table 9.5. Budget deficits in transition countries of CIS and Eastern Europe in 1997-2000 (% of GDP)**

	1997	1998	1999	2000	2001
Czech Republic	1.7	2.0	3.3	4.9	9.2
Slovakia	5.2	5.0	3.6	3.6	4.1
Poland	3.1	3.2	3.7	3.2	4.0
Croatia	1.9	1.0	6.5	6.9	5.3
Romania	4.6	5.0	3.5	3.7	3.7
Moldova	6.6	5.7	5.4	4.0	3.8
Ukraine	5.4	2.8	2.4	1.3	1.7
Armenia	4.7	3.6	5.2	4.8	4.2
Georgia	6.7	5.4	6.7	4.6	3.5
Kazakhstan	7.0	7.7	5.0	0.8	2.5
Kyrgyz Republic	8.8	11.2	12.8	9.6	5.9
Uzbekistan	2.4	3.0	2.8	1.2	1.0

*Source: TransMONEE 2002 Database, UNICEF IRC, Florence.*

- 451. Budget formulation and execution in the coming years will take place in the environment of expenditures prevailing over revenues with involvement of both domestic and foreign sources of budget deficit financing. The principal share of budget deficit financing will be borrowings. The large portion of funds borrowed from external sources will be of a targeted nature and will be channeled to financing investment programs in social sector and public infrastructure. Budget deficit will be gradually declining from 3.2% of GDP in 2003 to 1.56% in 2015 (see Table 9.6).

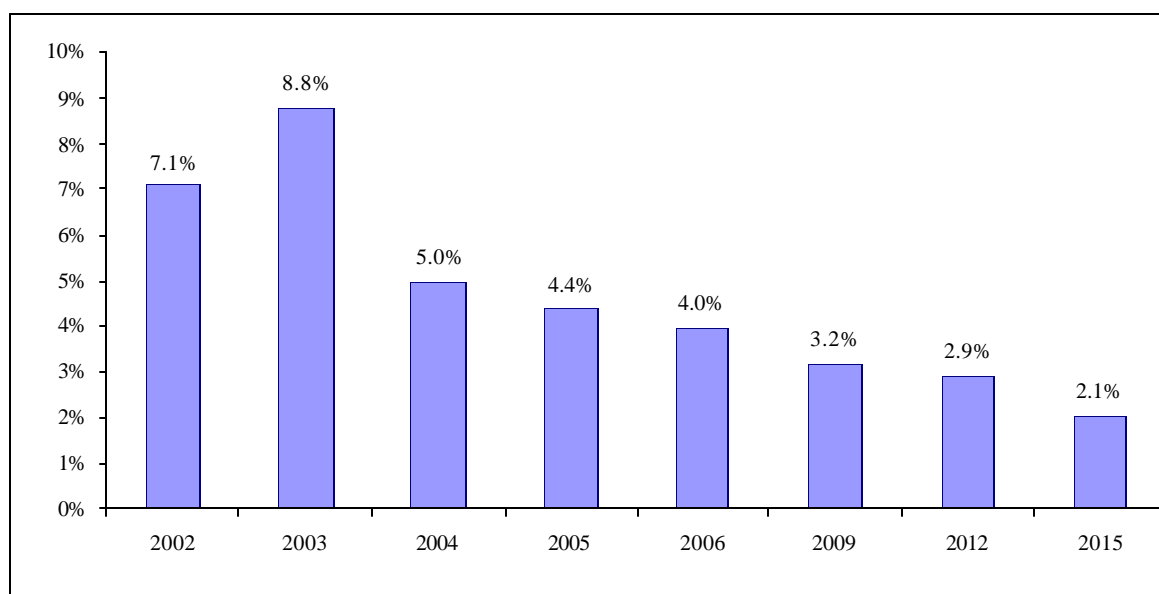
<sup>132</sup> Possible deviations from the projected scenario and their consequences are summarized in the box below.

**Table 9.6. Structure of budget deficit financing (% of GDP), 2002-2015**

	2002	2003	2004	2005	2006	2009	2012	2015
Deficit financing	2.4	3.2	2.6	2.2	2.0	2.0	1.9	1.6
Domestic Sources	-0.3	0.1	0.2	0.2	0.2	0.3	0.3	0.7
Treasury Bills	0.3	0.1	0.2	0.2	0.2	0.3	0.3	0.7
Other	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External Sources	2.7	3.1	2.4	2.0	1.8	1.7	1.6	0.9
Disbursements	3.6	4.7	2.9	2.5	2.3	2.1	2.1	1.4
Amortization	-0.9	-1.6	-0.5	-0.5	-0.5	-0.4	-0.5	-0.5

452. Within the period under consideration the share of domestic sources of deficit financing will gradually increase up from 0.1% of total deficit financing in 2003 to 0.7% in 2015 (mostly due to issuance of treasury bills).
453. Similar to the most of CIS and Eastern European countries in transition public finances in Armenia have certain dependency on external fund flows (foreign loans and official transfers). Despite the fact that such dependency will be persistent, it is envisaged that it will have pronounced declining trends (Figure 9.2). Since budget deficit is chiefly financed by means of borrowings, its level and structure are closely related with the indicators describing domestic and foreign debt of the country.

**Figure 9.2. External financing of the consolidated budget deficit (% of GDP)**



**Box 9.1. Possible Deviations from the Planned Scenario and Their Consequences**

The successful implementation of the PRSP largely depends on the degree to which the consolidated budget is implemented. In other words, differences between indicators for the planned and actual implementation of the consolidated budget can have a significant impact on the PRSP objectives. These differences can be the result of both unpredicted changes in general macroeconomic indicators, and sheer taxation/budgetary factors. For effective PRSP management, risks related to these changes need to be accurately evaluated; in order to reduce their possibility to a minimum, as well as to ensure the maximum implementation of all PRSP objectives through appropriate counter-measures.

It is possible that for certain years within the planned period the GDP growth rate will be lower than those projected in the program. As a result, all other conditions unchanged, there will be a lower growth rate for tax revenues of the budget. In this case, in order to ensure the complete financing of expenditures planned in the PRSP, it is possible to increase the budget deficit for those years using mainly concessional foreign resources. As already indicated, even a 30 percent increase in the budget deficit for certain years will not have a negative impact on indicators characterizing the public debt.

However, it is also possible that GDP growth rates will be higher than the corresponding projections. The resulting additional budget revenues will be entirely allocated to human capital development, i.e. health and education sectors, which incorporate the main PRSP priorities in a comprehensive manner.

The appropriate planning and timely receipt of grants need to be particularly mentioned among the purely taxation/budgetary risks to the implementation of the consolidated budget. In this regard the inclusion of all types of grants in the consolidated budget is very important, since it will allow for better control over their receipt and use, more coordinated activities with donors and timely completion of the corresponding conditionality for receiving grants. Since grants are mainly allocated to the financing of specific programs, delays or discontinuation of their provision will directly reduce the possibilities for implementing those programs. Thus, the discontinuation of grants from the American Lincy Foundation will immediately reduce the corresponding capital expenditures mainly on public infrastructures, which will have a negative impact on the implementation of the PR SP program.

In order to avoid deviations in programs financed through foreign credits, it is necessary for the government to implement the measures stated in the corresponding credit agreements in a timely manner.

**CHAPTER 10. PUBLIC DEBT OF THE REPUBLIC OF ARMENIA**

454. The public debt of Armenia emerged from the zero-level in 1992-93, when first foreign loans were received (European Union, Russia). In 1993 the first issue of state bonds and in 1995 the issue of treasury bills laid grounds for establishment of domestic securities market. The level of public debt increased at an accelerated pace and already in 1999 it was over USD 900 million. Increase of public debt gave rise to rather serious problems in the end 90-ies both in terms of management and servicing. In particular, in respect of external debt, these problems were related to the servicing of non-concessional loans received in 1992-96.

**Table 10.1. Public debt in 2002-2015 (USD million)**

	2002	2003	2004	2005	2006	2009	2012	2015
Total public debt	1 088.8	1 072.8	1 175.0	1 206.6	1 241.4	1 381.8	1 579.4	1 871.8
<i>% of GDP</i>	46.0	42.7	43.0	40.7	38.5	33.6	30.8	29.3
External Debt	1 025.2	1 007.2	1 104.3	1 129.5	1 157.0	1 275.5	1 430.0	1 611.7
of which: CBA debt	194.8	202.1	201.0	165.9	135.9	68.2	13.6	0.0
Domestic debt	63.6	65.6	70.7	77.1	84.4	106.3	149.4	260.1

455. **Domestic Debt:** The problems inherent to early stages of formation and establishment of public securities market were linked to the limited number of market participants (which made agreements between them with the objective to exercise influence on yield rates fluctuations possible), to the shortcomings in the procedures for issue, circulation and repayment of short-term securities, as well as to the non-optimal structure of investors.

456. In 1999 new rules for issuing securities were enforced, a new procedure for allocation, circulation and repayment was adopted and the Treasury Direct system was established. In 2000 treasury bills with medium term maturity were issued and allocated in the public securities market, which enabled expansion of government domestic debt without jeopardizing its solvency, since the average daily domestic debt ratio to average daily tax income was reduced from 36-37% down to 20-21%.
457. The substantial fall of domestic debt burden is reflected in the drastic decline in interest payments resulted from the decline in yields of the public securities. This is more evident given the growth of GDP and tax revenues. A prospective direction of the domestic debt management is cheaper domestic debt, longer maturities, in particular through increasing the publicity of securities market and ensuring higher degree of predictability.
458. **External Debt:** In 1999-2002 the government succeeded in carrying out negotiations on restructuring of non-concessional loan obligations, which made it possible to repay these under the conditions most favorable for Armenia without jeopardizing country's solvency (the maturity date of the Turkmen loan of about USD 11 million was extended, with an opportunity of partial in-kind repayment, while the Russian loans of USD 93.76 million has been repaid under equity-swap arrangements).
459. Around 4/5 of the foreign debt in 2002 reflected loans received from international financial institutions on concessional terms (see Table 10.2). These were mainly earmarked to support structural reforms of the government, as well as financing of public investment programs in certain sectors (energy, housing and utilities, agriculture, transport, etc).

**Table 10.2. Main indicators of external public debt in 2002-2015 (USD million)**

	2002	2003	2004	2005	2006	2009	2012	2015
Government external debt	830.4	805.1	903.3	963.6	1021.1	1207.3	1416.4	1611.7
<i>% of GDP</i>	<i>35.1</i>	<i>32.0</i>	<i>33.1</i>	<i>32.5</i>	<i>31.7</i>	<i>29.4</i>	<i>27.6</i>	<i>25.2</i>
Net present value of government external debt	489.0	434.5	452.9	459.1	458.7	500.1	544.3	595.5
<i>% of GDP</i>	<i>20.7</i>	<i>17.3</i>	<i>16.6</i>	<i>15.5</i>	<i>14.2</i>	<i>12.2</i>	<i>10.6</i>	<i>9.3</i>
Average effective interest rate	2.0	1.3	1.0	0.9	0.9	0.8	0.8	0.8
Share of concessional debt (%)	82.5	95.0	96.9	98.2	99.0	99.7	100.0	100.0
Debt Service	48.3	158.4	22.6	22.6	26.1	27.8	36.8	41.8
Amortization	29.6	147.1	13.4	13.3	16.7	17.9	25.7	29.4
Interest payments	18.7	11.3	9.2	9.3	9.4	9.9	11.1	12.4
Debt service/export, %	6.9	20.6	2.7	2.5	2.6	2.1	2.2	1.9
Interest payments/export, %	2.7	1.5	1.1	1.0	0.9	0.8	0.6	0.6
Debt service/GDP, %	2.0	6.3	0.8	0.8	0.8	0.7	0.7	0.7
Interest payments/tax revenues, %	5.4	3.0	2.2	2.0	1.8	1.4	1.2	1.0
Interest payments/state budget expenditures, %	3.9	2.1	1.6	1.5	1.4	1.2	1.0	0.9

*\* High indicators of debt service in 2003 reflects the repayment of the debt to Russia*

460. With regard to external debt management, the debt basket structure by currencies is an important factor. In particular, crises of recent years (in South-Eastern Asia in 1997-98), as well as fluctuations in the US Dollar/Euro exchange rate call for special attention to this factor.
461. Taking into account the above, it is necessary to follow closely the developments in the world foreign exchange markets (with the objective of more efficient risk management), and, in future, in parallel with the growing role of Euro in Armenian exports with EU countries to apply Euro-denominated foreign debt service/export ratio for evaluation of debt burden.
462. As the table shows, given the restructuring of external non-concessional debt obligations, an increase of foreign debt will not have a serious impact on solvency of the country, because a series of qualitative indicators are not expected to change, or are expected to change in the positive direction. In particular, the external debt-to-GDP and net present value of external debt-to-GDP ratios will decline, interest payments on external debt will decrease (primarily as a result of restructuring the non-concessional loans), which will ease the external debt service burden on the budget, while tax

revenues will grow. Given the relatively stable level of resources earmarked for servicing and repayment of external debt, the sustainable growth in exports will bring substantial improvement of external debt interest payment-to-export and external debt service-to-export ratios. These positive trends are also a result of prudent government policies, according to which credits whereby the grant element is lower than 35% are not acceptable<sup>133</sup>.

463. In the coming years, fiscal policy in Armenia should be aimed at utmost expansion of non-interest expenditures, consistent with unchanged burden of public debt. This means that the growth of public debt in present value terms may not exceed economic growth; moreover, growth of public debt should be accompanied by faster growth of tax revenues.
464. In 2003-2008 it will be appropriate to finance budget deficit exclusively from external concessional sources (increase of concessional lending in the loan portfolio of the country is expected in 2003-2008), and later, in parallel with shrinking potential for borrowing from external concessional sources and reduction of interest rates in the domestic market, to attach priority to domestic sources of financing as well. Growth of the external debt should be accompanied by relative stability of indicators that evaluate the external debt burden, or, at least, growth of external debt burden should be accompanied by reduction of domestic debt.
465. In terms of external debt burden it is important to investigate the debt sensitivity. In terms of debt sensitivity it is necessary to take into consideration the risk of changes in the debt burden resulting from deviations from the macroeconomic scenario for 2003-2015. To this end, debt burden may be evaluated in the framework of pessimistic macroeconomic scenario whereby economic growth will make 3% per annum (instead of the planned 6%), and export growth rate of 5% (instead of the planned 9-10% planned). Impact of inflation deviation from the program indicator may be neglected here, because a net inflow of borrowings from foreign sources is expected during the coming years. In this circumstances indicators describing the debt burden will be as follows:

**Table 10.3. Main indicators of external public debt in 2002-2015: pessimistic scenario (USD million)**

	2002	2003	2004	2005	2006	2009	2012	2015
Government external debt	830.4	805.1	903.3	963.6	1 021.1	1 207.3	1 416.4	1 611.7
<i>% of GDP</i>	35.1	33.2	43.2	41.8	40.5	37.9	36.0	34.5
Net present value of government external debt	489.0	434.5	452.9	459.1	458.7	500.1	544.3	595.5
<i>% of GDP</i>	20.7	17.9	24.4	23.4	22.1	20.4	18.9	17.5
Average effective interest rate	2.0	1.3	1.0	0.9	0.9	0.8	0.8	0.8
Share of concessional debt (%)	82.5	95.0	96.9	98.2	99.0	99.7	100.0	100.0
Debt Service	48.3	158.4	22.6	22.6	26.1	27.8	36.8	41.8
Amortization	29.6	147.1	13.4	13.3	16.7	17.9	25.7	29.4
Interest payments	18.7	11.3	9.2	9.3	9.4	9.9	11.1	12.4
Debt service/export, %	6.9	21.6	7.4	7.3	6.7	5.1	4.7	3.2
Interest payments/export, %	2.7	1.5	1.4	1.3	1.2	1.1	1.0	0.9
Debt service/GDP, %	2.0	6.5	2.2	2.2	2.0	1.5	1.4	0.9
Interest payments/tax revenues, %	5.4	3.0	2.2	2.0	1.8	1.4	1.2	1.0
Interest payments/state budget expenditures, %	3.9	2.1	1.6	1.5	1.4	1.2	1.0	0.9

466. Following the analysis of the data in Table 10.2 and Table 10.3, debt burden increases substantially; in 2015 the share of debt service in GDP will increase by 28-36%, while the debt service/export ratio will grow by 50-65%. However, given the rather low values of the above indicators, such a growth will not affect fiscal stability and solvency of the country, while the external debt of the government will be in the range of acceptable indicators describing light debt burden.

<sup>133</sup> The grant element is the indicator of loan's concessionality, calculated as a difference between nominal value and present value of borrower's future debt servicing in relation to nominal value of the borrowing.

467. This analysis allows a conclusion that in the circumstances of favorable macroeconomic situation and availability of concessional foreign borrowings, the government will be in a position to expand the budget deficit by some 30% without facing serious problems in respect of debt service, thus implementing public investment programs in full, in particular, in social sectors and public infrastructures.

## CHAPTER 11. PRSP AND MEDIUM TERM EXPENDITURE PROGRAMMING

468. Feasibility of the PRSP and efficiency of its implementation largely depend on the extent to which it is incorporated in public policy processes and consistent with social and economic policies of the government, in particular, with the medium term expenditure framework and the state budget.

469. Main principles of the interim PRSP are reflected in the 2002 programs of the government. Some important measures envisaged in the full PRSP and agreed upon within the 2003-2005 medium term expenditure framework are reflected in the Law of Armenia on the 2003 State Budget. In particular, the state budget 2003 incorporates the following major measures envisaged in the PRSP:

- (i) As an important implementation modality of the civil service reform and anti-corruption program, the salaries of civil servants, tax and customs service staff will be increased by 78% in 2003;
- (ii) In the framework of education sector reforms the increase of pupil-teacher ratio will be accompanied with 34% salary increase for teachers and administrative staff in the schools;
- (iii) Priority in health sector is given to medical services to vulnerable groups of population and primary health care system. In general, health sector financing increased by around 31% as compared to the previous year, with the 73.5% of the increase allocated to the above-mentioned two priorities.
- (iv) In accordance with the reforms in pension system, social pensions from now on will be paid from the state budget.

470. Majority of PRSP measures pertain to the volume and structure of public finances. To this end, the most important medium term strategic document of the government is the medium term expenditure framework, which reflects macroeconomic, monetary, fiscal and public investment priorities. Consequently, incorporation of the PRSP policies and measures in the medium term expenditure framework will make implementation of the PRSP more realistic. Assessment of the PRSP process by international financial institutions<sup>134</sup> emphasizes this necessity. Moreover, these programs should be prepared and discussed in parallel in order to avoid possible disproportions and discrepancies<sup>135</sup>. Today we have enough confidence that public expenditure program envisaged in the full PRSP and budget framework under the 2004-2006 MTEF are absolutely consistent. On the other hand, in order to safeguard the continuity and sustainability of this process it is necessary to consistently incorporate MTEF in the budget process.

471. Effective 2003, the MTEF of Armenia is officially incorporated in the general budget process. It means that in advance of the start of the budget formulation activities for the subsequent year (end of the Q1 of the current year), the government has to have the MTEF for the coming three years approved. In particular, prior to 2004 budget formulation, the 2004-2006 MTEF should be approved by the Government of Armenia (by July 1). This provision has been stipulated in the legislation, namely in the Law on Introduction of Amendments and Additions in the Law on Budgetary System, adopted by the National Assembly on April 11 2003.

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<sup>134</sup> *Poverty reduction strategy paper (PRSP) – progress in implementation, IMF, WB, 2002.*

<sup>135</sup> *In prioritizing this task, the PRSP coordinating council issued a decision to include the experts elaborating the MTEF in the PRSP preliminary discussions with a view to safeguard harmonization of these two programs.*



## SECTION 5. PRSP IMPLEMENTATION MANAGEMENT, MONITORING AND REGULATION

472. The most important prerequisite for the effective implementation of the PRSP is the establishment of an implementation, monitoring and evaluation system with the participation of all segments of society. The UNDP and the WB supported the establishment of the participatory process throughout the development phase of the PRSP. It is expected that the WB, UNDP, DFID, EU and GTZ will also support Government's efforts in setting up a PRSP implementation, monitoring and evaluation system.
473. The Government of Armenia, with the support of international organizations, organized a workshop with the participation of the PRSP Working Group members, as well as representatives from the government, civil society and donor community, in order to develop common strategic approaches on the management and monitoring of PRSP implementation. The workshop decided that the PRSP Working Group will lead the development of the management and monitoring strategy for PRSP implementation, with the following main components:
- (i) **Institutional and organizational framework.** As a first step in PRSP implementation, the responsibilities of each and every actor involved in the process and main directions of information flows should be clearly defined. The Government will conduct the actual management and monitoring of PRSP implementation, while other structures will be formed with the participation of all stakeholders for evaluation of PRSP implementation results and developing recommendations for its further development.
  - (ii) **PRSP monitoring strategy.** The monitoring strategy should define the entire set of indicators to be tracked, as well as the main functions of those conducting the monitoring. The existing capacity of those involved in monitoring activities should be studied and an action plan for strengthening their capacity should be developed. The mechanisms and standards applying to the selection of civil society organizations participating in the monitoring process should also be clearly defined.
  - (iii) **PRSP implementation action plan.** The action plan should be developed by working groups formed within and across agencies. Sectoral working groups formed within and across agencies will develop action plans for various sections of the PRSP and the overall coordination will be provided by the Ministry of Finance and Economy. Sectoral working groups will also include representatives from NGOs, which are socially active in the relevant sector.

## CHAPTER 12. PRSP IMPLEMENTATION MANAGEMENT STRUCTURE

474. National, regional and local governments will actually implement activities planned in the PRSP, with the active participation and support of civil society organizations, donor community, Armenian Apostolic Church and its sister churches, and Diaspora organizations.
475. Much like the development of the PRSP, its implementation also requires coordinated efforts made by individual structures at numerous levels. The organizational structure coordinating and supervising PRSP development activities remains almost unchanged during the first phase of PRSP implementation. Thus, the mentioned working group is regarded as a transitional measure. The final structural and organizational framework will be developed by a special working sub-group.
476. The Government of Armenia is responsible for the implementation of all measures, and as represented by the Ministry of Finance and Economy manages and coordinates the process of PRSP implementation (approval of PRSP Implementation Action Plan will follow the PRSP approval by the Government being consistent with policies described in the PRSP). The Steering Committee will no longer continue in its previous form and function and will transform into the PRSP Participatory Steering Committee (PSC), with the corresponding new members and functions. Heads of ministries closely involved in the implementation of the PRSP, the president of the National Statistical Service, Chairpersons of Standing Committees of the Parliament, leaders of parties and blocks represented in the Parliament, representatives of civil society (NGOs) and donor community will make up the PSC. Members of the PSC and its statute will be approved by the Government of Armenia/ The main objective of the Participatory Steering Committee will be to ensure the participation of all stakeholders

in PRSP implementation, further elaboration and revision, as well as discussion of current approaches and formulating relevant recommendations for the Government.

477. The day-to-day activities within the framework of the functions of the PRSP Participatory Steering Committee will be implemented by the PRSP Working Group (WG), the membership and statute of which will be proposed by the Participatory Steering Committee and approved by the Government of Armenia. The main objectives of the WG will be to: (i) monitor the objectives, intermediate and target indicators, and implementation of program activities; (ii) assess impacts of PRSP policies; (iii) prepare and publish an annual report; (iv) revise and finalize the PRSP; and (v) ensure international cooperation throughout the PRSP implementation. Until the end of the interim phase, i.e. in the next 6 to 12 months, the WG will maintain its current membership.
478. The PRSP Secretariat, formed by the Government of Armenia with support from the UNDP, WB, GTZ and DFID, will organize the implementation of activities, which should be conducted within the framework of the functions of the PRSP Participatory Steering Committee and the Working Group. The Secretariat will conduct PRSP monitoring and policy impact assessment, prepare and publish annual PRSP implementation reports, update and revise the PRSP in close cooperation with structures involved in PRSP implementation, including PRSP Coordination and Monitoring Unit in the Ministry of Finance and Economy, and, as necessary, will involve experts and specialized structures and commission separate studies.
479. The Ministry of Finance and Economy, in accordance with its statute, will coordinate and monitor the PRSP implementation, which on the one hand implies: (i) monitoring of the PRSP implementation action plan<sup>136</sup>; (ii) adapting programs outlined in the PRSP to the Medium Term Expenditure Framework (MTEF) and the annual state budget; and on the other hand (iii) coordinating PRSP implementation monitoring information flows, their analysis and evaluation. The mentioned activities will be conducted by the Unit especially established for that purpose in the Ministry of Finance and Economy.

### CHAPTER 13. PRSP MONITORING, EVALUATION SYSTEM AND REVISION

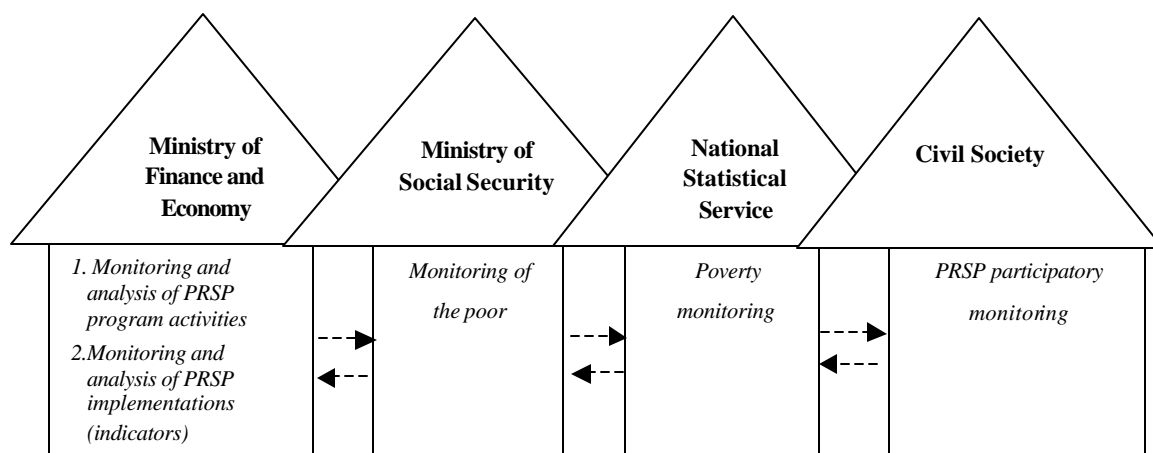
480. The PRSP monitoring and evaluation system to be formed should on the one hand define the roles and functions of all parties, and on the other hand the levels and responsibilities relating to collection of data on indicators. The system of PRSP monitoring indicators to be formed should be comparable, to the extent possible, to Millennium Development Goals declared by the UN.
481. Building and strengthening relevant capacity both inside and outside the government is of great significance for the formation of the PRSP monitoring and evaluation system. Various donor organizations have already shown interest in supporting the necessary training activities.
482. Various agencies at different levels of PRSP management system will ensure the bottom-up functioning (information collection, preliminary analysis and information flow) of the PRSP monitoring system.
  - (i) The National Statistical Service conducts regular monitoring of poverty at national and regional levels, revealing the level of poverty in the country, its depth and severity, poverty risk groups and their characteristics, specific manifestations of poverty at national and regional levels. The National Statistical Service needs support for improving the methodology of household surveys and conducting such surveys on an annual basis. The World Bank has already provided some support in that direction.
  - (ii) The Ministry of Social Security conducts regular monitoring of the poor at national and regional levels, focusing on identifying poor people and including them in the family benefit and other assistance systems, thus improving the living standard of the poor. The Ministry has a large and regularly updated data bank on the mentioned beneficiaries, as well as governmental and non-governmental programs for improving their conditions.
  - (iii) Ministries involved in PRSP implementation provide the monitoring and evaluation of indicators

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<sup>136</sup> The PRSP Plan of Actions will be approved by the Government of Armenia within two months after the approval of the PRSP.

relevant to their spheres. A number of ministries already have some experience in this regard, the others, however, need the necessary technical and expert assistance.

- (iv) Governor Offices will conduct the monitoring and evaluation of PRSP program activities, target and intermediate indicators at marz level, and the UNDP is currently supporting them through capacity building and technical assistance activities.



**Box 13.1. Civil Society Participation in PRSP Implementation**

Active participation of civil society in PRSP implementation is one of the prerequisites for successful implementation of the program. During the PRSP implementation measures for wider civil society participation will be undertaken at local and national government levels.

Measures contributing to participation at local government level are:

- ?? involve active community members, representatives of poor and vulnerable groups in the management of community and inter-community associations and unions, as well as individual committees formed by community council (in particular when these committees deal with the implementation of social programs, supervision of budget performance, etc.);
- ?? involve NGOs, entrepreneurs, individual businessmen, religious organizations and other stakeholders working in the area in community budget preparation;
- ?? prepare an information booklet explaining community budget for residents;
- ?? establish information-analytical units in local governments;
- ?? periodical information provision on the process of program implementation through local TV stations and community journals;
- ?? training for community residents on mechanisms of participation in decision-making, monitoring and evaluation, as well as teamwork, human rights and other subjects.

Measures contributing to participation at national government level are:

- ?? introduce reporting forms for governmental agencies, preparation of regular reports and their publication in official press (as well as at the relevant internet);
- ?? publish drafts of important laws (programs) and organize discussions in the civil society;
- ?? publish informational booklets explaining the state budget to the wide public;
- ?? streamline the work and functions of civil society relations departments in governmental agencies, incorporate the responsibility for cooperation with civil society organizations.

Measures for wider participation of civil society in decision-making will contribute to the formation of a culture of participation and a more transparent governance system.

483. The Government of Armenia should pay special attention to the monitoring and evaluation of programs implemented by development partners, as well as those stemming from the PRSP. Participation of civil society in monitoring and evaluation processes, which will be ensured through the establishment of a comprehensive participatory body at PSC level, should also be a matter of concern. The civil society evaluation of PRSP implementation process should be examined annually and the results should be included in the annual report of PRSP implementation.
484. The Government, with the support of the donor community and in order to organize and regulate the monitoring and impact assessment of PRSP implementation, will develop and approve a PRSP management and monitoring strategy, which will define:
- (i) the set of PRSP monitoring indicators;
  - (ii) the methodology for monitoring indicators;
  - (iii) methods and periodicity of collecting data on indicators and methodologies for their summarization, processing and analysis;
  - (iv) training and capacity building measures for PRSP monitoring and evaluation staff; and mechanisms for the participation of civil society in PRSP implementation and monitoring processes and informing the public on the results.
485. Target and intermediate indicators, policies and priorities are not meant to be unalterable, they are, however, the basis for implementing long-term objectives and provide the means for the necessary assessment of the process of PRSP implementation and consequently the necessary adjustments and changes to PRSP target indicators and priority policies. The PRSP will be reviewed once every two years, taking into account recommendations presented by all stakeholders and results of the monitoring. Summary reports on the progress will be prepared annually.

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## Annex 1. Poverty Reduction Strategy: Summary Indicators

	2002	2003	2004	2005	2006	2007	2012	2015
	<i>Actual</i>	<i>Prog.</i>	<i>Projections</i>					
<b>(i) POVERTY AND INEQUALITY</b>								
Number of Poor, % of total population	50.9 <sup>1</sup>	46.2	43.7	41.0	37.9	30.8	26.3	19.7
<i>of which: Very Poor, % of total population</i>	16.0 <sup>1</sup>	15.2	14.7	14.2	13.5	11.4	8.6	4.1
Gini Coefficient of Income Inequality	0.535 <sup>1</sup>	0.510	0.498	0.491	0.483	0.469	0.458	0.446
Incomes of the poorest population as a % of incomes of the richest	5.9 <sup>1</sup>	6.9	7.4	7.9	8.4	8.7	8.8	9.1
<b>(ii) HUMAN POVERTY</b>								
School-Life Expectancy, years <sup>2</sup>	...	11.6	...	...	11.8	12.0	12.1	12.3
General secondary school completion rate, %	63	67	...	...	69	77	80	85
Child Mortality Rate, per 1000 live births <sup>3</sup>	15.9	15.6	...	...	14.4	13.0	11.5	10.0
Mother Mortality Rate, per 100000 live births <sup>3, 4</sup>	34.4	27.0	...	...	22.0	15.5	13.0	10.0
Access to Drinking Water, %								
Urban Population	87 <sup>1</sup>	90	...	...	93	95	98	98
Rural Population	45 <sup>1</sup>	47	...	...	49	51	70	70
<b>(iii) LIVING STANDARDS AND SOCIAL PROTECTION</b>								
GDP per Capita, thousand drams	451	489	533	580	631	808	1 006	1 244
GDP per Capita, USD	786	834	904	980	1 061	1 338	1 640	1 999
Average Monthly Wage, drams	26 488	29 462	32 078	35 048	38 235	48 927	59 609	71 607
Minimum Monthly Wage, drams	5 000	5 000	12 767	13 053	13 387	14 414	15 446	16 588
Average Monthly Family Benefit per Capita, drams	1 893	2 140	2 702	3 393	4 396	6 188	8 849	10 661
Average Monthly Pension, drams	5 148	6 365	7 407	8 939	10 138	15 755	20 994	26 714
Monthly Extreme Poverty Line, drams	7 576	7 632	7 827	8 002	8 207	8 836	9 469	10 169
Monthly Poverty Line, drams	12 358	12 450	12 767	13 053	13 387	14 414	15 446	16 588
<b>(iv) MACROECONOMIC INDICATORS</b>								
Nominal GDP, dram bn	1 357	1 474	1 609	1 757	1 918	2 485	3 143	3 976
Real GDP, year-on-year % change	12.9	7.0	6.0	6.0	6.0	5.5	5.0	5.0
Investments, % of GDP	19.5	22.6	20.6	20.4	20.8	21.9	22.7	24.3
National Savings, % of GDP	13.4	16.1	14.8	14.9	15.5	17.3	18.5	20.0
Period Average CPI, year-on-year % change	1.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Period Average Exchange Rate, dram/USD	573.9	586.3	589.3	592.2	595.2	604.2	613.3	622.5
Exports of Goods and Services, USD million	699	768	840	920	1 007	1 313	1 704	2 210
Imports of Goods and Services, USD million	-1 082	-1 170	-1 256	-1 354	-1 460	-1 814	-2 216	-2 751
Current Account Balance, % of GDP	-6.2	-6.5	-5.8	-5.5	-5.2	-4.6	-4.3	-4.3
<b>(v) FISCAL SECTOR<sup>5</sup></b>								
Total Revenues and Grants, % of GDP	22.6	23.1	21.5	21.8	22.0	22.8	23.5	23.9
<i>of which: Tax Revenues, % of GDP</i>	17.9	18.3	18.8	19.3	19.8	21.2	22.0	22.6
Total Expenditure and Net Lending, % of GDP	23.4	25.5	24.1	24.0	24.1	24.8	25.4	25.5
<i>of which: Capital Expenditure, % of GDP</i>	4.8	6.8	5.4	4.5	4.4	4.3	4.1	4.0
Overall Balance, % of GDP	-0.8	-2.5	-2.6	-2.2	-2.0	-2.0	-1.9	-1.6
<b>(vi) PUBLIC EXPENDITURE ON BASIC SERVICES AND INFRASTRUCTURE</b>								
General Public Services, % GDP	1.7	1.9	2.2	2.4	2.3	2.6	3.0	3.1
Social Expenditures, % of GDP	7.8	8.7	9.3	10.1	10.5	11.4	11.6	12.0
<i>of which: Education, % of GDP</i>	2.2	2.4	2.7	3.0	3.1	3.6	3.8	4.0
<i>Health, % of GDP</i>	1.2	1.4	1.5	1.8	1.9	2.1	2.3	2.5
<i>Social Protection, % of GDP</i>	4.4	4.8	5.1	5.4	5.6	5.7	5.5	5.4
Drinking Water and Irrigation, % of GDP	1.5	1.7	1.3	1.5	1.6	1.5	1.5	1.5
Road Construction, % of GDP	0.5	2.3	1.1	1.2	1.2	1.3	1.2	1.1
<b>Memorandum Item</b>								
<i>De facto population, thousand people</i>	3 008.6	3 013.8	3 020.5	3 028.4	3 038.1	3 074.2	3 125.7	3 196.0

<sup>1</sup> 2001 data. <sup>2</sup> At the age of 6-21 years old. <sup>3</sup> Projections based on official data of the National Statistical Service.

<sup>4</sup> Three-year average. <sup>5</sup> Consolidated budget operations.

Source: National Statistical Service of the Republic of Armenia, Ministry of Finance and Economy of the Republic of Armenia and PRSP projections.

Annex 2. Breakdown of Gross Domestic Product by Main Sector

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Prog.</i>	<i>Projections</i>					
<i>in billions of drams, current prices</i>								
<b>Gross Domestic Product</b>	<b>1 357.3</b>	<b>1 474.1</b>	<b>1 609.4</b>	<b>1 757.1</b>	<b>1 918.4</b>	<b>2 485.0</b>	<b>3 143.4</b>	<b>3 976.3</b>
Industry	278.2	303.7	337.9	372.4	406.5	529.1	682.1	875.3
Agriculture	312.0	329.6	348.9	365.1	385.4	453.6	525.9	609.9
Construction	179.8	231.8	237.9	262.4	294.4	406.8	549.4	739.0
Transport and Communications	91.1	95.1	103.8	113.7	124.1	161.5	210.2	265.9
Trade	124.9	129.9	148.3	163.2	180.4	239.1	307.3	398.3
Others	239.4	244.0	270.2	298.1	321.1	405.4	489.1	580.3
Net Indirect Taxes	131.9	139.9	162.4	182.3	206.5	289.7	379.4	507.7
<i>year-on-year % change</i>								
<b>Gross Domestic Product</b>	<b>12.9</b>	<b>7.0</b>	<b>6.0</b>	<b>6.0</b>	<b>6.0</b>	<b>5.5</b>	<b>5.0</b>	<b>5.0</b>
Industry	14.2	6.0	8.0	7.0	6.0	6.0	5.5	5.5
Agriculture	4.4	2.6	2.8	1.6	2.5	2.5	2.0	2.0
Construction	43.0	25.7	-0.4	7.1	9.0	8.0	7.4	7.0
Transport and Communications	5.3	2.8	6.0	6.3	6.0	6.0	6.0	5.0
Trade	15.6	3.3	11.4	7.6	7.8	5.8	5.9	6.7
Others	5.6	4.2	6.8	6.1	3.7	3.6	2.7	0.8
Net Indirect Taxes	13.6	4.5	12.6	9.0	10.0	7.5	5.9	7.6
<i>in percent of GDP</i>								
<b>Gross Domestic Product</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Industry	20.5	20.6	21.0	21.2	21.2	21.3	21.7	22.0
Agriculture	23.0	22.4	21.7	20.8	20.1	18.3	16.7	15.3
Construction	13.2	15.7	14.8	14.9	15.3	16.4	17.5	18.6
Transport and Communications	6.7	6.4	6.4	6.5	6.5	6.5	6.7	6.7
Trade	9.2	8.8	9.2	9.3	9.4	9.6	9.8	10.0
Others	17.6	16.6	16.8	17.0	16.7	16.3	15.6	14.6
Net Indirect Taxes	9.7	9.5	10.1	10.4	10.8	11.7	12.1	12.8
<i>contribution to GDP growth, percentage points</i>								
<b>Gross Domestic Product</b>	<b>12.9</b>	<b>7.0</b>	<b>6.0</b>	<b>6.0</b>	<b>6.0</b>	<b>5.5</b>	<b>5.0</b>	<b>5.0</b>
Industry	2.9	1.3	1.7	1.5	1.3	1.3	1.2	1.2
Agriculture	1.0	0.6	0.6	0.3	0.5	0.4	0.3	0.3
Construction	4.6	3.5	-0.1	1.1	1.4	1.3	1.3	1.3
Transport and Communications	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.4
Trade	1.5	0.3	1.1	0.8	0.8	0.6	0.7	0.8
Others	1.0	0.7	1.1	1.0	0.6	0.6	0.4	0.1
Net Indirect Taxes	1.3	0.4	1.2	0.9	1.0	0.9	0.7	0.9

Source: National Statistical Service of the Republic of Armenia and PRSP projections.

Annex 3. Use of Gross Domestic Product

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Prog.</i>	<i>Projections</i>					
<i>in billions of drams, current prices</i>								
<b>Gross Domestic Product</b>	<b>1 357.3</b>	<b>1 474.1</b>	<b>1 609.4</b>	<b>1 757.1</b>	<b>1 918.4</b>	<b>2 485.0</b>	<b>3 143.4</b>	<b>3 976.3</b>
Final Consumption	1 312.0	1 376.3	1 522.8	1 656.2	1 789.5	2 242.6	2 742.8	3 346.2
Private	1 160.8	1 198.8	1 334.9	1 436.4	1 548.0	1 905.5	2 285.9	2 758.6
Public	151.2	177.6	187.9	219.8	241.5	337.1	456.9	587.6
Gross Capital Formation	265.2	333.3	331.9	358.2	398.5	545.1	715.0	967.0
Private	200.6	232.3	245.0	279.7	314.7	439.2	584.9	806.8
Public	64.5	101.0	86.9	78.5	83.7	105.9	130.2	160.2
Net Exports of Goods and Services	-219.9	-235.5	-245.3	-257.3	-269.5	-302.7	-314.4	-336.9
<i>year-on-year % change</i>								
<b>Gross Domestic Product</b>	<b>12.9</b>	<b>7.0</b>	<b>6.0</b>	<b>6.0</b>	<b>6.0</b>	<b>5.5</b>	<b>5.0</b>	<b>5.0</b>
Final Consumption	6.9	4.1	7.9	6.4	5.4	4.5	4.3	4.3
Private	7.1	2.5	8.6	5.2	5.1	3.7	3.7	4.1
Public	5.3	16.5	3.2	14.4	7.1	9.2	7.8	5.3
Gross Capital Formation	15.1	22.6	-3.4	4.8	8.1	9.1	7.4	7.6
Private	7.2	12.9	2.3	10.9	9.3	10.2	7.9	8.2
Public	49.2	52.6	-16.5	-12.3	3.7	4.9	5.3	4.6
Net Exports of Goods and Services	14.3	-8.5	-4.2	-6.7	-4.7	-4.5	-4.4	-5.1
<i>in percent of GDP</i>								
<b>Gross Domestic Product</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Final Consumption	96.7	93.4	94.6	94.3	93.3	90.2	87.3	84.2
Private	85.5	81.3	82.9	81.7	80.7	76.7	72.7	69.4
Public	11.1	12.0	11.7	12.5	12.6	13.6	14.5	14.8
Gross Capital Formation	19.5	22.6	20.6	20.4	20.8	21.9	22.7	24.3
Private	14.8	15.8	15.2	15.9	16.4	17.7	18.6	20.3
Public	4.8	6.8	5.4	4.5	4.4	4.3	4.1	4.0
Net Exports of Goods and Services	-16.2	-16.0	-15.2	-14.6	-14.0	-12.2	-10.0	-8.5

Source: National Statistical Service of the Republic of Armenia and PRSP projections.



## Annex 4. Consolidated Budget Operations (on a commitment basis)

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Budget</i>	<i>Projections</i>					
	<i>in billions of drams</i>							
<b>Total Revenue and Grants</b>	<b>307.1</b>	<b>339.9</b>	<b>346.2</b>	<b>383.0</b>	<b>422.9</b>	<b>566.8</b>	<b>737.9</b>	<b>950.5</b>
Total Revenue	259.8	279.0	312.9	349.6	390.7	541.1	711.8	924.0
Tax Revenue	242.4	269.4	302.2	338.8	379.8	526.2	690.8	899.1
Non-Tax Revenue	14.8	7.6	9.8	10.1	10.3	14.7	20.8	24.7
Capital Revenue	2.6	1.9	0.9	0.8	0.6	0.2	0.2	0.2
Grants	47.3	61.0	33.3	33.4	32.2	25.7	26.1	26.5
Current	17.0	14.1	9.7	9.0	8.5	10.3	10.5	10.6
Capital	30.3	46.9	23.7	24.4	23.7	15.4	15.6	15.9
<b>Total Expenditure and Net Lending</b>	<b>317.4</b>	<b>376.5</b>	<b>388.1</b>	<b>422.2</b>	<b>461.5</b>	<b>617.2</b>	<b>799.0</b>	<b>1 012.2</b>
Current Expenditure	239.2	279.0	294.0	335.6	366.7	498.4	655.8	838.9
<i>of which: Interest Payments</i>	<i>15.9</i>	<i>13.9</i>	<i>12.6</i>	<i>12.5</i>	<i>12.6</i>	<i>13.8</i>	<i>18.7</i>	<i>27.2</i>
Capital Expenditure	64.5	101.0	86.9	78.5	83.7	105.9	130.2	160.2
<i>of which: Capital Grant Financed</i>	<i>30.3</i>	<i>46.9</i>	<i>23.7</i>	<i>24.4</i>	<i>23.7</i>	<i>15.4</i>	<i>15.6</i>	<i>15.9</i>
Net Lending	13.6	-3.5	7.2	8.2	11.1	13.0	13.0	13.0
<b>Overall Balance</b>	<b>-10.2</b>	<b>-36.5</b>	<b>-41.9</b>	<b>-39.2</b>	<b>-38.6</b>	<b>-50.4</b>	<b>-61.1</b>	<b>-61.7</b>
<b>Financing</b>	<b>10.2</b>	<b>36.5</b>	<b>41.9</b>	<b>39.2</b>	<b>38.6</b>	<b>50.4</b>	<b>61.1</b>	<b>61.7</b>
Identified	10.2	36.5	41.9	39.2	30.0	-0.3	-4.1	6.1
Domestic Sources	-26.8	46.4	2.7	3.6	4.3	7.9	10.7	25.8
External Sources	37.0	-9.9	39.2	35.6	25.7	-8.2	-14.8	-19.6
Non-Identified <sup>1</sup>	0.0	0.0	0.0	0.0	8.6	50.7	65.2	55.6
	<i>in percent of GDP</i>							
<b>Total Revenue and Grants</b>	<b>22.6</b>	<b>23.1</b>	<b>21.5</b>	<b>21.8</b>	<b>22.0</b>	<b>22.8</b>	<b>23.5</b>	<b>23.9</b>
Total Revenue	19.1	18.9	19.4	19.9	20.4	21.8	22.6	23.2
Tax Revenue	17.9	18.3	18.8	19.3	19.8	21.2	22.0	22.6
Non-Tax Revenue	1.1	0.5	0.6	0.6	0.5	0.6	0.7	0.6
Capital Revenue	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Grants	3.5	4.1	2.1	1.9	1.7	1.0	0.8	0.7
Current	1.3	1.0	0.6	0.5	0.4	0.4	0.3	0.3
Capital	2.2	3.2	1.5	1.4	1.2	0.6	0.5	0.4
<b>Total Expenditure and Net Lending</b>	<b>23.4</b>	<b>25.5</b>	<b>24.1</b>	<b>24.0</b>	<b>24.1</b>	<b>24.8</b>	<b>25.4</b>	<b>25.5</b>
Current Expenditure	17.6	18.9	18.3	19.1	19.1	20.1	20.9	21.1
<i>of which: Interest Payments</i>	<i>1.2</i>	<i>0.9</i>	<i>0.8</i>	<i>0.7</i>	<i>0.7</i>	<i>0.6</i>	<i>0.6</i>	<i>0.7</i>
Capital Expenditure	4.8	6.8	5.4	4.5	4.4	4.3	4.1	4.0
<i>of which: Capital Grant Financed</i>	<i>2.2</i>	<i>3.2</i>	<i>1.5</i>	<i>1.4</i>	<i>1.2</i>	<i>0.6</i>	<i>0.5</i>	<i>0.4</i>
Net Lending	1.0	-0.2	0.4	0.5	0.6	0.5	0.4	0.3
<b>Overall Balance</b>	<b>-0.8</b>	<b>-2.5</b>	<b>-2.6</b>	<b>-2.2</b>	<b>-2.0</b>	<b>-2.0</b>	<b>-1.9</b>	<b>-1.6</b>
<b>Financing</b>	<b>0.8</b>	<b>2.5</b>	<b>2.6</b>	<b>2.2</b>	<b>2.0</b>	<b>2.0</b>	<b>1.9</b>	<b>1.6</b>
Identified	0.8	2.5	2.6	2.2	1.6	0.0	-0.1	0.2
Domestic Sources	-2.0	3.2	0.2	0.2	0.2	0.3	0.3	0.6
External Sources	2.7	-0.7	2.4	2.0	1.3	-0.3	-0.5	-0.5
Non-Identified <sup>1</sup>	0.0	0.0	0.0	0.0	0.4	2.0	2.1	1.4
<b>Memorandum Items</b>								
<i>Social Expenditure<sup>2</sup>, % of GDP</i>	<i>7.8</i>	<i>8.7</i>	<i>9.3</i>	<i>10.1</i>	<i>10.5</i>	<i>11.4</i>	<i>11.6</i>	<i>12.0</i>
<i>Primary Balance<sup>3</sup>, % of GDP</i>	<i>0.4</i>	<i>-1.5</i>	<i>-1.8</i>	<i>-1.5</i>	<i>-1.4</i>	<i>-1.5</i>	<i>-1.3</i>	<i>-0.9</i>

<sup>1</sup> It is projected that the gap will be covered by concessional external financing.

<sup>2</sup> Includes expenditures on education, health care, social security and social insurance.

<sup>3</sup> Defined as overall balance excluding interest payments.

Source: Ministry of Finance and Economy of the Republic of Armenia and PRSP projections.

## Annex 5. Consolidated Budget Operations: External Financing Requirements

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Budget</i>	<i>Projections</i>					
<i>in billions of drams</i>								
<b>1. Total Domestic Revenue</b>	<b>259.8</b>	<b>279.0</b>	<b>312.9</b>	<b>349.6</b>	<b>390.7</b>	<b>541.1</b>	<b>711.8</b>	<b>924.0</b>
Tax Revenue	242.4	269.4	302.2	338.8	379.8	526.2	690.8	899.1
Non-Tax and Capital Revenue	17.4	9.6	10.7	10.8	11.0	14.9	21.0	24.9
<b>2. Domestic Financing</b>	<b>-26.8</b>	<b>46.4</b>	<b>2.7</b>	<b>3.6</b>	<b>4.3</b>	<b>7.9</b>	<b>10.7</b>	<b>25.8</b>
<b>3. Total Domestic Resources Available (1+2)</b>	<b>233.0</b>	<b>325.4</b>	<b>315.6</b>	<b>353.2</b>	<b>395.0</b>	<b>549.0</b>	<b>722.5</b>	<b>949.7</b>
<b>4. Total Expenditure and Net Lending</b>	<b>317.4</b>	<b>376.5</b>	<b>388.1</b>	<b>422.2</b>	<b>461.5</b>	<b>617.2</b>	<b>799.0</b>	<b>1 012.2</b>
Current Expenditure	239.2	279.0	294.0	335.6	366.7	498.4	655.8	838.9
<i>of which: Interest Payments</i>	<i>15.9</i>	<i>13.9</i>	<i>12.6</i>	<i>12.5</i>	<i>12.6</i>	<i>13.8</i>	<i>18.7</i>	<i>27.2</i>
Capital Expenditure	64.5	101.0	86.9	78.5	83.7	105.9	130.2	160.2
Net Lending	13.6	-3.5	7.2	8.2	11.1	13.0	13.0	13.0
<b>5. External Financing Requirements (4-3)</b>	<b>84.3</b>	<b>51.0</b>	<b>72.5</b>	<b>69.0</b>	<b>66.5</b>	<b>68.3</b>	<b>76.5</b>	<b>62.4</b>
<b>5.1. Identified</b>	<b>84.3</b>	<b>51.0</b>	<b>72.5</b>	<b>69.0</b>	<b>57.9</b>	<b>17.5</b>	<b>11.3</b>	<b>6.9</b>
Grants	47.3	61.0	33.3	33.4	32.2	25.7	26.1	26.5
Current	17.0	14.1	9.7	9.0	8.5	10.3	10.5	10.6
Capital	30.3	46.9	23.7	24.4	23.7	15.4	15.6	15.9
Loans/Credits	37.0	-9.9	39.2	35.6	25.7	-8.2	-14.8	-19.6
<b>5.2. Non-Identified</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>8.6</b>	<b>50.7</b>	<b>65.2</b>	<b>55.6</b>
<i>in millions of US dollars</i>								
<b>1. Total Domestic Revenue</b>	<b>452.7</b>	<b>475.8</b>	<b>531.0</b>	<b>590.3</b>	<b>656.5</b>	<b>895.6</b>	<b>1 160.7</b>	<b>1 484.3</b>
Tax Revenue	422.4	459.4	512.8	572.0	638.1	871.0	1 126.5	1 444.3
Non-Tax and Capital Revenue	30.3	16.3	18.2	18.3	18.4	24.6	34.2	39.9
<b>2. Domestic Financing</b>	<b>-46.6</b>	<b>79.2</b>	<b>4.6</b>	<b>6.1</b>	<b>7.2</b>	<b>13.0</b>	<b>17.4</b>	<b>41.4</b>
<b>3. Total Domestic Resources Available (1+2)</b>	<b>406.1</b>	<b>555.0</b>	<b>535.6</b>	<b>596.5</b>	<b>663.7</b>	<b>908.6</b>	<b>1 178.1</b>	<b>1 525.6</b>
<b>4. Total Expenditure and Net Lending</b>	<b>553.0</b>	<b>642.0</b>	<b>658.6</b>	<b>713.0</b>	<b>775.4</b>	<b>1 021.6</b>	<b>1 302.8</b>	<b>1 625.9</b>
Current Expenditure	416.9	475.8	499.0	566.7	616.1	824.9	1 069.3	1 347.7
<i>of which: Interest Payments</i>	<i>27.6</i>	<i>23.7</i>	<i>21.4</i>	<i>21.0</i>	<i>21.2</i>	<i>22.9</i>	<i>30.4</i>	<i>43.6</i>
Capital Expenditure	112.4	172.2	147.4	132.5	140.7	175.2	212.3	257.4
Net Lending	23.7	-6.0	12.2	13.8	18.6	21.5	21.2	20.9
<b>5. External Financing Requirements (4-3)</b>	<b>146.9</b>	<b>87.1</b>	<b>123.1</b>	<b>116.5</b>	<b>111.7</b>	<b>113.0</b>	<b>124.8</b>	<b>100.3</b>
<b>5.1. Identified</b>	<b>146.9</b>	<b>87.1</b>	<b>123.1</b>	<b>116.5</b>	<b>97.3</b>	<b>29.0</b>	<b>18.5</b>	<b>11.0</b>
Grants	82.5	104.0	56.5	56.4	54.0	42.6	42.6	42.6
Current	29.6	24.0	16.4	15.2	14.2	17.1	17.1	17.1
Capital	52.8	80.0	40.2	41.3	39.8	25.5	25.5	25.5
Loans/Credits	64.4	-16.9	66.5	60.1	43.3	-13.6	-24.1	-31.5
<b>5.2. Non-Identified</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>14.4</b>	<b>84.0</b>	<b>106.3</b>	<b>89.3</b>
<i>in percent of GDP</i>								
<b>1. Total Domestic Revenue</b>	<b>19.1</b>	<b>18.9</b>	<b>19.4</b>	<b>19.9</b>	<b>20.4</b>	<b>21.8</b>	<b>22.6</b>	<b>23.2</b>
Tax Revenue	17.9	18.3	18.8	19.3	19.8	21.2	22.0	22.6
Non-Tax and Capital Revenue	1.3	0.7	0.7	0.6	0.6	0.6	0.7	0.6
<b>2. Domestic Financing</b>	<b>-2.0</b>	<b>3.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.6</b>
<b>3. Total Domestic Resources Available (1+2)</b>	<b>17.2</b>	<b>22.1</b>	<b>19.6</b>	<b>20.1</b>	<b>20.6</b>	<b>22.1</b>	<b>23.0</b>	<b>23.9</b>
<b>4. Total Expenditure and Net Lending</b>	<b>23.4</b>	<b>25.5</b>	<b>24.1</b>	<b>24.0</b>	<b>24.1</b>	<b>24.8</b>	<b>25.4</b>	<b>25.5</b>
Current Expenditure	17.6	18.9	18.3	19.1	19.1	20.1	20.9	21.1
<i>of which: Interest Payments</i>	<i>1.2</i>	<i>0.9</i>	<i>0.8</i>	<i>0.7</i>	<i>0.7</i>	<i>0.6</i>	<i>0.6</i>	<i>0.7</i>
Capital Expenditure	4.8	6.8	5.4	4.5	4.4	4.3	4.1	4.0
Net Lending	1.0	-0.2	0.4	0.5	0.6	0.5	0.4	0.3
<b>5. External Financing Requirements (4-3)</b>	<b>6.2</b>	<b>3.5</b>	<b>4.5</b>	<b>3.9</b>	<b>3.5</b>	<b>2.7</b>	<b>2.4</b>	<b>1.6</b>
<b>5.1. Identified</b>	<b>6.2</b>	<b>3.5</b>	<b>4.5</b>	<b>3.9</b>	<b>3.0</b>	<b>0.7</b>	<b>0.4</b>	<b>0.2</b>
Grants	3.5	4.1	2.1	1.9	1.7	1.0	0.8	0.7
Current	1.3	1.0	0.6	0.5	0.4	0.4	0.3	0.3
Capital	2.2	3.2	1.5	1.4	1.2	0.6	0.5	0.4
Loans/Credits	2.7	-0.7	2.4	2.0	1.3	-0.3	-0.5	-0.5
<b>5.2. Non-Identified</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.4</b>	<b>2.0</b>	<b>2.1</b>	<b>1.4</b>

Source: Ministry of Finance and Economy of the Republic of Armenia and PRSP projections.

Annex 6. Projections of Consolidated Budget Expenditure by Main Functions (on a commitment basis)

	2003	2004	2005	2006	2009	2012	2015
	Budget	Projections					
	<i>in billions of drams</i>						
<b>Total Expenditure</b>	<b>376.5</b>	<b>388.1</b>	<b>422.2</b>	<b>461.5</b>	<b>617.2</b>	<b>799.0</b>	<b>1012.2</b>
General Public Services	28.3	35.5	41.8	43.9	65.3	93.8	122.0
Defense, Public Order and Safety	61.3	66.8	73.4	77.3	97.0	123.3	150.9
Education and Science	38.2	46.1	55.5	63.0	94.6	128.3	170.6
Health	21.0	24.9	30.8	35.5	52.7	73.3	101.1
Social Security and Social Insurance	73.1	84.4	95.9	109.0	144.0	175.5	218.0
Culture, Information, Sports and Religion	16.5	9.4	10.5	12.7	13.6	16.1	20.0
Housing and Public Utilities	36.1	24.0	24.4	27.7	49.8	59.5	80.4
Fuel and Energy	12.2	13.5	8.4	8.2	0.0	0.0	0.0
Agriculture, Forestry and Water, Fishing	19.2	17.0	13.8	13.6	18.8	23.8	30.3
Manufacturing, Mining, Construction and Environment	4.6	6.5	5.4	5.2	4.0	3.6	3.7
Transportation, Road Utility and Communications	36.6	25.3	25.9	26.1	33.0	38.4	44.4
Other Expenditure	29.4	34.8	36.6	39.2	38.0	49.5	55.5
<i>of which: Debt Servicing</i>	<i>13.9</i>	<i>12.6</i>	<i>12.5</i>	<i>12.6</i>	<i>13.8</i>	<i>18.7</i>	<i>27.2</i>
Non-classified	0.0	0.0	0.0	0.0	6.5	13.9	15.1
	<i>in percent of GDP</i>						
<b>Total Expenditure</b>	<b>25.5</b>	<b>24.1</b>	<b>24.0</b>	<b>24.1</b>	<b>24.8</b>	<b>25.4</b>	<b>25.5</b>
General Public Services	1.9	2.2	2.4	2.3	2.6	3.0	3.1
Defense, Public Order and Safety	4.2	4.1	4.2	4.0	3.9	3.9	3.8
Education and Science	2.6	2.9	3.2	3.3	3.8	4.1	4.3
Health	1.4	1.5	1.8	1.9	2.1	2.3	2.5
Social Security and Social Insurance	5.0	5.2	5.5	5.7	5.8	5.6	5.5
Culture, Information, Sports and Religion	1.1	0.6	0.6	0.7	0.5	0.5	0.5
Housing and Public Utilities	2.5	1.5	1.4	1.4	2.0	1.9	2.0
Fuel and Energy	0.8	0.8	0.5	0.4	0.0	0.0	0.0
Agriculture, Forestry and Water, Fishing	1.3	1.1	0.8	0.7	0.8	0.8	0.8
Manufacturing, Mining, Construction and Environment	0.3	0.4	0.3	0.3	0.2	0.1	0.1
Transportation, Road Utility and Communications	2.5	1.6	1.5	1.4	1.3	1.2	1.1
Other Expenditure	2.0	2.2	2.1	2.0	1.5	1.6	1.4
<i>of which: Debt Servicing</i>	<i>0.9</i>	<i>0.8</i>	<i>0.7</i>	<i>0.7</i>	<i>0.6</i>	<i>0.6</i>	<i>0.7</i>
Non-classified	0.0	0.0	0.0	0.0	0.3	0.4	0.4
	<i>in percent of total expenditure</i>						
<b>Total Expenditure</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
General Public Services	7.5	9.1	9.9	9.5	10.6	11.7	12.1
Defense, Public Order and Safety	16.3	17.2	17.4	16.8	15.7	15.4	14.9
Education and Science	10.1	11.9	13.1	13.6	15.3	16.1	16.9
Health	5.6	6.4	7.3	7.7	8.5	9.2	10.0
Social Security and Social Insurance	19.4	21.7	22.7	23.6	23.3	22.0	21.5
Culture, Information, Sports and Religion	4.4	2.4	2.5	2.7	2.2	2.0	2.0
Housing and Public Utilities	9.6	6.2	5.8	6.0	8.1	7.4	7.9
Fuel and Energy	3.2	3.5	2.0	1.8	0.0	0.0	0.0
Agriculture, Forestry and Water, Fishing	5.1	4.4	3.3	2.9	3.0	3.0	3.0
Manufacturing, Mining, Construction and Environment	1.2	1.7	1.3	1.1	0.6	0.5	0.4
Transportation, Road Utility and Communications	9.7	6.5	6.1	5.7	5.3	4.8	4.4
Other Expenditure	7.8	9.0	8.7	8.5	6.2	6.2	5.5
<i>of which: Debt Servicing</i>	<i>3.7</i>	<i>3.2</i>	<i>3.0</i>	<i>2.7</i>	<i>2.2</i>	<i>2.3</i>	<i>2.7</i>
Non-classified	0.0	0.0	0.0	0.0	1.0	1.7	1.5

Source: Ministry of Finance and Economy of the Republic of Armenia and PRSP projections.

Annex 7. Consolidated Budget Social Expenditure (on a commitment basis)

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Budget</i>	<i>Projections</i>					
	<i>in billions of drams</i>							
<b>Total Social Expenditure</b>	<b>106.1</b>	<b>127.6</b>	<b>150.3</b>	<b>176.8</b>	<b>201.7</b>	<b>283.3</b>	<b>365.4</b>	<b>475.3</b>
Education	29.7	35.2	42.8	52.0	59.0	88.7	118.8	158.7
Health	16.0	21.0	24.9	30.8	35.5	52.7	73.3	101.1
Social Security and Social Insurance <sup>1</sup>	60.3	71.4	82.6	94.0	107.1	141.9	173.2	215.5
<i>of which: Family Benefits</i>	<i>12.1</i>	<i>12.7</i>	<i>16.1</i>	<i>20.2</i>	<i>24.9</i>	<i>29.8</i>	<i>33.0</i>	<i>39.8</i>
	<i>year-on-year % change</i>							
<b>Total Social Expenditure</b>	<b>-0.1</b>	<b>20.3</b>	<b>17.8</b>	<b>17.6</b>	<b>14.1</b>	<b>40.5</b>	<b>28.9</b>	<b>30.1</b>
Education	-0.7	18.3	21.6	21.4	13.6	10.8	10.2	10.1
Health	-18.6	31.2	18.6	23.5	15.4	12.4	11.5	11.2
Social Security and Social Insurance <sup>1</sup>	6.6	18.4	15.8	13.8	13.9	8.2	6.8	7.8
<i>of which: Family Benefits</i>	<i>-31.6</i>	<i>5.5</i>	<i>26.3</i>	<i>25.6</i>	<i>23.4</i>	<i>0.3</i>	<i>3.2</i>	<i>8.1</i>
	<i>in percent of GDP</i>							
<b>Total Social Expenditure</b>	<b>7.8</b>	<b>8.7</b>	<b>9.3</b>	<b>10.1</b>	<b>10.5</b>	<b>11.4</b>	<b>11.6</b>	<b>12.0</b>
Education	2.2	2.4	2.7	3.0	3.1	3.6	3.8	4.0
Health	1.2	1.4	1.5	1.8	1.9	2.1	2.3	2.5
Social Security and Social Insurance <sup>1</sup>	4.4	4.8	5.1	5.4	5.6	5.7	5.5	5.4
<i>of which: Family Benefits</i>	<i>0.9</i>	<i>0.9</i>	<i>1.0</i>	<i>1.2</i>	<i>1.3</i>	<i>1.2</i>	<i>1.1</i>	<i>1.0</i>
	<i>in percent of consolidated budget total expenditure</i>							
<b>Total Social Expenditure</b>	<b>33.4</b>	<b>33.9</b>	<b>38.7</b>	<b>41.9</b>	<b>43.7</b>	<b>45.9</b>	<b>45.7</b>	<b>47.0</b>
Education	9.4	9.4	11.0	12.3	12.8	14.4	14.9	15.7
Health	5.0	5.6	6.4	7.3	7.7	8.5	9.2	10.0
Social Security and Social Insurance <sup>1</sup>	19.0	19.0	21.3	22.3	23.2	23.0	21.7	21.3
<i>of which: Family Benefits</i>	<i>3.8</i>	<i>3.4</i>	<i>4.1</i>	<i>4.8</i>	<i>5.4</i>	<i>4.8</i>	<i>4.1</i>	<i>3.9</i>

<sup>1</sup> Excluding expenditure on the system maintenance and development.

Source: Ministry of Finance and Economy of the Republic of Armenia and PRSP projections.

## Annex 8. Balance of Payments: Medium and Long Term Projections

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Prog.</i>	<i>Projections</i>					
	<i>in millions of US dollars, unless otherwise indicated</i>							
<b>Current Account</b>	<b>-146</b>	<b>-163</b>	<b>-159</b>	<b>-163</b>	<b>-169</b>	<b>-191</b>	<b>-220</b>	<b>-275</b>
Trade Balance	-353	-362	-373	-390	-408	-447	-489	-563
Exports (f.o.b.)	519	583	639	701	767	1 005	1 293	1 662
Imports (f.o.b.)	-872	-945	-1 012	-1 091	-1 176	-1 452	-1 781	-2 225
Services (net)	-30	-40	-43	-44	-45	-54	-24	22
Credits	180	185	201	219	240	308	411	548
Debits	-210	-225	-244	-263	-284	-362	-435	-526
Income and Private Transfers (net)	183	184	202	216	229	256	238	211
Official Transfers (net)	55	55	55	55	55	55	55	55
<b>Capital and Financial Account</b>	<b>214</b>	<b>132</b>	<b>202</b>	<b>191</b>	<b>184</b>	<b>146</b>	<b>186</b>	<b>248</b>
Capital Transfers (net)	60	80	55	57	56	30	30	30
Foreign Direct Investments (net)	110	135	80	94	105	130	180	250
Portfolio Investments (net)	0	0	0	0	0	0	0	0
Public Sector (net)	29	-57	67	40	23	-14	-24	-32
Disbursement	51	78	80	54	40	5	0	0
Amortization	-21	-135	-13	-13	-17	-18	-24	-32
Other Capital (net)	15	-26	0	0	0	0	0	0
<b>Overall Balance</b>	<b>68</b>	<b>-31</b>	<b>42</b>	<b>28</b>	<b>15</b>	<b>-44</b>	<b>-34</b>	<b>-27</b>
<b>Financing:</b>								
Change in Gross Reserves (- increase)	-111	-13	-36	-14	-21	-19	-56	-60
IMF (net)	8	4	-6	-34	-29	-21	-16	-2
Financing Gap	35	40	0	20	34	84	106	89
World Bank	35	40	0	20	20	0	0	0
Other	0	0	0	0	14	84	106	89
<b>Memorandum Items</b>								
Current Account, in % of GDP	-6.2	-6.5	-5.8	-5.5	-5.2	-4.6	-4.3	-4.3
<i>excluding official transfers</i>	-8.5	-8.7	-7.9	-7.3	-7.0	-6.0	-5.4	-5.2
Gross Reserves (end of period)	431	444	480	494	515	604	732	906
<i>in months of imports of goods and non-factor services</i>	4.8	4.6	4.6	4.4	4.2	4.0	4.0	4.0
Nominal External Debt	1 025	1 007	1 104	1 129	1 157	1 275	1 430	1 612
<i>External Debt-to-GDP Ratio, %</i>	43.3	40.1	40.4	38.1	35.9	31.0	27.9	25.2
Net Present Value (NPV) of External Debt	673	598	623	632	631	688	749	820
<i>NPV of Debt-to-GDP Ratio, %</i>	28.5	23.8	22.8	21.3	19.6	16.7	14.6	12.8
<i>NPV of Debt-to-goods and non-factor services Exports Ratio, %</i>	96.3	77.9	74.2	68.7	62.7	52.4	44.0	37.1

Source: National Statistical Service of the Republic of Armenia and PRSP projections.

Annex 9. The main directions of PRSP implementation policies for 2003-2006

	Policy	Objective	Responsible Agency	Timing
1.	PRSP awareness	Increasing the level of public awareness about PRSP main directions	Ministry of Finance and Economy Other ministries and departments	2003
2.	Provision of annually 6 percent economic growth in the medium -term	Increasing of the population income and welfare	Ministry of Finance and Economy Ministry of Trade and Economic Development Other ministries and departments	2004 – 2006
3.	Provision of accelerating growth rates of the investment relative to GDP	Provision of the necessary investment base for the sustainable high economic growth	Ministry of Trade and Economic Development Line ministries	2004-2006
4.	Development of the social collaboration and introduction of its mechanisms	Formation of the institutional mechanisms for collaboration between the Governmental and non-governmental organizations and groups in the PRSP frameworks	Ministry of Finance and Economy Other ministries and departments	2003
5.	Development of PRSP process assessment indicators system and mechanisms for its introduction (PAIS)	Estimation of the different poverty characteristics by different regions as well as vulnerable groups of the population	Ministry of Finance and Economy Other ministries and departments	2003
6.	Development of the comprehensive program for PRSP monitoring, analysis and impact assessment	PRSP implementation management, monitoring and coordination	Ministry of Finance and Economy Other ministries and departments	2003
7.	Provision of the conditions for the accelerating growth of the exports	Provision of the high growth rates in long-term	Ministry of Trade and Economic Development Ministry of Finance and Economy	2004-2006
8.	Introduction and development of the main economic institutions based on the knowledge production	Provision of the high growth rates in long-term	Ministry of Trade and Economic Development Ministry of Finance and Economy	2004 To be continued
9.	Improvement of the agricultural financing mechanisms and the development of the conditions for credit growth	Sustainable growth of agriculture, substantial reduction of the rural population poverty and inequality	Ministry of Agriculture Ministry of Finance and Economy	2004 To be continued
10.	Development of the growth conditions for the irrigation and water use, land use, yield, production and volumes	Sustainable growth of agriculture, substantial reduction of the rural population poverty and inequality	Ministry of Agriculture Ministry of Finance and Economy	2004
11.	Development of the conditions for creation of commodity sale markets and institutions	Sustainable growth of agriculture, substantial reduction of the rural population poverty and inequality	Ministry of Agriculture Ministry of Finance and Economy	2004-2005
12.	Development of the financing of the agriculture and insurance institutions	Sustainable growth of agriculture, substantial reduction of the rural population poverty and inequality	Ministry of Agriculture Ministry of Finance and Economy	2004-2005
13.	Increasing of the opportunities for the non-agricultural activities in rural areas	Sustainable growth of agriculture, substantial reduction of the rural population poverty and inequality	Ministry of Agriculture Ministry of Trade and Economic Development	2004

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
14.	Development of the necessary prerequisites for the land market formation (mechanisms for the market value definition and alienation of the land and pawning of the land)	Growth of the agriculture efficiency	Ministry of Justice State Committee of the Real Estate Cadastre under the Government	2004
15.	Development of the Concept for the definition of the agricultural household marginal size differentiating by marzes	Growth of the agriculture efficiency	Ministry of Agriculture	2004
16.	Development of the legal and other mechanisms to prohibit disuse or pointless use of the land	Putting into the economic circulation the idle lands	Ministry of Agriculture	2004
17.	Used irrigation water volume and norms determination	Increasing the efficiency of the irrigation system	Water Management State Committee under the Government	2004
18.	Improvement of the management structure of the irrigation system	Increasing the efficiency of the irrigation system	Water Management State Committee under the Government	2003-2004
19.	Improvement of the technical conditions of the irrigation network	Increasing the efficiency of the irrigation system	Water Management State Committee under the Government	2004 To be continued
20.	Gradual transformation of the mechanical irrigation systems to the gravity-based systems and introduction of new irrigation technologies	Increasing the efficiency of the irrigation system	Water Management State Committee under the Government	2004 To be continued
21.	Improvement of the conditions of the community roads	Increase the level of the rural population mobility	Ministry of Transportation and Communication	2004-2006
22.	Promoting creation and activities of the institutions as farm cooperatives or unions	Promoting of the institutions for the agricultural products sale and creation of processing units	Ministry of Agriculture	2004
23.	Realization of efficient mechanisms of land market and land pledge	Developing conditions emergence of an organizations network in the field of agricultural technologies	Ministry of Justice State Committee of the Real Estate Cadastre under the Government	2004
24.	Providing conditions for closer contacts between farms and credit organizations	Promoting creation of institutions for selling and processing of agricultural products	Ministry of Agriculture	2004
25.	Expanding consulting services provision to farms at preferential terms	Growth of agricultural productivity and the share of commercial production	Ministry of Agriculture	2004 To be continued
26.	Development of mechanisms to create an operational insurance system jointly financed by farms and the state	Growth of agricultural productivity and the share of commercial production	Ministry of Finance and Economy Ministry of Agriculture	2004-2005
27.	Development of conditions for emergence of non-agricultural micro-enterprises in rural areas, including through micro credits mechanisms development	Expansion of opportunities for non-agricultural employment	Ministry of Finance and Economy Ministry of Agriculture	2004
28.	Development of credit mechanisms for processing of agricultural products	Expansion of opportunities for non-agricultural employment	Ministry of Finance and Economy Ministry of Agriculture	2004 To be continued
29.	Strengthening of the structural reforms in the state governmental system	Increase the efficiency of the public management system	Ministry of Cabinet Chief of Staff	2003-2004
30.	Introduction and development of the civil service system	Increase the efficiency of the public management system	Civil Service Council	2003-2004

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
31.	Strengthening of the financial management system reforms	Increase the efficiency of the public management system	Ministry of Finance and Economy	2004
32.	Improvement of the functions of the regional governmental bodies	Increase the efficiency of the regional governance system	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
33.	Introduction of modern technologies and communications means in the governmental bodies	Increase the efficiency of the state governance system	Ministry of Finance and Economy	2004-2006
34.	Increase of salaries of civil servants in the governance and juridical system	Increase the efficiency of the state governance system and fight against corruption	Ministry of Finance and Economy	2004-2006
35.	Expand the use of modern governance technologies (e-Governance)	Increase public awareness on legislation and projects, providing for feedback	Ministries and departments	2004
36.	Enhance cooperation between the population and central and community governments, using modern technologies (e-Governance)	Enhance the public control over governance	State and community governance bodies	2004
37.	Adoption of the law on lobbying	Strengthening the protection of rights of the public institutions, including specialized non-governmental organizations and business unions	Ministry of Justice	2004
38.	Amendments in the "Law on Chambers of Commerce"	Strengthening chambers of commerce so that they serve as a center providing for collaboration between business units.	Ministry of Trade and Economic Development Ministry of Justice	2004
39.	Expanding opportunities for specialized non-governmental organizations to participate in state decision-making	Improvement of investment environment	Ministry of Trade and Economic Development	2003-2004
40.	Increasing the level of the female participation in the state governance system	Provision of equality of rights for males and females at all levels of governance	Ministry of Cabinet Chief of Staff	2004-2006
41.	Consistency between the Budget and the Medium-term Expenditures Framework of the Government	Increasing the efficiency of budget management	Ministry of Finance and Economy	2004
42.	Increasing the level of public awareness in the whole budget process	Increasing the efficiency of budget management	Ministry of Finance and Economy Other ministries and departments	2004
43.	Expanding the budget frameworks including all cash and non-cash financial flows in the Budget	Increasing the efficiency of budget management	Ministry of Finance and Economy	2004
44.	Strengthening the control over Budget performance, increasing the role of the Chamber of Control of the National Assembly	Increasing the efficiency of budget management	Ministry of Finance and Economy	2004
45.	Increasing the predictability of the Budget	Increasing the efficiency of budget management	Ministry of Finance and Economy	2004
46.	Increasing the clarity and accessibility of the budget for all users	Increasing the efficiency of budget management	Ministry of Finance and Economy	2004-2006
47.	Optimization of the administrative and regional division of the country based on comprehensively justified principles	Increasing the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006



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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
48.	Consistent social and economic development of the administrative regional units of the country	Increasing the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures Ministry of Finance and Economy	2004-2006
49.	Accelerated development of the small and medium sized cities with high level of poverty	Increasing the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006
50.	Improvement of the legal framework regulating the activities of central community governance bodies	Increasing the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
51.	Increasing the transparency and public awareness on the community budget formulation process	Increasing the efficiency of local governance	Local Self-governance Bodies Ministry of Finance and Economy	2004-2006
52.	Increasing the affordability of tariffs and duties charged for the services provided to the population by community governments	Increasing the efficiency of local governance	Ministry of Finance and Economy Community governments	2004
53.	Streamlining the roles and responsibilities of rural, municipal and territorial administrations	Increasing the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2005
54.	Legally defining the rules of implementation of mandatory responsibilities by local governments	Increasing the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
55.	Enhancing of the management skills and professional knowledge in the local governance system	Improving the community governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006
56.	Developing a draft law on the service in the self-governance bodies	Legal framework for regulating the flows of human resources in local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
57.	Financial support to the development of inter-community unions and networks of their infrastructures	Increasing the efficiency of local governance	Ministry of Finance and Economy	2004-2006
58.	Gradual transmission of the functions of local significance in the supervision of the secondary education, health, social services systems to local governance bodies	Increasing the accessibility and improving the quality of public services	Ministry of Education and Science Ministry of Health Ministry of Social Security	2004-2006
59.	Development of a targeted g system of the privileges, discounts and allowances in the earthquake zone, near-border, mountainous and high mountainous regions and small communities	Implementation of state policy differentiated by communities	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
60.	Provision of sufficient material, technical and human resources to investigation centers and ensure the accessibility of their services to the public	Establishment of an efficient and accessible judicial system, increase the efficiency of legal practice	Ministry of Justice	2004-2005
61.	Revise the Constitutional provisions, regarding the Justice Council and the Constitutional court	Streamlining of jurisdiction of these bodies and guaranteeing of the highest possible level of independence of officials	Ministry of Justice	2004-2006
62.	Streamlining of principles of justice practice.	Increase the effectiveness of justice	Ministry of Justice	2004
63.	Setting requirements for publication of decisions and verdicts on trial cases	Opportunity for the public to assess the practice of justice	Ministry of Justice	2005
64.	Increase the salaries of employees in the judicial field`	Increase the effectiveness of Justice	Ministry of Justice	2004-2006
65.	Revising the rates of legal duties, development of mechanisms for deferral of payment.	Increase the availability of judicial services for vulnerable groups.	Ministry of Finance and Economy Ministry of Justice	2005
66.	Support to permanent independent investigation processes (independent from governmental bodies)	Streamlining of legislative and sub-legislative regulations	Ministry of Justice	2005
67.	Adoption of an anti-corruption strategy and relevant measures	Prevention of Corruption	Ministry of Cabinet Chief of Staff	2003
68.	Detection and prevention of profits from illegal economic activities	Prevention of Corruption	State Tax Service under the Government State Customs Service under the Government	2003 To be continued
69.	Limiting of tax exemptions and strengthening of tax and customs administration	Prevention of tax and customs corruption	Ministry of Finance and Economy State Tax Service under the Government State Customs Service under the Government	2003 To be continued
70.	Streamlining and simplification of customs legislation	Prevention of tax and customs corruption	State Customs Service under the Government Ministry of Finance and Economy Ministry of Trade and Economic Development	2003 To be continued
71.	Streamlining and improving bankruptcy legislation`	Acceleration and simplification bankruptcy processes	Ministry of Justice	2004
72.	Regulation of monopoly behavior	Support competition	Ministry of Trade and Economic Development	2005
73.	Legal regulation of political lobbying	Legal regulation of rights of all participants of political field	Ministry of Justice	2005
74.	Improvement of the elections system	Prevention of political corruption	Ministry of Justice	2004 To be continued
75.	Active cooperation with civil society in corruption prevention	Ensure effectiveness of the anti corruption strategy implementation and monitoring	Ministry of Cabinet Chief of Staff Other ministries and departments	2003 To be continued
76.	Reducing the number of activities subject to licensing	Improvement of businesses environment	Ministry of Justice	2004
77.	Simplifying the licensing procedure	Improvement of businesses environment	Licensing Agencies	2004

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
78.	Installation of electronic systems of registration and licensing (e-Government)	Improvement of businesses environment	Ministry of Justice Licensing Agencies	2005
79.	Transmission of several functions of professional qualification to business units	Improvement of businesses environment	Professional qualification Bodies	2004-2006
80.	Acceleration of bankruptcy of noncompetitive state enterprises	Improvement of businesses environment	Ministry of Justice	2004
81.	Facilitation of improvement of mechanisms for venture financing	Facilitation of entrance of new companies in production and hi-tech industries	Ministry of Trade and Economic Development Ministry of Finance and Economy	2004
82.	Development of legislation on employment relations	Modifying working relations to contemporary standards	Ministry of Justice	2004
83.	Improvement of legislation regulating companies' activities	Strengthening the protection of small shareholders' and investors' rights	Ministry of Justice	2004
84.	Provision of consulting services to SME-s	Expansion of financing and investment opportunities	Ministry of Trade and Economic Development	2003 To be continued
85.	Develop strategies for limiting monopolization and enhancing competition in the economy	Enhance competition	Ministry of Trade and Economic Development	2004
86.	Adoption of sustainable economic development strategy for Armenia	Improvement of investment environment, export promotion	Ministry of Trade and Economic Development	2003
87.	Facilitation of micro financing projects aimed at expanding non agricultural employment	Expansion of non agricultural employment in villages and small towns	Ministry of Trade and Economic Development Ministry of Finance and Economy	2004
88.	Elimination of state registration requirement of entrepreneurs for activities that don't require special qualification	Limitation and prevention of "shadow" activities	Ministry of Justice	2004
89.	Developing mechanisms for labor market development and labor force registration	Limitation and prevention of "shadow" activities	State Tax Service under the RA Government Social Insurance State Fund	2003 To be continued
90.	Improve the regulation of money circulation and increase the level of control	Limitation and prevention of "shadow" activities	Ministry of Finance and Economy State Tax Service under the RA Government	2004
91.	Streamlining of existing enforcement rules, reducing the time for enforcement	Reduce the obstacles to credit expansion	Ministry of Justice Central Bank	2004
92.	Reduce the expenses, related to the registration of real estate	Reduce the obstacles to credit expansion	State Committee of the Real Estate Cadastre Central Bank	2004
93.	Reduce the obstacles to the management of property transferred to banks as pledges	Reduce the obstacles to credit expansion	Ministry of Justice Central Bank	2004
94.	Development of mortgage credit mechanisms	Increase opportunities to purchase a flat for those in need of housing	Central Bank	2004
95.	Related to WTO accession, develop mechanisms of VAT taxation of agriculture to avoid negative impact on agricultural development	Simplification of taxation mechanisms	Ministry of Finance and Economy	2006

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
96.	Reduce the differences in accounting and tax calculation related to taxation and accounting of profit tax	Simplification of taxation mechanisms	Ministry of Finance and Economy	2004 To be continued
97.	Reduce opportunities to avoid profit tax	Establishment of fair taxation principle	Ministry of Finance and Economy	2004
98.	Substitute the progressive scale of income tax and the regressive scale of social payments with a proportional scale	Simplification of taxation mechanisms	Ministry of Finance and Economy	2006
99.	Increase of justice of assessed tax usage	Establishment of fair taxation principle	Ministry of Finance and Economy	2005
100.	Simplification tax accounting for SME-s	Simplification of taxation mechanisms	Ministry of Finance and Economy	2004 To be continued
101.	Grouping tax laws in a Tax Code, following consistency principles.	Simplification of taxation mechanisms	Ministry of Finance and Economy	2005
102.	Increase the targeting of family benefits system	Increase of the efficiency social services system	Ministry of Social Security	2004 To be continued
103.	Increase the accessibility and targeting of services to disabled people, orphans refugees and displaced people	Increase of the efficiency social services system	Ministry of Social Security	2004 To be continued
104.	Continuing increase of pensions	Increase the social protection of pensioners	Social Insurance State Fund	2004 To be continued
105.	Reforming the principles of pension assignment	Increase the efficiency of the compulsory social insurance system	Social Insurance State Fund	2005
106.	Radical changes of the existing policy of unemployment insurance and shift to active employment policy implementation	Increase the efficiency of employment policy	Ministry of Social Security	2004
107.	Accelerated growth of salaries for employees of budgetary and social infrastructures	Increase the efficiency of state governance, improve the quality of social services	Ministry of Finance and Economy	2004 To be continued
108.	Ensure consistency between the number of beneficiary households and the number of very poor households	Increasing the efficiency of social services	Ministry of Social Security	2004 To be continued
109.	Removing of the one-off allowances and allocating the savings thereof to family benefits	Enhance the targeting of the allowances system	Ministry of Social Security	2004
110.	Gradual transition from the currently existing indirect system of household evaluation (scoring) to a direct one	Enhance the targeting of the allowances system	Ministry of Social Security	2004-2005
111.	Introduction of the family allowances system efficiency assessment based on the integrated household surveys	Increasing the efficiency of the assessment of family allowances targeting	Ministry of Social Security	2004-2005
112.	Introducing legal regulations of relationships involving state benefits	Improving the system of state benefits	Ministry of Social Security	2004
113.	Reformation of the system of appeals and complaints on allowances	Reforming appeals system, creating a simplified, understandable, transparent and fair system	Ministry of Social Security	2004
114.	Elaboration of effective mechanisms of monitoring the family benefit appointment and payment system	Prevention of corruption and potential preferential treatment	Ministry of Social Security	2004
115.	Continuous growth of one-off allowances to cover the costs related to birth of a child	Increasing the efficiency of one-off allowances to cover the costs related to birth of a child	Ministry of Social Security Ministry of Finance and Economy	2004-2006

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
116.	Reduce the duration of the partially paid leave provided for taking care of infants	Increasing the efficiency of allowances to cover the costs related to children	Social Insurance State Fund Ministry of Social Security	2004
117.	Introduce legislation to provide that the temporary incapacity benefit be partially paid by the employer	Partial payment of the temporary incapacity benefit by the employer will allow to control the use of these benefits more efficiently	Social Insurance State Fund Ministry of Social Security	2004
118.	Elimination of allocations for provision of free recreational treatment in sanatoriums	Increasing the efficiency of the Social Insurance system	Social Insurance State Fund Ministry of Social Security	2003
119.	Development state assistance programs for graduates from orphanages	Improve the social assistance to children	Ministry of Social Security	2004
120.	Improve the living conditions of refugees living in temporary shelters	Improve the social security system for refugees	Department of Migration and Refugees under the Government	2004
121.	Increase opportunities for very poor rural refugees to be engaged in farming and cattle breeding	Creating equal opportunities for refugees to those of residents	Department of Migration and Refugees under the Government	2005
122.	Development of post-conflict rehabilitation programs	Ensuring conditions for population immigration	Ministry of Regional Government and Coordinating the Operation and Infrastructures	2004
123.	Simplification of the mandatory social contributions collection system	Increase the efficiency of mandatory social contributions system	Social Insurance State Fund	2004
124.	Differentiating between social and retirement pension financing	Increase the efficiency of retirement pension system	Ministry of Finance and Economy Social Insurance State Fund	2004
125.	Increasing the progressivity of retirement pensions according to years of employment	Increase the equitability and fairness of the pension system	Social Insurance State Fund	2004-2006
126.	Increasing austerity in he terms of pension eligibility	Increase the effectiveness of the pension system	Social Insurance State Fund	2004
127.	Finalizing the introduction of the individual (personal) registration system	Accurate accounting of insurer's payments and liabilities	Social Insurance State Fund	2005
128.	Development of mechanisms of pensions appointments based on the data of the individual registration system	Increase he effectiveness of the pension system	Social Insurance State Fund	2005
129.	Increase of the minimum wage so that it is equal to the general poverty line	Wage inequality and poverty reduction	Ministry of Finance and Economy	2004
130.	Revise the disability categories by differentiation of the functional disability	Increase the effectiveness of the social security system	Ministry of Social Security	2004
131.	Elimination of the new pensions for the 3 <sup>rd</sup> disability group starting 2004	Increase the effectiveness of the social security system	Ministry of Social Security	2004
132.	Legislative regulation of the social protection of disabled people	Increase the social protection of disabled people	Ministry of Social Security	2004
133.	Elimination of the unemployment insurance scheme	Increasing the efficiency of the social insurance system	Ministry of Social Security	2004

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
134.	Abolish the payments which the employer has to make to the social insurance state fund in the case of firing the employee	Increasing the efficiency of the social insurance system	Ministry of Social Security	2004
135.	Expanding the sources of financing for disability insurance	Increasing the efficiency of the social insurance system	Ministry of Social Security	2004
136.	Development of mechanisms for financing of employment programs	Increasing the efficiency of the social insurance system	Ministry of Social Security	2004
137.	Development of mechanisms of training for the unemployed	Increasing the efficiency of the social insurance system	Ministry of Social Security	2004
138.	Substitute the unemployment benefits with support to the unemployed	Increasing the efficiency of the social insurance system	Ministry of Social Security	2004
139.	Discontinue the financial assistance provided to unemployed to engage in business activity and direct the savings thereof to the professional training of the unemployed	Increasing the efficiency of the employment programs	Ministry of Social Security	2004
140.	Streamlining the procedures of involving people in public works programs	Increasing the efficiency of the employment programs	Ministry of Social Security	2004
141.	Unify the procedures for involving people in public work programs funded from international, donor and non-governmental organizations	Increasing the efficiency of the employment programs	Ministry of Social Security	2004
142.	Increasing public expenditures in the health sector	Increasing the accessibility and improving the quality of health services	Ministry of Health Ministry of Finance and Economy	2004 To be continued
143.	Introduction of state control over wages and capital expenditures in the primary health care system	Improving the quality of health services	Ministry of Health Ministry of Finance and Economy	2004
144.	Increase the share of primary health care in total budget expenditures	Increasing the accessibility of the primary health care (out-patient and polyclinics)	Ministry of Health Ministry of Finance and Economy	2004 To be continued
145.	Development of the family healthcare system	Increasing the accessibility and improving the quality of the health services	Ministry of Health	2004
146.	Improving of the ambulance service	Increasing the accessibility and improving the quality of the health services	Ministry of Health	2004-2006
147.	Continuous improvement of health conditions of pregnant and nursing women and nutrition of children in the age of 0-5 years old	Improvement of health conditions of the population and poverty reduction	Ministry of Health	2004-2006
148.	Improvement of the quality of obstetrician and gynecological medical aid and enhancing equipment of obstetrician hospitals	Improvement of health conditions of the population and poverty reduction	Ministry of Health	2004-2006
149.	Expanding the programs on vaccinations and programs on healthy growth and development of children	Increasing the efficiency of the medical aid to the children	Ministry of Health	2004-2006
150.	Concentrating the limited public resources for hospitals as much as possible in few healthcare facilities	Enhancing the effectiveness of hospital healthcare	Ministry of Health	2004-2005
151.	Enhancing the efficiency of planning, budgeting and oversight functions at the level of medical institutions	Increasing the management efficiency	Ministry of Finance and Economy Ministry of Health	2004-2005

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
152.	Elaboration and introduction of quality control standards and revised sanitary norms and regulations	Strengthening the regulatory and supervisory functions of the state in the health care system	Ministry of Health	2004-2005
153.	Accelerated development of public education	Increasing the quality and efficiency of educational services	Ministry of Education and Science	2004-2006
154.	Growth of public expenditures in education	Increasing the quality and efficiency of educational services	Ministry of Education and Science	2004-2006
155.	Increasing remuneration and training provision for teachers	Improving quality of education	Ministry of Education and Science	2004 To be continued
156.	Text-books provision for the elementary school pupils	Improving quality of education	Ministry of Education and Science	To be continued
157.	Reconstruction of the school buildings and modernization of the heating systems	Improving quality of education	Ministry of Education and Science	2004 To be continued
158.	Modernization of teaching and learning materials	Ensuring quality education	Ministry of Education and Science	2004 To be continued
159.	Improving the quality of professional and training programs	Correspondence of the training programs to the contemporary education requirements	Ministry of Education and Science	2004 To be continued
160.	Optimization of the pupil/teacher ratio and the workload of teachers	Increasing the efficiency of educational services	Ministry of Education and Science	2004
161.	Creation (rehabilitation) of cultural units in communities	Prevent self-isolation of the poor, promote their participation in community cultural activities	Ministry of Culture and Youth Affairs Ministry of Finance and Economy	2004-2005
162.	Public participation in excavation, restoration and exhibition of a number of historic and cultural monuments	Enhancing national identity and the image of Armenia	Ministry of Culture and Youth Affairs	2004-2005
163.	Promoting national celebrations and festivals	Emphasizing social equality, enhancing civil participation and social activity	Ministry of Culture and Youth Affairs	2004 To be continued
164.	Improving the legal framework for environment protection and use of the natural resources	Prevention of environmental impediments to development	Ministry of Nature Protection	2004
165.	Ensure adequate fees and payments collection for the use of natural resources	Prevention of environmental impediments to development	Ministry of Trade and Economic Development Ministry of Finance and Economy	2004
166.	Establish a system of environmental standards and norms	Prevention of environmental impediments to development	Ministry of Nature Protection	2005
167.	Rehabilitation, protection and rational use of the ecological system of lake Sevan	Prevention of environmental impediments to development	Ministry of Nature Protection	2004-2006
168.	Strengthen the forest resources management system	Prevention of environmental impediments to development	Ministry of Nature Protection	2004-2006
169.	Improve the system of recording hazardous industrial waste	Prevention of environmental impediments to development	Ministry of Nature Protection	2004-2006
170.	Gradual reduction of subsidies to companies in potable water and irrigation systems	Increasing the efficiency of the water supply system	Water Management State Committee under the Government	2004-2006
171.	Shift to a zone tariff definition policy in the irrigation system	Increasing the efficiency of the water supply system	Water Management State Committee under the Government	2004-2005
172.	Introduction of management contracts with companies in the irrigation system	Increasing the efficiency of the water supply system	Water Management State Committee under the Government	2004-2005

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	<b>Policy</b>	<b>Objective</b>	<b>Responsible Agency</b>	<b>Timing</b>
173.	Development of the water calculation and recording system	Increasing the efficiency of the water supply system	Water Management State Committee under the Government	2004 To be continued
174.	Rehabilitation of the roads of the community (local) significance	Expansion of the agricultural products marketing opportunities for farms and increasing the accessibility of social services	Ministry of Transportation and Communication	2004-2006
175.	Increase the financing of road-construction up to 20 percent of budget revenues from fuel taxation	Financing of road-construction	Ministry of Finance and Economy Ministry of Transportation and Communication	2006
176.	Introduction of local heating systems	Increasing the level of heating accessibility	Ministry of Energy Ministry of Finance and Economy	2004-2006
177.	Development of the energy transmission and coordination system (Armenrgo, High power energy networks)	Increasing the efficiency of energy system	Ministry of Energy	2004 To be continued
178.	Financial rehabilitation of the energy system	Increasing the efficiency of energy system	Ministry of Energy Ministry of Finance and Economy	2004 To be continued
179.	Technical and financial support to multi-apartment buildings administration	Strengthening multi-apartment buildings administration (communities and owners union)	Ministry of Urban Development	2004 To be continued
180.	Comprehensive strengthening of the institutions of vocational education	Adequacy of the vocational educational system to the contemporary requirements	Ministry of Education and Science	2004
181.	Streamlining of responsibilities of PRSP implementation bodies and coordination of the main information flows	Establishment of the institutional and organizational structure	Ministry of Finance and Economy	2003-2004
182.	Establishment of institutions for assessment of PRSP implementation results and for further strategy development	Establishment of the institutional and organizational structure	Ministry of Finance and Economy Ministry of Social Security	2003-2004
183.	Streamlining of the monitoring indicators and of the main functions of responsible units	Introduction of an efficient PRSP monitoring system	Ministry of Finance and Economy	2003-2004
184.	Development of a detailed PRSP implementation measures and timetable	Introduction of an efficient PRSP monitoring system	Ministry of Finance and Economy Other ministries and departments	2003
185.	Establishment of the PRSP Coordination Participatory Committee (CPC)	Supervision of PRSP implementation process	Ministry of Finance and Economy	2003
186.	Formation of the PRSP Working Group Staff	Supervision of PRSP implementation process	Ministry of Finance and Economy	2003