

Republic of Armenia: Poverty Reduction Strategy Paper—Progress Report

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GOVERNMENT OF THE REPUBLIC OF ARMENIA

**PROGRESS REPORT ON THE SUSTAINABLE
DEVELOPMENT PROGRAM
(Year 2009-2010)**

**Yerevan
2011**

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Abbreviations

| | |
|---------|---|
| AIDS | Acquired Immune Deficiency Syndrome |
| ADB | Asian Development Bank |
| AMD | Armenian Dram |
| CBA | Central Bank of Armenia |
| CIS | Commonwealth of Independent States |
| CJSC | Closed Joint Stock Company |
| EBRD | European Bank for Reconstruction and Development |
| EU | European Union |
| EUR | Euro |
| FBS | Family Benefit System |
| GBP | Great Britain Pound Sterling |
| GDP | Gross Domestic Product |
| GoA | Government of Armenia |
| HIV | Human Immunodeficiency Virus |
| HPP | High Power Partner |
| IBRD | International Bank for Reconstruction and Development |
| IMF | International Monetary Fund |
| JPY | Japan Yen |
| KfW | Reconstruction Credit Institute |
| MCB | Minimum consumption basket |
| MTEF | Medium Term Expenditure Framework |
| NGO | Non-governmental Organization |
| NSS | National Statistical Service |
| OSCE | Organization for Security and Cooperation in Europe |
| PHC | Preliminary health care |
| PV | Passport Visa |
| PV | Present Value |
| Q | Quarter |
| RF | Russian Federation |
| RoA, RA | Republic of Armenia |
| SDP | Sustainable Development Program |
| SDR | Special Drawing Right |
| SRC | State Revenue Committee |
| USD | US dollar |
| VAT | Value-added Tax |
| WB | World Bank |

PREFACE

The Progress Report on the Sustainable Development Program (SDP) covers the period 2009-2010. The main objective of the report is to analyze the status of implementation of the SDP during this period, and discuss the need for revisions under the SDP due to the 2008-09 global financial-economic crisis.

Section 1 of the Report presents an analysis of social-economic progress in the context of the SDP. This section provides brief analyses of the macroeconomic and fiscal sectors, as well as comparing the main indicators with the plans set out in the SDP. The Section stresses the issues associated with public debt, in light of the recent increase in the debt burden. The Section also covers the “behavior” of the main indicators, describing poverty in Armenia in the reporting period and also providing an analysis of the reasons for, and consequences of, deviations of main target indicators under SDP.

The second section of the Report is devoted to the situational analysis of key sectors and fields, such as social protection, healthcare, education, infrastructures and institutional reforms.

The Report contains also an Annex, which is dedicated to tax policy reforms.

1. SOCIAL-ECONOMIC DEVELOPMENTS WITHIN THE CONTEXT OF THE SUSTAINABLE DEVELOPMENT PROGRAM 2009-2010

1.1. Macroeconomic developments and situation

1.1.1. Economic growth, general trends

The effect of the global financial and economic crisis, which started in September 2008, was felt in Armenia from Q4 2008, when GDP dropped by 1.2% against the same period in 2007, and continued into 2009, when a general drop of 14.1% was recorded. The crisis ended in 2010 when the global economy entered the recovery phase, as did Armenia, where economic growth of 2.1% was recorded (see Table 1):

Table 1. GDP Progress in 2008-2010, actual and according to SDP

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---------------------------------------|--------|--------|--------|--------|--------|
| GDP, AMD million at 2006 prices | 2656,2 | 3021,4 | 3229,9 | 2772,8 | 2831,0 |
| Rate of GDP growth, % | | 13,7 | 6,9 | -14,1 | 2,1 |
| GDP, AMD million, at 2006 prices, SDP | 2656,2 | 3021,4 | 3335,7 | 3643,6 | 3954,0 |
| Rate of GDP growth, %, SDP | | | 10,4 | 9,2 | 8,5 |
| Actual GDP/Forecast of GDP in SDP, % | | | 96,8 | 76,1 | 71,6 |

Source, NSS data, SDP forecast

In recent years (2003-2008), Armenia's development model was based on external financing (foreign direct investment and private transfers), the volume of which kept increasing from year to year. This led to an excessive growth of imports and non tradeables, reduced employment opportunities, and a relative and absolute reduction of exports and industry, in the context of a constant appreciation of the national currency.

In an environment characterized by an increasing inflow of money, the main drivers of economic growth were the construction and service sectors, whose aggregate share of GDP increased from 50,1 in 2003 up to 56,4% in 2007 and 59,3% in 2008.

On this basis, the SDP assumed a gradual transition to an economic model based on advanced growth of goods and services, as a result of which the dependence of the country on external financing should have gradually decreased, and, in particular, reduced the share of construction in GDP, which would drop up to 20,9% in 2015 and 15% in 2021, as compared with 23,3% recorded in 2007.

Table 2. GDP and foreign financial flows at current prices 2006-2010: actual and according to SDP forecast, in USD million

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---------------------------------------|--------|--------|---------|---------|---------|
| GDP, actual | 6384,5 | 9206,3 | 11662,0 | 8648,0 | 9371,2 |
| Foreign direct investments, net flows | 450,1 | 701,0 | 925,2 | 724,8 | 569,0 |
| Private transfers, net | 614,0 | 850,3 | 1062,4 | 733,2 | 844,2 |
| Official transfers, net | 80,0 | 94,5 | 75,2 | 80,7 | 79,8 |
| Total | 1144,0 | 1645,7 | 2062,9 | 1538,7 | 1493,0 |
| In %, as a share of GDP | | | | | |
| Foreign direct investments, net flows | 7,0 | 7,6 | 7,9 | 8,4 | 6,1 |
| Private transfers, net | 9,6 | 9,2 | 9,1 | 8,5 | 9,0 |
| Official transfers, net | 1,3 | 1,0 | 0,6 | 0,9 | 0,9 |
| Total | 17,9 | 17,9 | 17,7 | 17,8 | 15,9 |
| SDP forecast | | | | | |
| GDP | | | 12022,0 | 13651,0 | 15399,0 |
| Foreign direct investments, net flows | | | 778,1 | 863,6 | 958,6 |
| Private transfers, net | | | 1148,5 | 1470,1 | 1835,7 |
| Official transfers, net | | | 114,4 | 116,6 | 80,6 |
| Total | | | 2041,0 | 2450,3 | 2874,9 |
| In %, as a share of GDP | | | | | |
| Foreign direct investments, net flows | | | 6,5 | 6,3 | 6,2 |
| Private transfers, net | | | 9,6 | 10,8 | 11,9 |
| Official transfers, net | | | 1,0 | 0,9 | 0,5 |
| Total | | | 17,0 | 17,9 | 18,7 |

Source: NSS, SDP forecasts

On this basis, it is clear that the SDP's macroeconomic forecast for GDP has to be revised to reflect the new post-crisis reality.

These forecasts may not simply replace the SDP forecast with a corresponding change¹ of base year, based on the following main reasons:

- (1) The global economic crisis resulted in a substantial change in the structure of the economy (see Table 3), as a consequence of which it may now be considered more stable compared to the pre-crisis structure;
- (2) The drastic decline in the volume of foreign financing received by the country (by around 25%) in 2009-2010 prejudice the continuation of rapid economic growth in the medium-term based on the pre-crisis economic development model, and point to the need for incentives for exports and diversification, as well as encouraging of high quality job openings and high levels of productivity;
- (3) New risks to economic development, not anticipated when the SDP was prepared, have emerged, particularly the drastic increase of prices for food products in 2010- 2011², which,

¹ For instance, take the year 2010 as a base year and generate forecasts (rates of growth and changes) for 2015 or even for a later time for the year 2011.

² According to the WB, in January 2011 the prices for food products exceeded the highest level recorded in 2008, and on average, totalled 250% of the 2005 level. Such "behavior" of the prices for food products is driven by the aggregate effect of a number of factors, particularly by the increase of demand of developing world (China, India),

in the opinion of some experts, may prove protracted. In the case of Armenia, this creates additional tension both in terms of the trade balance and the overall balance of payments, since Armenia is a net importer of food products, as well as in terms of preventing the increase of the level of poverty through budgetary expenditures and for reaching strategic objectives of poverty reduction;

- (4) Global warming is also such a factor, which may increase the unpredictability of the climate, and may also result in reduced revenues of those involved in agricultural activities (particularly through a worsening of conditions for agricultural activities) and increased government expenditures (expenditures for compensation against changes of conditions and prevention of increase of rural poverty).

Based on these factors it will be crucial to update the SDP in order to reflect the new facts and risks, as well as work out a corresponding policy to take them into account and reduce or eliminate the possible negative effects.

1.1.2. Developments in the Main Sectors

The main result of the crisis and of the developments of the post-crisis period, which lasted for around 18 months, is the substantial change of the structure of branches of the economy, particularly the drastic reduction in the share of construction in GDP from 24.7%, recorded in pre-crisis period, down to 16.9% in 2010.

It should be noted that as a result of the crisis, the construction industry ceased to be the main driver of economic development as had been the case in 2003-2008. On the contrary, the drastic decline of construction, which was first of all caused by the fall in foreign investments as well as in the supply and demand for property, became the main reason for the 14.1% economic decline in 2009, thus bearing the responsibility for 73.9% of the economic decline in 2009.

As may be seen in Tables 3, 4 and 5, in 2009 a decline was recorded in all the macro branches of economy, as a result of which the main components of the economy's potential tax base also decreased, and indirect taxes fell by 20.5%:

It should be noted that the field of services was the one that was the least affected by the economic crisis, with only a 1.1% decrease in 2009, thus maintaining the previous status as the main driver of economic growth.

As has already been mentioned above, growth during the recovery might have been higher, around 4.8%, without the 14.2% decline in agricultural products.

advanced growth of the volume of production of bio-fuel, conditioned by the increase of prices for fuel, as well as by substantial increase of riskiness of agricultural production, caused by climatic changes, recorded in recent years (see "Rising Food and Energy Prices in Eastern Europe and Central Asia", World Bank, 2011)

Table 3. Development of GDP by branch, 2008-2010, actual and according to the SDP

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---------------|---------------|---------------|---------------|---------------|
| GDP, AMD million, at 2006 prices, SDP forecast | 2656,2 | 3021,4 | 3335,7 | 3643,6 | 3954,0 |
| <i>including</i> | | | | | |
| industry | 456,9 | 471,1 | 485,3 | 514,4 | 556,6 |
| agriculture and forestry | 497,1 | 547,8 | 569,7 | 594,8 | 619,4 |
| construction | 628,6 | 745,5 | 867,0 | 971,0 | 1063,3 |
| services | 848,1 | 961,6 | 1048,1 | 1138,3 | 1245,3 |
| net taxes | 225,4 | 295,4 | 365,6 | 425,1 | 469,5 |
| <i>% of total</i> | | | | | |
| industry | 17,2 | 15,6 | 14,5 | 14,1 | 14,1 |
| agriculture and forestry | 18,7 | 18,1 | 17,1 | 16,3 | 15,7 |
| construction | 23,7 | 24,7 | 26,0 | 26,6 | 26,9 |
| services | 31,9 | 31,8 | 31,4 | 31,2 | 31,5 |
| net taxes | 8,5 | 9,8 | 11,0 | 11,7 | 11,9 |
| | 2006 | 2007 | 2008 | 2009 | 2010 |
| GDP, AMD million, at 2006 prices, SDP forecast | 2656,2 | 3021,4 | 3229,9 | 2772,8 | 2831,0 |
| <i>including</i> | | | | | |
| industry | 456,9 | 471,1 | 482,4 | 445,8 | 488,1 |
| agriculture and forestry | 497,1 | 547,8 | 554,9 | 554,4 | 480,1 |
| construction | 628,6 | 745,5 | 799,1 | 461,1 | 478,2 |
| services | 848,1 | 961,6 | 1048,4 | 1037,3 | 1084,5 |
| net taxes | 225,4 | 295,4 | 345,0 | 274,3 | 300,0 |
| <i>% of total</i> | | | | | |
| industry | 17,2 | 15,6 | 14,9 | 16,1 | 17,2 |
| agriculture and forestry | 18,7 | 18,1 | 17,2 | 20,0 | 17,0 |
| construction | 23,7 | 24,7 | 24,7 | 16,6 | 16,9 |
| services | 31,9 | 31,8 | 32,5 | 37,4 | 38,3 |
| net taxes | 8,5 | 9,8 | 10,7 | 9,9 | 10,6 |

Source: NSS data, SDP forecasts

As a result, medium-term growth prospects will probably be lower than expected in the SDP, given the substantially changed structure of the economy, as well as the lower rate of future growth of developed countries and the Russian Federation³ compared with the pre-crisis forecasts⁴.

The results of Q1 of 2011 may also serve as evidence of this (a 0.3% increase of the indicator of economic activity, against Q1 of 2010)⁵:

³ The main source of external financing of the RoA economy (not-official transfers and foreign direct investments).

⁴ See, for instance, IMF - World Economic Outlook April 2011.

⁵ The indicator is calculated starting from 2011 and is aimed at replacing the computing of monthly indicators of GDP and characterizes the aggregate figure for the sectors of the economy for the given month, for the previous month and for the same month of the previous year.

Table 4. Sectoral dynamics of GDP in 2008-2010, actual and according to the SDP

| | 2007 | 2008 | 2009 | 2010 |
|---------------------------|------|------|-------|-------|
| GDP | 13,7 | 6,9 | -14,2 | 2,1 |
| including | | | | |
| industry | 3,1 | 2,4 | -7,6 | 9,5 |
| agriculture and forestry | 10,2 | 1,3 | -0,1 | -13,4 |
| construction | 18,6 | 7,2 | -42,3 | 3,7 |
| services | 13,4 | 9,0 | -1,1 | 4,6 |
| net taxes | 31,1 | 16,8 | -20,5 | 9,4 |
| SDP forecast | | | | |
| GDP against previous year | | 10,4 | 9,2 | 8,5 |
| including | | | | |
| industry | | | | |
| agriculture and forestry | | 3,1 | 3,0 | 6,0 |
| construction | | 10,2 | 4,0 | 4,4 |
| services | | 18,6 | 16,3 | 12,0 |
| net taxes | | 13,4 | 9,0 | 8,6 |
| industry | | 31,1 | 23,8 | 16,3 |

Source: NSS data, SDP forecasts

The review of 2008-2010 macrosectoral dynamics therefore also leads to the conclusion that it is necessary to revise the SDP, with particular attention paid to the tradeables sector, specifically higher value added and productivity, as well as to the establishment of sectors of products and services with more competitive value, and to promoting an acceleration of growth in these sectors, while seeking to increase the external competitiveness of the economy, which should become the main priority of sector policy.

Table 5. The input of macro branches into dynamics of GDP in 2008-2010, actual and according to SDP (%)

| | 2007 | 2008 | 2009 | 2010 |
|--------------------------|--------------|--------------|---------------|--------------|
| GDP total | 100,0 | 100,0 | -100,0 | 100,0 |
| including | | | | |
| industry | 3,9 | 5,4 | -8,0 | 72,7 |
| agriculture and forestry | 13,9 | 3,4 | -0,1 | -127,7 |
| construction | 32,0 | 25,7 | -73,9 | 29,4 |
| services | 31,1 | 41,7 | -2,5 | 81,4 |
| net taxes | 19,2 | 23,8 | -15,5 | 44,2 |
| SDP forecats | | | | |
| GDP total | | 100,0 | 100,0 | 100,0 |
| including | | | | |
| industry | | 4,5 | 9,5 | 13,6 |
| agriculture and forestry | | 7,0 | 8,2 | 7,9 |
| construction | | 38,7 | 33,8 | 29,7 |
| services | | 27,5 | 29,3 | 34,4 |
| net taxes | | 22,3 | 19,3 | 14,3 |

Source: NSS data, SDP forecast

1.1.3. External Commerce and Balance of Payment

The relative fall (as a proportion of GDP) of the volume of exporting of goods as well as services continued in the reporting period in the environment of a relative and absolute expansion of the volume of imports. In the crisis year of 2009, the absolute volumes of both exports and imports substantially dropped, yet recovered in the post crisis 2010.

Table 6. Exports, imports and current account, 2006-2010, actual and according to the SDP, in USD million

| Actual | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| GDP | 6384,5 | 9206,3 | 11662,0 | 8648,0 | 9371,2 |
| Exports, goods | 1025,4 | 1196,6 | 1112,0 | 748,9 | 1113,2 |
| Imports, goods | -1921,3 | -2796,9 | -3775,5 | -2830,1 | -3255,0 |
| Balance of goods | -895,9 | -1600,3 | -2663,5 | -2081,3 | -2141,8 |
| Exports, goods and services | 1510,2 | 1776,7 | 1757,0 | 1338,4 | 1862,7 |
| Imports, goods and services | -2536,4 | -3589,5 | -4747,6 | -3687,8 | -4245,5 |
| Balance of goods and services | -1026,2 | -1812,8 | -2990,6 | -2349,4 | -2382,8 |
| Current account | -117,1 | -589,3 | -1381,8 | -1369,5 | -1300,1 |
| % of GDP | | | | | |
| Exports, goods | 16,1 | 13,0 | 9,5 | 8,7 | 11,9 |
| Importing, goods | -30,1 | -30,4 | -32,4 | -32,7 | -34,7 |
| Balance of goods | -14,0 | -17,4 | -22,8 | -24,1 | -22,9 |
| Exports, goods and services | 23,7 | 19,3 | 15,1 | 15,5 | 19,9 |
| Imports, goods and services | -39,7 | -39,0 | -40,7 | -42,6 | -45,3 |
| Balance of goods and services | -16,1 | -19,7 | -25,6 | -27,2 | -25,4 |
| Current account | -1,8 | -6,4 | -11,8 | -15,8 | -13,9 |
| SDP forecasts | 2006 | 2007 | 2008 | 2009 | 2010 |
| GDP | | | 12021,9 | 13651,1 | 15399,2 |
| Exports, goods | | | 1232,5 | 1355,8 | 1627,0 |
| Importing, goods | | | -3636,0 | -4363,3 | -5148,6 |
| Balance of goods | | | -2403,5 | -3007,5 | -3521,7 |
| Exports, goods and services | | | 1913,7 | 2156,1 | 2587,3 |
| Imports, goods and services | | | -4619,3 | -5523,6 | -6517,8 |
| Balance of goods and services | | | -2705,7 | -3367,4 | -3930,4 |
| Current account | | | -1076,7 | -1304,9 | -1428,9 |
| % of GDP | | | | | |
| Exports, goods | | | 10,3 | 9,9 | 10,6 |
| Importing, goods | | | -30,2 | -32,0 | -33,4 |
| Balance of goods | | | -20,0 | -22,0 | -22,9 |
| Exports, goods and services | | | 15,9 | 15,8 | 16,8 |
| Imports, goods and services | | | -38,4 | -40,5 | -42,3 |
| Balance of goods and services | | | -22,5 | -24,7 | -25,5 |
| Current account | | | -9,0 | -9,6 | -9,3 |

Source: NSS data, SDP forecast

Compared with SDP forecasts of GDP and external financing, the relative volume of exports and imports generally correspond to SDP forecasts, although taking into account the substantial difference of actual and forecasted values for GDP and foreign financing, the relative values of the current account are substantially higher than SDP forecasts (13,9% and 9,3% correspondingly).

Table 7. The actual structure of exports, per main groups of commodities in 2006-2010, in USD million

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|--------|--------|--------|-------|--------|
| Agricultural product | 26.8 | 25.0 | 31.7 | 35.2 | 39.3 |
| Prepared food | 95.1 | 144.5 | 167.9 | 99.6 | 131.2 |
| Mineral products | 136.6 | 173.5 | 172.5 | 145.6 | 276.5 |
| Construction material | 9.4 | 21.2 | 14.3 | 13.5 | 16.2 |
| Chemical products, plastics, rubber, gum | 32.6 | 20.3 | 35.5 | 16.6 | 24.7 |
| Precious and semi-precious stones and metals | 301.0 | 208.7 | 173.1 | 105.1 | 134.1 |
| Non-precious metals and items made of them | 280.9 | 390.2 | 346.8 | 231.2 | 332.4 |
| Cars, equipments and machinery | 20.8 | 39.6 | 40.3 | 21.0 | 30.1 |
| Other* | 122.4 | 173.6 | 129.9 | 81.1 | 128.6 |
| Total** | 1025.5 | 1196.6 | 1112.0 | 748.9 | 1113.2 |
| % of total exports | | | | | |
| Agricultural product | 2.6 | 2.1 | 2.9 | 4.7 | 3.5 |
| Prepared food | 9.3 | 12.1 | 15.1 | 13.3 | 11.8 |
| Mineral products | 13.3 | 14.5 | 15.5 | 19.4 | 24.8 |
| Construction material | 0.9 | 1.8 | 1.3 | 1.8 | 1.5 |
| Chemical products, plastics, rubber, gum | 3.2 | 1.7 | 3.2 | 2.2 | 2.2 |
| Precious and semi-precious stones and metals | 29.3 | 17.4 | 15.6 | 14.0 | 12.0 |
| Non-precious metals and items made of them | 27.4 | 32.6 | 31.2 | 30.9 | 29.9 |
| Cars, equipments and machinery | 2.0 | 3.3 | 3.6 | 2.8 | 2.7 |
| Other* | 11.9 | 14.5 | 11.7 | 10.8 | 11.6 |

* Includes also the difference between the indicators of commodity exports according to the balance of payments and trade statistics.

** Total, according to the balance of payments statistics.

Source: Calculated based on NSS data.

As may be seen from Table 7, around 88% of exports consist of 10 macro product groups (3 of which, live animals and products with animal origin, products of vegetable origin and oil and grease are joined under the category “agricultural product”). As for exports from other branches, unfavorable price dynamics (particularly the high growth of wages and appreciation of the AMD), as well as restrictions on unworked diamond buying, substantially decreased the level of international competitiveness in the sectors of processing stones and jewellery, which had grown in the late 1990s and early 2000s. The evidence of this is the continuous fall in export volumes of these sectors in 2006-2010.

Table 8. Actual structure of import, by main groups of commodities in 2006-2010, in USD million

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|--------|--------|--------|--------|--------|
| Agricultural product | 179,7 | 282,0 | 411,8 | 347,3 | 366,4 |
| Readymade food | 163,8 | 256,4 | 348,7 | 264,7 | 309,6 |
| Mineral-rough procutsion | 366,0 | 516,4 | 664,5 | 540,6 | 679,2 |
| Consruction | 49,3 | 73,9 | 114,6 | 74,5 | 82,7 |
| Chemical products, plastics, rubber, gum | 229,0 | 264,7 | 456,9 | 382,9 | 422,6 |
| Precious and semi-precious stones and metals | 312,5 | 296,7 | 304,6 | 107,3 | 158,9 |
| Not precious metals and items, made of them | 163,7 | 341,3 | 418,6 | 375,6 | 368,5 |
| Cars, equipments and machinery | 304,4 | 427,3 | 645,0 | 628,7 | 655,0 |
| Other* | 152,9 | 338,2 | 410,7 | 108,6 | 212,2 |
| Total (FOB)** | 1921,3 | 2796,9 | 3775,6 | 2830,1 | 3255,0 |
| % of total imports | | | | | |
| Agricultural product | 9,4 | 10,1 | 10,9 | 12,3 | 11,3 |

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| | | | | | |
|--|------|------|------|------|------|
| Readymade food | 8,5 | 9,2 | 9,2 | 9,4 | 9,5 |
| Mineral-rough production | 19,1 | 18,6 | 17,6 | 19,1 | 20,9 |
| Construction | 2,6 | 2,6 | 3,0 | 2,6 | 2,5 |
| Chemical products, plastics, rubber, gum | 11,9 | 9,5 | 12,1 | 13,5 | 13,0 |
| Precious and semi-precious stones and metals | 16,3 | 10,6 | 8,1 | 3,8 | 4,9 |
| Not precious metals and items, made of them | 8,5 | 12,2 | 11,1 | 13,3 | 11,3 |
| Cars, equipments and machinery | 15,8 | 15,3 | 17,1 | 22,2 | 20,1 |
| Other* | 8,0 | 12,1 | 10,9 | 3,8 | 6,5 |

* Includes also the difference between the indicators of commodity import according to the balance of payments and trade statistics

** Total, according to the balance of payments statistics.

Source: Calculated based on NSS data.

To compare, Table 8 presents the structure of imports for the same commodity groups. It may be seen from the tables that for all the groups, including the main available export commodity groups, Armenia is a net importer.

Table 9. The share of exporting in the gross production of corresponding branches in 2006-2010 (%)

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|------|------|------|------|------|
| Agricultural product | 2,0 | 1,5 | 1,5 | 2,3 | 2,3 |
| Readymade food | 19,4 | 22,3 | 20,4 | 15,5 | 17,6 |
| Mineral-unrefined | 50,1 | 51,8 | 50,1 | 57,0 | 71,0 |
| Construction material | 12,5 | 18,0 | 9,0 | 12,6 | 12,1 |
| Non precious metals and items made from them | 97,9 | 97,5 | 85,7 | 79,7 | 87,8 |

Sources: Calculated based on NSS data.

Table 9 shows that from the short to medium-term perspective, the sectors that have the most realistic prospects for a significant increase in exports are agricultural goods and the production of prepared food, taking into account both the low share of exporting in gross production as well as beneficial dynamics of their prices for exporting.

In the medium term perspective, given a suitably favorable policy environment, other sectors may also have export potential, including production of construction materials and engineering.

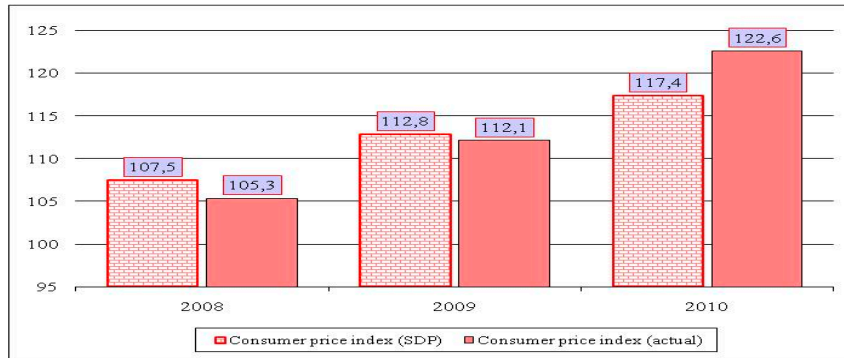
It therefore follows that it is necessary to revise the SDP with regard to external economic relations, especially forecasts of exports to ensure progress and to elaborate and introduce an appropriate policy.

1.1.4. Prices and Exchange Rate

As can be seen from Figure 1, SDP forecasts for consumer price indices in 2008-2010 mainly correspond to actual developments, yet the actual values for 2010 were higher mainly due to an increase of prices for food. As has already been mentioned above, in the medium-term perspective the increase of prices for food and fuel, as well as metals, will continue further, which means that the SDP forecasts for indices for the years after 2010 (per annum 3% increase) will need to be revised, taking into account the trend of growth of international prices.

Given that inflation exceeded the SDP forecast, and that the increase of state revenues was lower than the SDP forecast, there will be a need in the medium term to revise the targets which formed the basis of a number of government expenditure programs, in particular the SDP forecasted target for pension insurance (minimum consumer basket) for 2012.

Figure 1. Dynamics of consumer price indices in 2008-2010, actual and SDP forecasts against December 2007

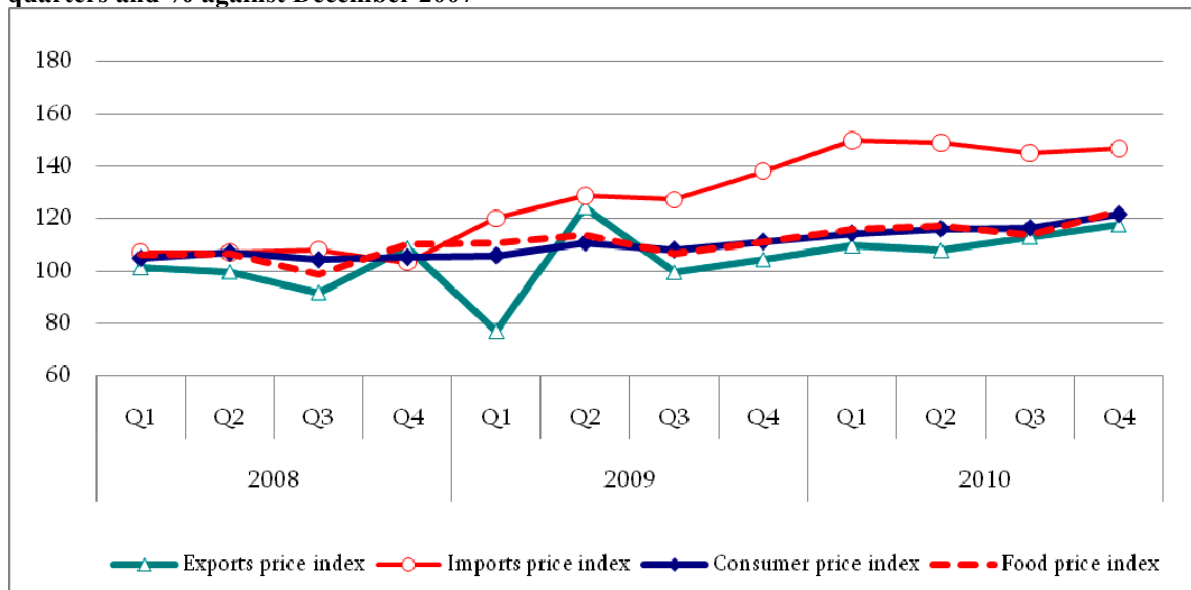


Source: NSS data, SDP forecasts

As for SDP forecasts of the AMD/USD exchange rate, in the light of general difficulty of forecasting of exchange rates, an absolute value of AMD 305,4 = USD 1 for Q1 of 2008 was used.

Further external and internal developments, particularly the expansionary monetary policy applied by the USA before the crisis and especially in the post crisis period resulted in intermittent changes from March 1, 2009 and further relative stabilization.

Figure 2. Actual dynamics of consumer, food, exporting and importing price indices in 2008-2010, in quarters and % against December 2007



Source NSS data

As may be seen from Figure 2, the prices of imported goods have increased rapidly by 46.8% within 3 years, thus creating large inflationary pressures, driven by external factors, i.e. an increase of international prices for those goods for which Armenia is just an importer. This increase was notably higher than the increase of exporting price indices, which also means a relative worsening of the exporting price index, and also of conditions of external commerce, which took place mainly during 2010.

The above-mentioned external pressure of inflation was neutralized mainly by a tough monetary policy.

Table 10. Actual dynamics of exchange rate, official reserves of foreign currency and monetary base in 2008-2010

| | 2008 | | | |
|---|--------|--------|--------|--------|
| | I | II | III | IV |
| Exchange rate for AMD/1USD | 308,1 | 307,1 | 302,3 | 306,4 |
| Official reserves of foreign currency, mln. USD | 1602,3 | 1578,2 | 1585,3 | 1405 |
| Monetary base, billion AMD | 380,8 | 412,7 | 438,3 | 449,7 |
| | 2009 | | | |
| | I | II | III | IV |
| Exchange rate, AMD /1USD | 325.6 | 370.5 | 372.6 | 384.4 |
| Official reserves of foreign currency, USD mln. | 1222.6 | 1962.4 | 2025.9 | 2003.4 |
| Monetary base, billion AMD | 391.7 | 407.9 | 461.7 | 511.7 |
| | 2010 | | | |
| | I | II | III | IV |
| Exchange rate, AMD/USD 1 | 384.1 | 384.3 | 365.5 | 360.7 |
| Official reserves of foreign currency, USD mln. | 1911.3 | 1786.9 | 1852.6 | 1865.8 |
| Monetary base, billion AMD | 465.0 | 434.5 | 438.4 | 507.6 |

Source: NSS data

In the revised SDP, an application of a more balanced approach should be sought to balance the encouragement of exports and economic development with anti-inflation policies, taking into account expected external inflation pressures and the necessity of minimizing of the level of dependence on the external world.

1.1.5. Fiscal Sector

In 2009-2010 the RoA fiscal policy was aimed at mitigating and partially neutralizing the negative effects of the global financial-economic crisis on the RoA economy, as well as assuring social protection of the population. The activities of expanding fiscal policy and enhancing gross demand have supported the system of setting-up enterprises and the mortgage loan market and implementing large-scale programs for improving of infrastructures, etc. In the environment of decreasing revenues, state budget expenditures increased, which resulted in a budget deficit and consequently also an increase of public debt.

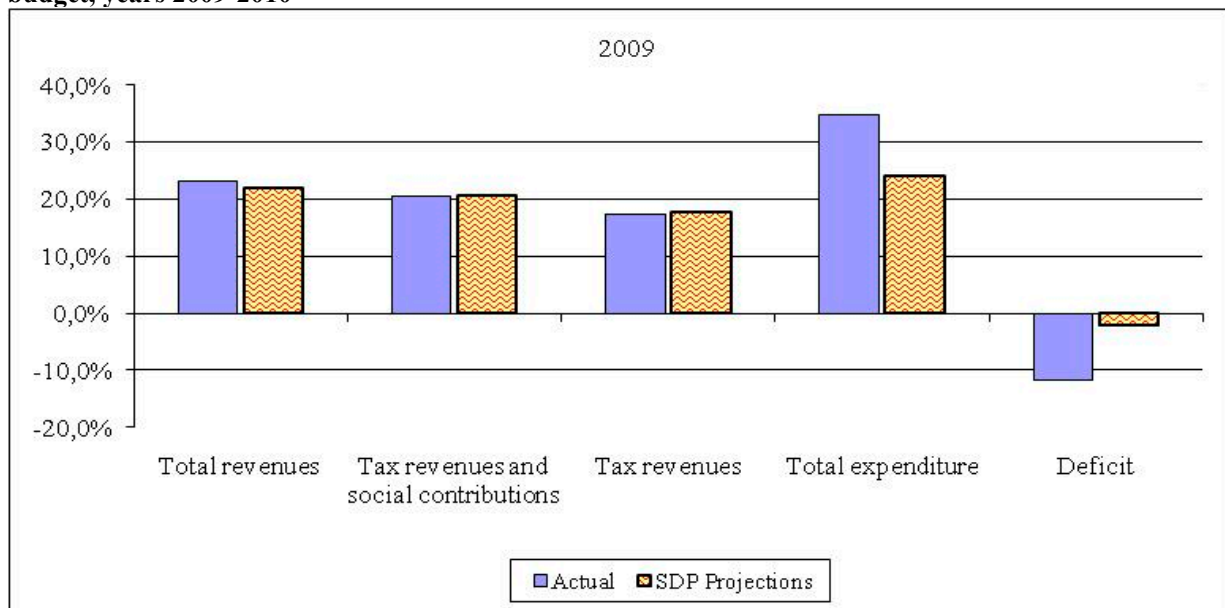
General indicators of RoA consolidated budget are presented in Table 11 and Figure 3.

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Table 11. Revenues, expenditures and balance of RoA consolidated budget in 2009-2010 (% of GDP)⁶

| Year 2009 | | | |
|--------------------------|---------|--------|------------|
| | Actual | SDP | Difference |
| Revenues | 23.19% | 22.10% | 1.09% |
| Tax and social insurance | 20.46% | 20.81% | -0.35% |
| Tax | 17.19% | 17.77% | -0.58% |
| Expenditures | 34.84% | 24.05% | 10.79% |
| Social | 14.34% | 11.56% | 2.78% |
| Economic | 8.16% | 2.58% | 5.57% |
| Deficit | -11.65% | -1.95% | -9.71% |
| Year 2010 | | | |
| | Actual | SDP | Difference |
| Revenues | 23.47% | 22.14% | 1.33% |
| Tax and social insurance | 20.51% | 21.20% | -0.69% |
| Tax | 17.51% | 18.06% | -0.55% |
| Expenditures | 28.98% | 24.44% | 4.54% |
| Social | 12.66% | 12.11% | 0.55% |
| Economic | 3.69% | 2.00% | 1.69% |
| Deficit | -5.51% | -2.30% | -3.21% |

Figure 3. Comparison of Actual and SDP forecasted revenues, expenditures and deficit of consolidated budget, years 2009-2010



⁶ In order to compare, all the indicators are presented by the former classification.

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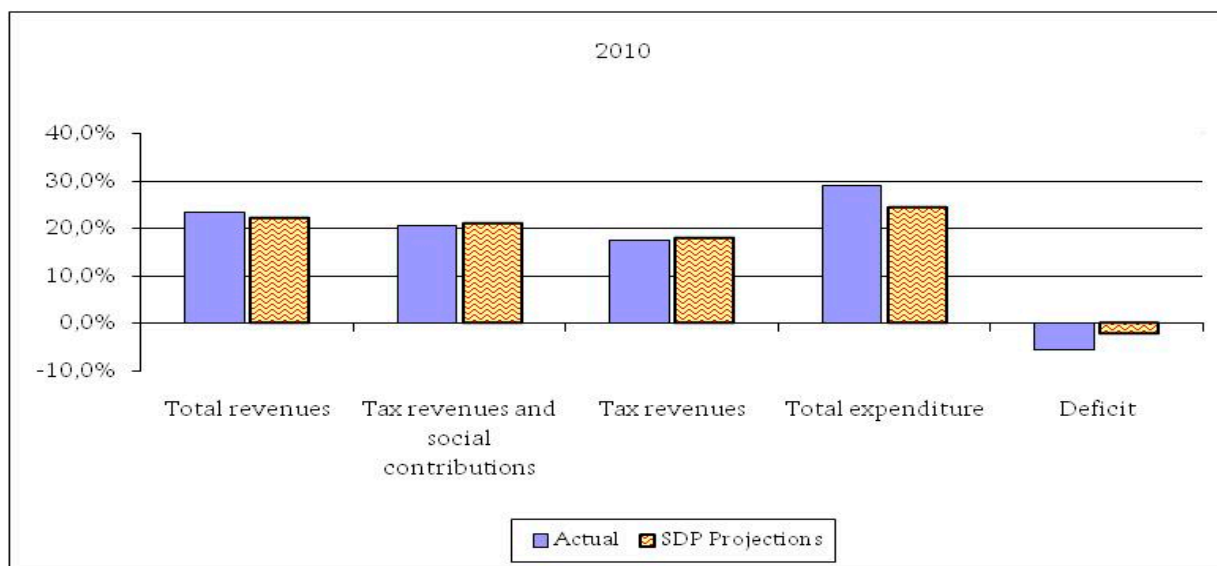


Table 11 shows that an increase of revenues in percent of GDP against SDP forecast was recorded in both 2009 and 2010, yet this occurred in the context of a reduction in the level of tax revenues.

The increase of 2009-2010 expenditures in percent of GDP was substantially higher than projected in the SDP, especially in 2009, which has resulted in substantial increase of the deficit, in comparison with the SDP. Moreover, the relative increase in the level of 2009 expenditures compared to the SDP was mainly caused by the increase of expenditures in social and economic sectors, and around 74% of the change of the expenditures to GDP ratio was conditioned by this factor.

The above-mentioned facts clearly illustrate also the fact that RoA tax revenues are mostly sensitive to import volumes. The drastic decrease of gross demand in 2009, which was mainly due to the reduction in private transfers to the republic as a result of the global financial-economic crisis, was the main reason for the falling tax revenues. This means that despite the considerable level of tariff liberalization for external commerce, efforts should be made in the future to develop and introduce a tax system which would enhance diversification and international cooperation, and support an economic system for internal productivity and enhancing exports.

Together with the increase of state budget expenditures starting from 2009, the share of capital expenditures and net credit in the total expenditures of the budget increased. As was mentioned, this had a clear anti-crisis nature, the field of construction received additional support (it was possible to maintain to a certain extent the level of employment in this field), since it was the most affected as a result of the financial-economic crisis.

In 2009 the state budget expenditures for the social sector exceeded the corresponding indicator forecast under the SDP, by around 20%, which is also explained by anti-crisis actions taken by the government for the social protection of the population (see Table 12):

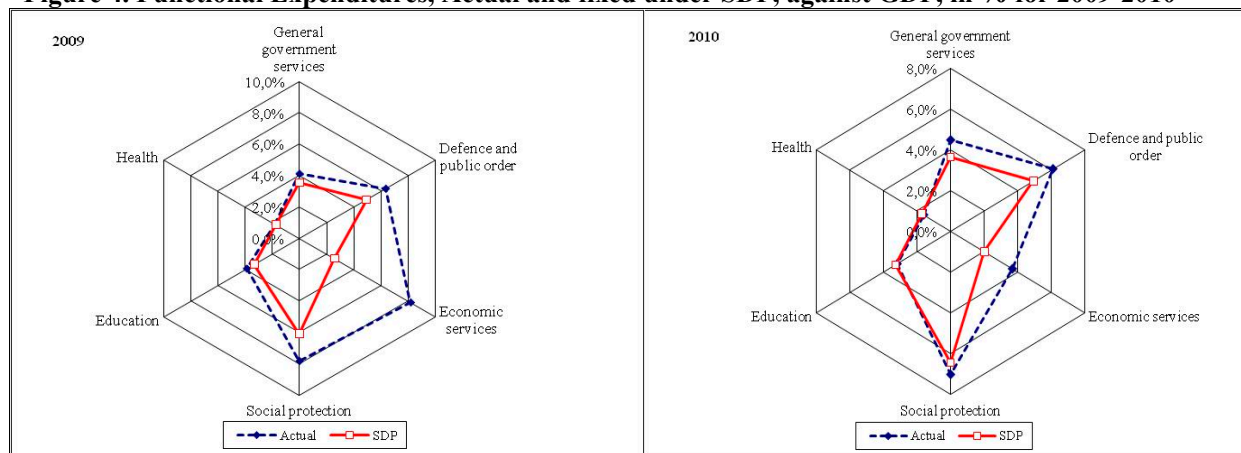
Table 12. Expenditures of RoA consolidated budget according to functional classification, 2009-2010 (as % of GDP)

| | Year 2009 | | | Participation in the increase of expenditures, % |
|---------------------------|-----------|-------|-------------|--|
| | Actual | SDP | Difference. | |
| Total | 34.8% | 24.1% | 10.8% | |
| Of general nature | 4.1% | 3.6% | 0.6% | 5.2% |
| Official and public order | 6.3% | 4.9% | 1.4% | 13.1% |
| Economic | 8.2% | 2.6% | 5.6% | 51.6% |
| Social insurance | 7.8% | 6.1% | 1.7% | 16.0% |
| Education | 3.9% | 3.3% | 0.5% | 5.0% |
| Healthcare | 1.8% | 1.7% | 0.1% | 0.6% |
| Other | 2.8% | 1.9% | 0.9% | 8.6% |

| | Year 2010 | | | Participation in the increase of expenditures, % |
|---------------------------|-----------|-------|------------|--|
| | Actual | SDP | Difference | |
| Total | 29.0% | 24.4% | 4.5% | |
| Of general nature | 4.5% | 3.6% | 0.8% | 18.2% |
| Official and public order | 6.1% | 4.9% | 1.2% | 26.1% |
| Economic | 3.7% | 2.0% | 1.7% | 37.2% |
| Social insurance | 7.0% | 6.4% | 0.6% | 12.9% |
| Education | 3.2% | 3.3% | -0.1% | -2.7% |
| Healthcare | 1.6% | 1.7% | -0.1% | -2.5% |
| Other | 2.9% | 2.4% | 0.5% | 10.9% |

Generally speaking, as a result of the financial-economic crisis, the scope of the SDP for 2009-2010 underwent substantial changes. This was mainly caused by anti-crisis activities, as a result of which government expenditures substantially increased (Figure 4).

Figure 4. Functional Expenditures, Actual and fixed under SDP, against GDP, in % for 2009-2010



It should be noted that as a result of the crisis, the government had to temporarily rescind a number of expenditure priorities set under the SDP, such as the healthcare and education sectors, where government expenditures in their absolute level are substantially lower than the targets set under SDP, and have even declined in real terms in 2010 against 2009.

1.1.6. Public Debt

The most significant effect of the financial-economic crisis was the effect of the state budget deficit on the financial system, and consequently also the substantial increase in public debt. As a result of

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expansionary fiscal policy of the GoA, the increase of the state budget deficit as well as the increase of CBA reserves resulted in an increase of public debt, which, naturally, substantially deviates from the corresponding SDP forecasts (see Table 13).

Table 13. RoA public debt in 2009-2011 (% of GDP)

| | 2009 | | 2010 | | 2011 | |
|------------------------|----------|--------|----------|--------|----------|--------|
| | SDP plan | actual | SDP plan | actual | SDP plan | actual |
| Public debt, including | 15.9 | 40.4 | 16.4 | 39.4 | 17.0 | 41.3 |
| External Debt | 13.2 | 35.7 | 13.2 | 34.2 | 13.3 | 35.9 |
| Domestic Debt | 2.7 | 4.8 | 3.2 | 5.1 | 3.7 | 5.4 |

As may be seen from the table, the actual indicators for public debt in 2009-2011 exceed the planned SDP indicators by around 2.5 times; moreover, the rate of growth of external debt exceeds the rate of growth of domestic debt, as a result of which the share of domestic debt in public debt has fallen. The possibility of such a large deviation (or risks of implementation of the SDP public debt scenario) was discussed in the SDP in terms of a substantial increase in the consolidated budget as a result of breaching the macroeconomic and fiscal scenario, but without indicating the negative effects of the financial-economic crisis, since even in 2007 or 2008 it was difficult to predict the magnitude of the effect⁷.

In order to withstand the crisis, the GoA had to attract large loan proceeds from international financial organizations and states in a rather short period of time. And given the fact that concessional public debt was extremely limited, this resulted in drop of the level of concessionality of RoA public debt. The evidence of this is the pre-crisis forecast of the present value and post crisis estimates and their comparison with corresponding indicators of public debt (see Table 14).

Table 14. Present value of public debt, 2009-2013 (% of GDP)

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|--|------|------|------|------|------|
| Pre-crisis forecast ⁸ | 6.6 | 6.3 | 6.1 | 6.0 | 6.0 |
| Post crisis actual and corrected forecast ⁹ | 27.2 | 26.9 | 28.7 | 28.3 | 27.0 |

As may be seen from the above-mentioned tables, the precrisis forecasts (which are based on 2005-2007 actual indicators) of the value of public debt to GDP were around 2 times less than the nominal value of debt (% of GDP), whereas according to post-crisis actual indicators and forecasts, corrected based on the latter, the difference is around 30%.

Despite of high rate of growth of RoA public debt, it remains manageable and in the upcoming years will not exceed the maximum threshold set under the RoA Law on Public Debt. According to the GoA Debt Management 2012- 2014 strategy paper, the maximum level of public debt will be in 2011-2012, after which it will gradually drop, totaling 38.1% of GDP in 2014.

Thus, in the past 2-3 years, Armenia remained on the list of countries with light debt burdens and only exceeded the class of countries with average burden of debt for some indicators (see Table 15):

⁷ See Sustainable Development Program, page 310.

⁸ See Joint IMF/World Bank Debt Sustainability Analysis.Armenia.2008

⁹ RoA 2012-2014 Debt Management Strategic Paper of the GoA

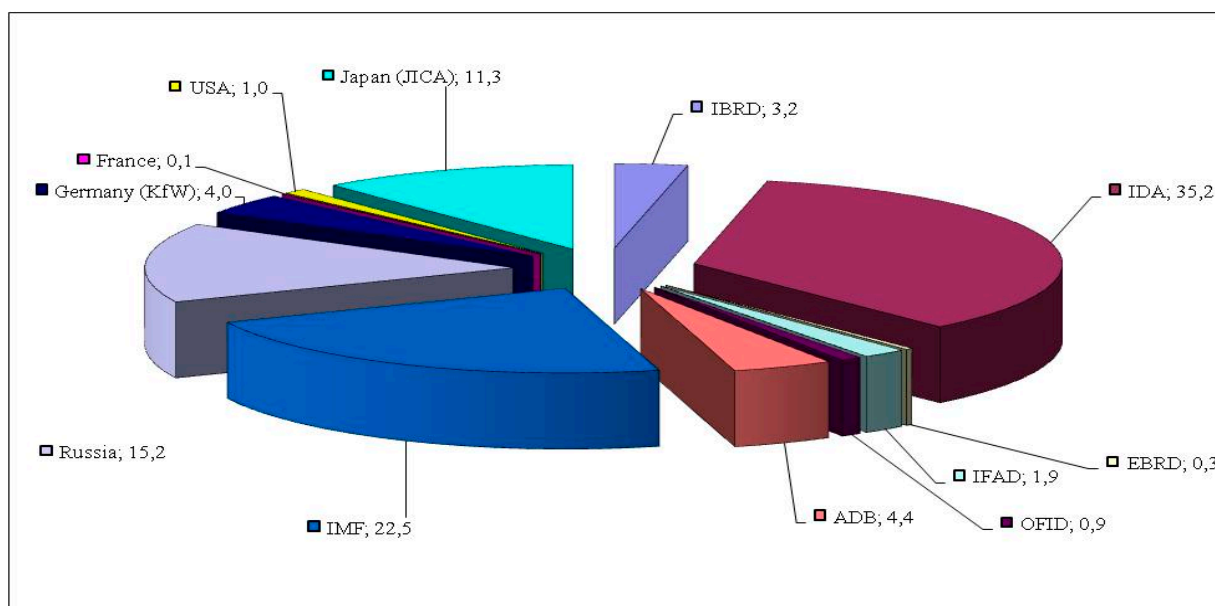
Table 15. RoA Public Debt Indicators 2007-2010 (%)

| | Public Debt PV/GDP | | | | PV of public debt /exports | | | | Interest payment of public debt /exports | | | | Public debt/ exports | | | |
|---------------------------------------|--------------------|------|------|------|----------------------------|------|------|------|--|------|------|------|----------------------|------|------|------|
| Countries with most heavy debt burden | >80 | | | | >220 | | | | >20 | | | | >275 | | | |
| Countries with average debt burden | 48 - 80 | | | | 132 - 220 | | | | 12 - 20 | | | | 165 - 275 | | | |
| Countries with light debt burden | <48 | | | | <132 | | | | <12 | | | | <165 | | | |
| Republic of Armenia | 2007 | 2008 | 2009 | 2010 | 2007 | 2008 | 2009 | 2010 | 2007 | 2008 | 2009 | 2010 | 2007 | 2008 | 2009 | 2010 |
| | 9 | 9 | 27 | 27 | 47 | 57 | 169 | 139 | 1 | 1 | 2 | 2 | 82 | 90 | 222 | 117 |

As may be seen from Table 15, as of the year 2010 for only indicator, public debt/exports, is Armenia in the group of the countries with an average burden of debt, whereas in case of the rest of indicators, it is in the group of countries with low debt burdens.

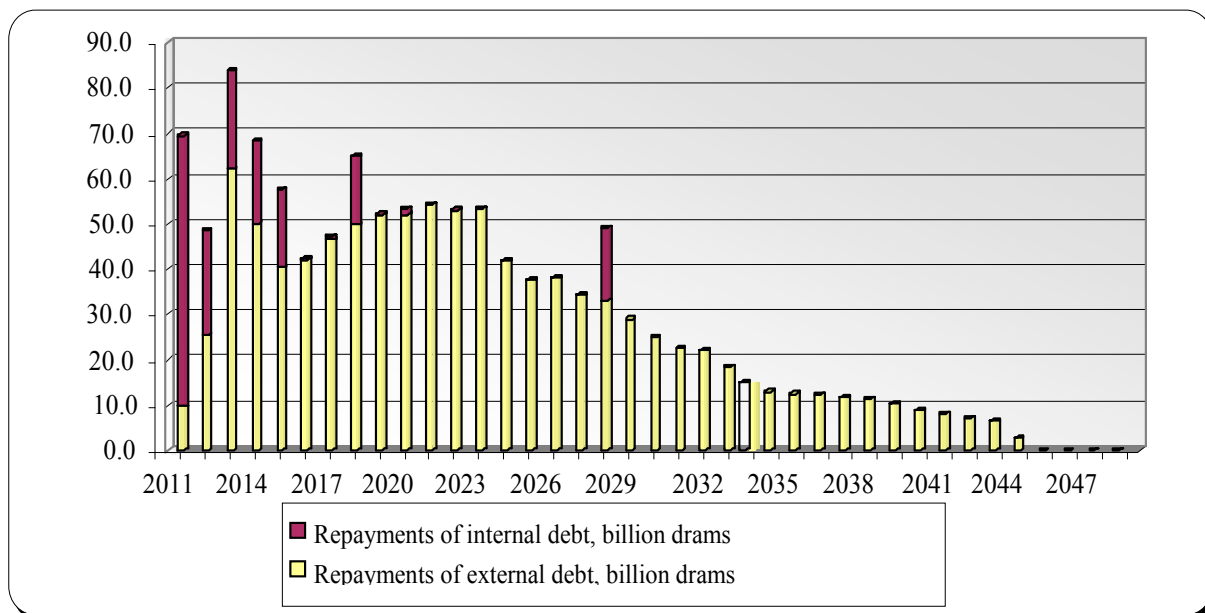
The number of external creditors presently exceeds a dozen, and in recent years the share of IMF, ADB and RF has increased (see Figure 5).

Figure 5. The structure of RoA public debt per creditors as of December 31, 2010



Source: MoF of RoA

Figure 6. Amortization Schedule for GoA debt, generated as of December 31, 2010



Source: MoF of RoA

Along with the increase of the public debt burden, the assessment of the riskiness of debt is considered important, which is one of the main outputs of analysis of the sustainability of public debt¹⁰. In this sense especially refinancing, interest rate, exchange rate and operational risk management become crucial. Moreover, the risks of refinancing, interest rate and exchange rate in case of public debt and refinancing, interest rate and operational risks in the case of domestic debt are stressed¹¹.

It may be seen from the Figure that the periodicity of repayment of domestic debt exceeds the corresponding indicator for public debt by several times, or in other words, the average repayment period for the debt of government is 3.9 years, for public debt 12.6 years, which illustrates the higher level of riskiness of domestic debt against public debt in terms of refinancing.

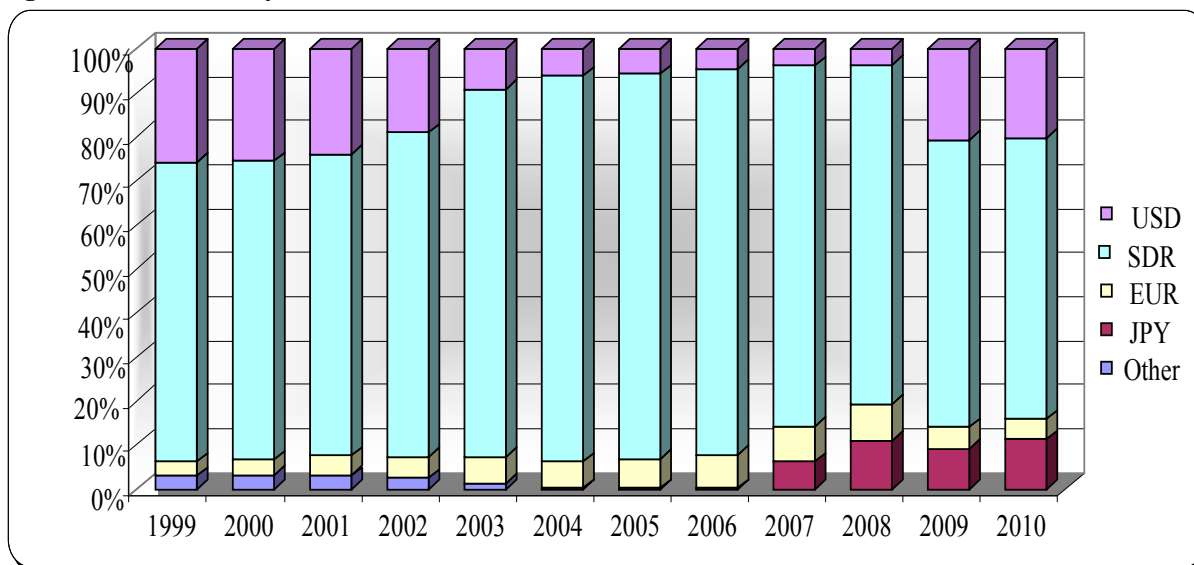
Another indicator of the risk of refinancing is the correlation of domestic debt (meaning the gross figure for repaid interest payments and principle) and of public debt of the Government. It is much higher than the value calculated for external debt (around 2.2 times).

The risk associated with the exchange rate of public debt is substantial, since the external debt, comprising the largest part of public debt, is in different currencies. The structure of currencies of RoA public debt is presented in Figure 7. Among the loans provided in different currencies, the SDR predominates (this is a basket of 4 freely-convertible currencies (USD, EUR, GBP, JPY)). Here, the rather high level of diversification of the currency composition of external debt substantially decreases the risks of exchange rate, associated with servicing of external debt.

¹⁰ The Public Debt Sustainability analysis is currently being implemented by MoF with support of WB experts.

¹¹ See Public Debt Sustainability Strategy 2012-2014

Figure 7. The Currency Structure of RoA External Debt 1999-2010.



Source: MoF of RoA

The risks associated with interest rates become more crucial because of the decreasing availability of credits on concessional terms and an increase in loans on commercial terms. These risks increase even more when commercial loans are taken with variable and not fixed interest rates. In recent years loans with variable interest rates have tended to increase.

To minimize the operational risk, it is necessary to clearly define in the debt management division the functions of the employees as well as the succession planning for employees. It is also necessary to ensure appropriate back-up of debt data to be able to ensure timely and correct implementation of debt obligations in case of force majeure.

One of the directions of reforms in the system of RoA public finances is to increase the efficiency of public debt management, which is especially important also in parallel to the expansion of the burden of debt. Some activities have been fulfilled in 2009-2011 and the following developments have been recorded:

- Debt keeping and registration DMFAS 6 software had been purchased. After installation, it would correspond with other public finance management software, enabling timely collection, processing, analyzes and use of complete set of information by the public debt management agency.
- For strengthening of the predictability and transparency of the state bonds market, an annual program of state bonds issuing and the main principles have been developed and published. They contain information on bonds maturity, issuing dates and approximate volumes of placement. Starting from 2011, 7-years maturity benchmark bonds have been issued, which will contribute to a more full development of the yield curve.
- Starting from Q4, 2010 a significant growth of public mid and long-term bonds has been observed, which was caused by the insurance sector reforms and introduction of mandatory vehicle insurance.
- GoA continues cooperation with international donor-organizations for attracting more concessional funds. In particular, per the agreement reached with the IMF, the average level of concessional of borrowing will be maintained in the area of 30% until the end of the year. In

the overall volume of attracted external loans in 2010, the effective weight of commercial loans accounted 55%, as compared with 65% in 2009.

The analysis of the experience of public debt management in 2009-2011 suggests the following key challenges and strategic directions of public loan management.

- Ensuring the transparency of public debt management and strengthening of investors' trust.
- Increasing of the effective weight of domestic borrowings in the long-term financing of state budget deficit.
- Diversification of debt sources.
- More efficient coordination of fiscal and monetary policies in the context of public debt management.
- Expansion of cooperation with multilateral and bilateral donors, seeking to attract more concessional loans.

1.2. Poverty and inequality snapshot

1.2.1. Poverty

The main objectives of the SDP are growth of the population's welfare, poverty reduction and elimination of extreme poverty¹². The SDP envisages rapid poverty reduction in the country, making it 6.8 percent in 2021. The three strategic priorities of sustainable economic growth, proactive and targeted social policy and public administration reforms are the precondition for reaching this goal. But SDP implementation coincided with country's decline in 2008Q4. This resulted in difficulty meeting the SDP short- and medium- term targets for poverty and inequality.

Before the crisis, Armenia recorded a reduction of the poverty rate every year and rapid economic growth. With the onset of the crisis, the trend reversed¹³. In 2004-2008, the overall share of the population below the poverty line reduced by 11.1 percentage points, constituting 23.5 percent in 2008 (against 34.6 percent in 2004)¹⁴. Despite the fact that the economic recession did not cause the poverty rate to grow, nevertheless it affected the projected pace of poverty reduction. In 2009, for the first time since 1999, the share of poor population had grown and constituted 28.7 percent¹⁵, falling back to the levels of 2005-2006. The same trend was recorded for extreme poverty rates.

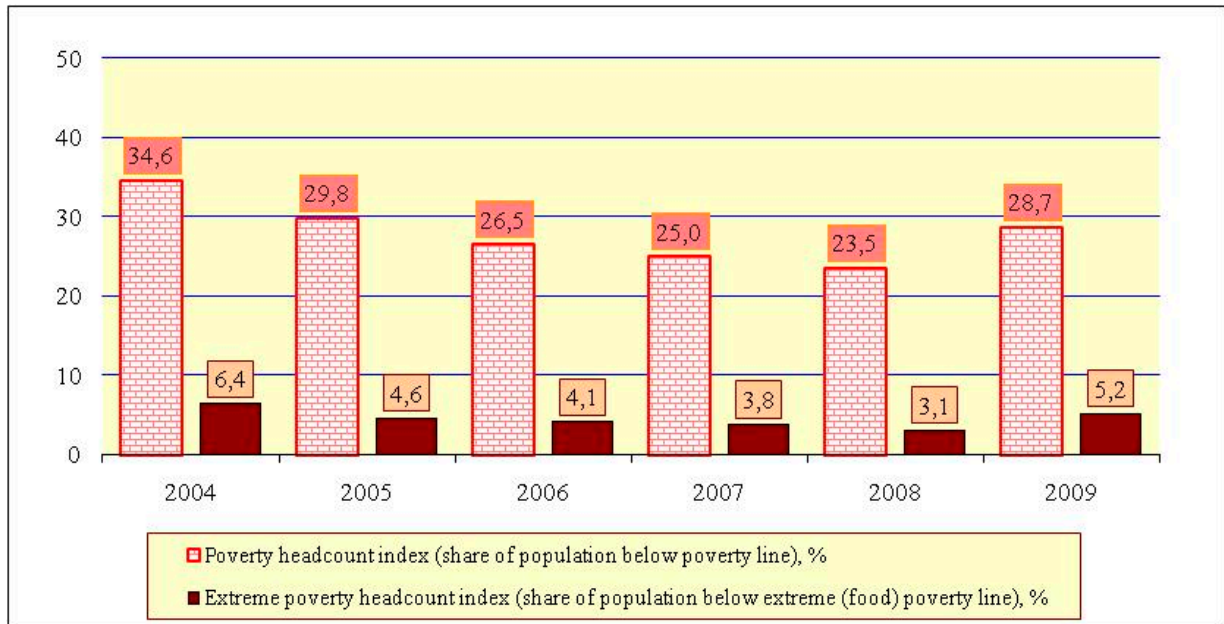
¹² Sustainable development program, p 36.

¹³ At the time this report was developed, the most recent published data on poverty in Armenia is 2009. Hence, SDP progress could only be assessed up to 2009.

¹⁴ From the results of the RA NSS "Household living conditions consolidated survey" and published in "Social snapshot and poverty" in Armenia, RA NSS, 2005-2010.

¹⁵ In order to ensure the comparability of data over time, the NSS "old" methodology that has been used since 2004 for the calculation of poverty data is applied to 2009. A new methodology has been used since 2009, wherein the share of poor population is 34.1percent.

Figure 8. The dynamics of poverty in Armenia, 2004-2009



Source: "Armenia's social snapshot and poverty, RA NSS, 2010

The developments made the SDP's mid-term and possibly long-term targets¹⁶ difficult to achieve, as these were developed based on a more favorable pre-crisis macroeconomic and fiscal outlook and the continued decline in poverty in Armenia.

Table 16. Actual poverty indicators and SDP indicators comparison

| | | Poor, of which %, | Extreme poor, % | Reduction of the poverty rate, as compared with the previous year, % |
|------|-----------------------------|----------------------|--------------------|--|
| 2004 | Actual | 34.6 | 6.4 | -- |
| 2005 | Actual | 29.8 | 4.6 | 13.9 |
| 2006 | Actual | 26.5 | 4.1 | 11.1 |
| 2007 | Actual | 25.0 | 3.8 | 5.7 |
| 2008 | Actual | 23.5 | 3.1 | 6.0 |
| | SDP targets * | 19.7 | 2.9 | |
| | Actual/SDP targets, % | 119.3 | 106.9 | |
| 2009 | Actual | 28.7 | 5.2 | -22.1 |
| 2010 | SDP target* | 17.0 | 2.5 | |
| | 2009 actual/2010 SDP target | 168.8 | 208.0 | |
| 2012 | SDP target | 14.0 | 2.1 | |
| | 2009 actual/2010 SDP target | 205.0 | 247.6 | |

Source: «Armenia's social snapshot and poverty», RA NSS, 2010, «Sustainable development program», GoA 2008

* SDP forecasts

¹⁶ The SDP targets were made with a long term perspective. Based on these, projections for 2008, 2010, 2012, 2015, 2018, and 2021 were made and target values were set.

It should also be mentioned that the SDP envisages increasing the poverty line and putting it on par with the minimum consumption basket (MCB) in 2018. In the SDP context, the MCB is equal to the minimum life sustenance budget. The SDP economic and social policies, according to the forecasts, should lead to MCB-calculated poverty rates of 24.8 percent in 2012 and 11.4 percent in 2021. Like the poverty line, the MCB increased in 2006-2009 by the same proportion (about 20 percent)¹⁷, and the poverty rate for the same period of time also increased by 8.3 percent. Thus, the SDP mid-term poverty rate target, using the MCB, would also be unreachable. With regards to the long-term targets, taking into account the MCB actual value (published by the NSS on a quarterly basis), the MCB forecast and the related poverty projection should be revised.

The poverty growth in the country is also reflected in the increase of the poverty level in individual groups of population (Table 17). The SDP targets for these groups are unachievable in the mid-term. Likewise, in order to reach the SDP target for 2012, in 2009-2012, the poverty rate of children under 5 years should be reduced 3 times, those of pensioners and wage-earners 7 times, and those of the self-employed 2 times.

Table 17. Poverty indicators and SDP targets of individual groups of population

| | | Poverty rate by population individual groups, % | | | |
|------|---------------------------------------|---|--------------|----------------|---------------|
| | | Children under 5 years | Pensioners | Wage-employees | Self-employed |
| 2004 | Actual | 41.9 | 33.2 | 27.5 | 31.0 |
| 2005 | Actual | 34.9 | 30.0 | 22.7 | 27.3 |
| 2006 | Actual | 35.3 | 26.5 | 21.3 | 23.9 |
| 2007 | Actual | 33.2 | 27.6 | 20.0 | 20.8 |
| 2008 | Actual | 32.0 | 34.5 | 20.7 | 23.3 |
| 2009 | Actual | 39.6 | 39.9 | 25.5 | 29.7 |
| 2012 | <i>SDP target</i> | <i>12.9</i> | <i>5.8</i> | <i>3.6</i> | <i>14.1</i> |
| | <i>2009 actual/2012 SDP target, %</i> | <i>307.0</i> | <i>687.9</i> | <i>708.3</i> | <i>210.6</i> |

Source: Social snapshot and poverty in Armenia, NSS RA 2005, 2008, 2009, 2010 and Sustainable development program, RA Government, 2008

The SDP envisaged special policies for poverty reduction of pensioners and wage-employees. These policies were particularly aimed at the growth of employment, as well as the increase of pensions, benefits and average and minimum wages and their gradual approximation to the MCB. Taking into account the apparent growth of the MCB in quarterly estimation, we do believe that we would need to review the long-term projections and related policies in the SDP. These policies should indirectly contribute to the reduction of child poverty. Ultimately, given the fiscal difficulties caused by the crisis, it was impossible to fulfill the SDP policies at the same pace. Hence, the increase of poverty in the target groups is explained by this fact. It can also be explained by the structure of poor families or the combination of working members, children, and pensioners in a family.

Poverty reduction in Armenia before the crisis was mainly driven by sustainable economic growth. Population income and, particularly, wage revenues were growing: the wage incomes of the poor population were growing even faster. Likewise, in 2004-2008, the per capita average monthly monetary income on average grew by 17 percent compared with the previous year. About 70 percent of this income was accounted for by wages received from employment and the sale of

¹⁷ In 2006, the overall monthly poverty line for an adult is 21,555 AMD and, using the MCB, 31,961 AMD or 148 percent of the poverty line. In 2009, the poverty line is 25,877 AMD, and using the MCB, 38,273 AMD, or again 148 percent of the poverty line.

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agricultural goods. Employment income recorded a progressive growth in the structure of the monetary incomes of the population (Table 18). However, starting from 2008, a slowdown of monetary and employment income growth was recorded. In 2009, the population's per capita monthly monetary income showed lower growth than in 2008. Moreover, employment income declined both in nominal terms and as a share of monetary income.

Table 18. Dynamics of the populations' per capita average monthly monetary income, 2004-2009

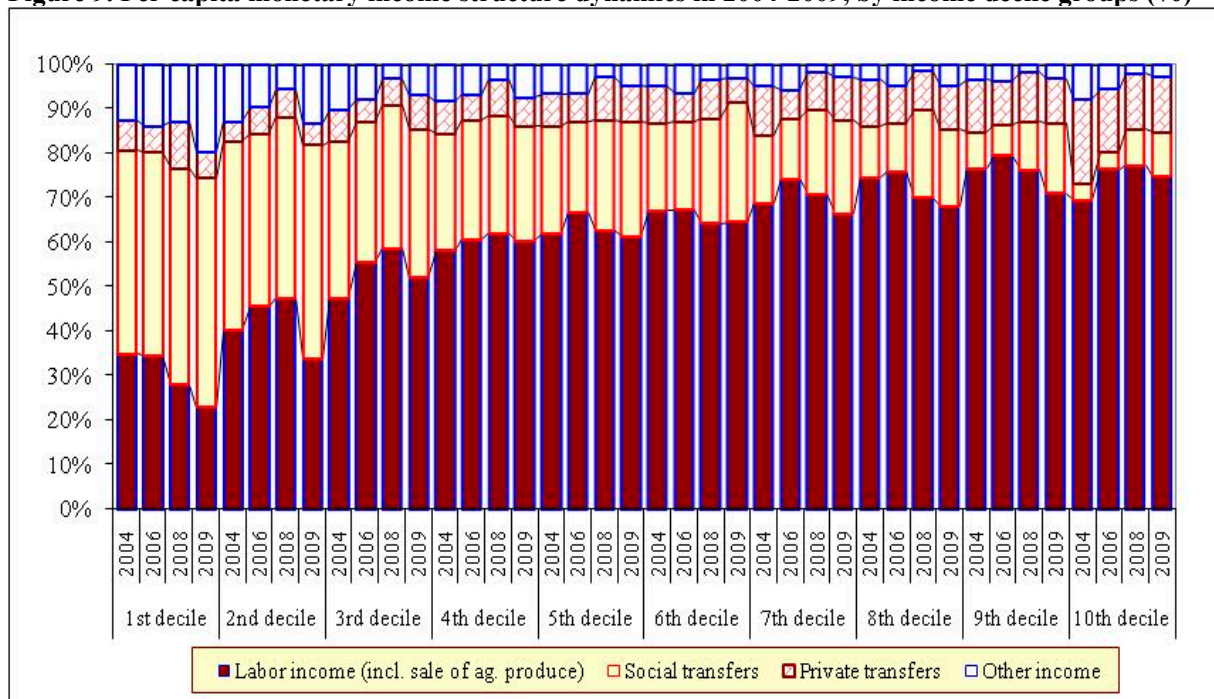
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
| Average monthly monetary per capita income, AMD | 14,450 | 15,949 | 18,446 | 22,287 | 26,866 | 28,038 |
| Annual growth, % | -- | 10.4 | 15.7 | 20.8 | 20.5 | 4.4 |
| Of which- | | | | | | |
| Income from employment and sale of agricultural goods, AMD | 9,770 | 11,297 | 13,120 | 16,148 | 18,647 | 18,529 |
| Share in monetary incomes, % | 67.6 | 70.8 | 71.1 | 72.5 | 69.4 | 66.1 |
| Growth compared with previous year, % | -- | 15.6 | 16.1 | 23.1 | 15.5 | -0.6 |
| social transfers¹⁸ | 1,962 | 2,253 | 2,559 | 3,068 | 4,870 | 5,615 |
| Share in monetary incomes, % | 13.6 | 14.1 | 13.9 | 13.8 | 18.1 | 20.0 |
| Growth compared with previous year, % | -- | 14.8 | 13.6 | 19.9 | 58.7 | 15.3 |
| private transfers | 1,817 | 1,680 | 1,698 | 2,374 | 2,692 | 2,669 |
| Share in monetary incomes, % | 12.6 | 10.5 | 9.2 | 10.7 | 10.0 | 9.5 |
| Growth compared with previous year, % | -- | -7.5 | 1.1 | 39.8 | 13.4 | -0.9 |
| other monetary income | 901 | 719 | 1,069 | 697 | 657 | 1,225 |
| Share in monetary incomes, % | 6.2 | 4.5 | 5.8 | 3.1 | 2.4 | 4.4 |
| Growth compared with previous year, % | | -20.2 | 48.7 | -34.8 | -5.7 | 86.5 |

Source: Social snapshot and poverty in Armenia, NSS RA, 2009, 2010

Despite the economic recession and the challenging fiscal situation, the Government went on fulfilling its social commitments to the extent possible. In the crisis years of 2008-2009, the nominal value and share of state social transfers in the structure of monetary income recorded a significant growth (Figure 9): If in 2004-2007, social transfers amounted to 14 percent of per capita income, this went up to 18 percent in 2008 and 20 percent in 2009. This was caused by the increase of the average amount of social and insurance pensions, as well as family and other benefits granted, as set by SDP policies. State social policy was focused on reducing the risk of poverty and, particularly, providing opportunities for the poor under conditions of economic recession and employment income decrease. As a source of income and survival, social transfers are particularly necessary for the poor population. In 2009, they accounted about 50 percent of per capita monetary incomes of 20 percent of nations' most poor (and 13 percent of per capita monetary income of the nations' richest 20 percent (Figure 9). In 2009, in the 2 poorest deciles, this share increased by 5 percentage points vis-à-vis 2008, and by 8 percentage points vis-a-vis 2007. Figure 9 shows that both the share of social transfers and their growth in 2008-09 in the richer deciles were commensurably smaller. Thus, social policy has also been focused on the mitigation of inequality of income distribution.

¹⁸ All the pensions, benefits and allowances are included in this category.

Figure 9. Per capita monetary income structure dynamics in 2004-2009, by income decile groups (%)



Source: Social snapshot and poverty in Armenia, NSS RA, 2010

1.2.2 Inequality

Before the crisis, economic growth was oriented to the poor. Despite the fact that, in 2004-2008, income caused by economic growth (employment and sales of agricultural products) had a small share (37 percent) in the income structure of the poorest 20 percent of the population, this income nevertheless grew faster than overall monetary income. The poor population's monetary income grew faster than that of the non-poor. Likewise, in 2004-2008, the monthly per capita monetary income of the poorest deciles grew 2.3 times and 1.7 times in the richest deciles. For the same period of time, economic growth caused average monthly monetary income in the poorest deciles to grow 2.4 times and that of the two richest deciles by 1.8 times. Hence, income inequality and the income gap between the poor and the non-poor were reduced. As a matter of fact, the monetary income of the richest 20 percent of the population exceeded the income of the poorest 20 percent by 10.6 times in 2004. This went down to 7.8 times in 2008. The Gini coefficient was also reduced during the same period (Table 19). In 2009, alongside with the growth of poverty indicators, inequality indicators also increased. It should be mentioned, that based on its policies and priorities, the SDP targets are a slow but sustainable reduction of inequality, even though target values were not set for the inequality indicators.

Table 19. Indicators of income distribution inequality 2004-2009

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|-------|-------|-------|-------|-------|-------|
| Monetary income ratio between the richest 20% of the population and poorest 20% of the population | 10.6 | 9.5 | 7.6 | 8.0 | 7.8 | 8.0 |
| Monetary income ratio between the richest 10% of the population and the poorest 10% of the population | 20.8 | 17.9 | 13.9 | 15.6 | 14.1 | 14.5 |
| Gini coefficient | 0.395 | 0.359 | 0.369 | 0.371 | 0.339 | 0.355 |

Source: Social snapshot and poverty in Armenia, NSS RA, 2007, 2008, 2010

The new trends, as well as a comparison of actual poverty and inequality indicators with SDP short and medium term projections, suggest that the SDP economic and social policies for the short-term perspective should be reviewed. Economic growth and distribution should focus more on the direct and indirect growth of the poor's income

1.2.3 Poverty and inequality snapshot in the regional profile

One of the priorities of the SDP is regional policy targeted at the mitigation of regional development disparities. Through the introduction of pro-active regional policies, the SDP aims to reach economic development, as well as sound reduction in the disparity of regional poverty rates. In this regard, the SDP set a target indicator for regional poverty reduction, distinguishing Yerevan, other cities, and villages (rural areas).

Despite the rapid poverty reduction in 2004-2008, the differences in poverty levels are maintained both in rural/urban and regional profiles

Before the crisis, poverty and extreme poverty were mostly spread in small and medium-sized urban areas (except Yerevan), while they were at relatively low levels in the rural areas. During 2008-2009, the poverty level recorded a more significant increase in the rural than in the urban areas (6.2 percentage points compared with 4.6 of in the cities). This resulted in higher poverty levels in the rural areas than in urban areas and the rest of the state. Nevertheless, the same cannot be stated in the extreme poverty context. Extreme poverty was lowest in rural areas in 2004-2009, even though it doubled there in 2008-2009.

During the entire period of 2004-2009, poverty and extreme poverty were mostly spread in the secondary cities of Armenia and they showed the most drastic growth there in 2008-2009 (as compared with 2008, they grew in 2009 by 7.2 and 4.2 percentage points respectively, see Table 20). From this point of view, Yerevan remains in the most favorable situation, and the observed growth of poverty indicators in 2009 was the lowest.

In contrast to this actual situation, regional policy, favorable economic growth, and social policy envisaged by the SDP in the long-term perspective should have resulted in sound poverty reduction both in the cities and the rural areas. According to the SDP, poverty would record the fastest decrease in Yerevan, caused by economic growth. SDP projections for the other cities were based on mitigation policy to address regional disparities (This should have been developed and introduced in 2008-2009, p. 172 of the SDP. A draft concept paper is currently being developed). The policy is supposed to have higher economic growth in other cities, compared with Yerevan and the state average. According to SDP estimates, rural poverty should have been reduced much slower

than in Yerevan and other cities, caused by the slower pace of agricultural growth (Table 20).

Table 20. Regional dynamics and SDP targets of poverty rate in Armenia, 2004-2009

| | Actual | | | | | | | 2012 SDP target | 2009 Actual/2012 SDP target, % |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------------------------------|-----------------|--------------------------------|
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2009/2008 growth, percentage points | | |
| <i>Poverty rate, %</i> | | | | | | | | | |
| Yerevan | 29.2 | 23.9 | 21.0 | 20.0 | 19.7 | 22.0 | 2.3 | 8.7 | 252.9 |
| Other cities | 43.9 | 37.8 | 35.8 | 29.8 | 28.3 | 35.5 | 7.2 | 18.5 | 191.9 |
| Total for urban areas | 36.4 | 30.7 | 28.2 | 24.7 | 23.8 | 28.4 | 4.6 | 13.6 | 208.8 |
| Rural areas | 31.7 | 28.3 | 23.4 | 25.5 | 22.9 | 29.1 | 6.2 | 14.9 | 195.3 |
| Total for Armenia | 34.6 | 29.8 | 26.5 | 25.0 | 23.5 | 28.7 | 5.2 | 14.0 | 205.0 |
| <i>Including extreme poverty rate, %</i> | | | | | | | | | |
| Yerevan | 6.1 | 3.6 | 3.5 | 3.2 | 3.2 | 3.7 | 0.5 | 1.1 | 336.4 |
| Other cities | 9.2 | 7.2 | 6.6 | 6.1 | 4.6 | 8.8 | 4.2 | 2.9 | 303.4 |
| Total for urban areas | 7.5 | 5.3 | 5.0 | 4.6 | 3.9 | 6.1 | 2.2 | 2.0 | 305.0 |
| Rural areas | 4.4 | 3.2 | 2.4 | 2.3 | 1.7 | 3.4 | 1.7 | 2.3 | 147.8 |
| Total for Armenia | 6.4 | 4.6 | 4.1 | 3.8 | 3.2 | 5.2 | 2.0 | 2.1 | 247.6 |

Source: Social snapshot and poverty in Armenia, NSS RA, 2010 and Sustainable development program, RA Government, 2008

Actual developments showed that meeting the SDP mid-term targets for the urban/rural poverty profile is not realistic anymore. SDP targets are affected by the new reality. In order to meet the SDP 2012 poverty target for Yerevan, poverty there should be reduced by 2.5 times and extreme poverty by 3.4 times from 2009 to 2012. Meanwhile, in order to reach the SDP poverty target 2012 for the other cities of Armenia, poverty there should be reduced by 1.9 times and extreme poverty by 3 times from 2009 to 2012. In rural areas, poverty and extreme poverty should be reduced by 2 and 1.5 times, respectively.

Importance should be given to the introduction of a comprehensive policy of regional development. Given the fact that the country's economic activity (and hence its decline) is mainly consolidated in the urban areas and, particularly, in Yerevan and taking into account the increase of world food prices, we may suppose that the rising trend of poverty in the rural areas would not persist. Hence, the SDP regional policy should focus on the urban population, particularly, on small and medium size cities. In this regard, the development and introduction of a policy to address regional disparities is becoming more than important.

Based on the envisaged measures to remove marz disparities of economic development, the SDP foresees and targets the reduction and gradual convergence of marz poverty levels. Nonetheless, the SDP does not set a target indicator for marz poverty reduction profile.

Between 2008 and 2009¹⁹, the poverty rate increased in all the marzes and the disparity across marzes remained at the same level. The poorest are the earthquake zone marzes of Shirak and Lori, as well as Kotayk and Gegharkuniq. More favorable conditions are observed in Yerevan, Syunik and Aragatsotn. Hence, from this standpoint, the fulfillment of the SDP target is crucial.

Thus, the SDP targets relating to poverty and regional disparities of poverty and inequality need to be reviewed, taking into account the new realities. Social and economic policies under the SDP

¹⁹ RA NSS publicly available indicators on poverty rates on marz profile are not consistent with 2004-2007 and 2008-2009; hence this paper observes only 2008-2009 trends.

should also be reviewed, aligning them with the new macroeconomic outlook and fiscal framework, as well as new developments and priorities that emerged after the crisis.

2. SUSTAINABLE DEVELOPMENT PROGRAM PROGRESS ASSESSMENT OF INDIVIDUAL SECTORS

2.1 Agriculture

The main targets envisaged by the SDP for agriculture and the key developments of the sector are summarized in Table 21.

Table 21. Key indicators of agricultural development

| Indicators | 2006 | 2010 target | 2010 actual²⁰ | Actual/Target , % |
|--|-------------|--------------------|---------------------------------|------------------------------|
| Total | | | | |
| Value added, billion AMD in current prices | 495 | 697 | 609.4 | 87.4 |
| GDP ratio, in percent | 18.7 | 14.8 | 17.4 | 117.6 |
| Index (in real terms), 2006 = 100 | 100 | 125 | 94 | 75.2 |
| Average annual rate of real growth, in percent | | 5.74 | -1.47 | -25.6 |
| Average annual inflation in agriculture, in percent | 11.9 | 3.4 | 7.0 | 206 |
| Employment, labour productivity and income | | | | |
| Number of employed | 504.3 | 504.3 | 454.8 | 90.1 |
| Labour productivity, thousand AMD in current prices | 948.4 | 1383.1 | 1167.8 | 84.4 |
| Monthly employment income from agricultural activities, thousand AMD in current prices | 46.39 | 80.7 | 74.3 | 92.0 |
| Ratio compared with the monthly average wages in the non-agricultural sector, % | 61.1 | 57.1 | 56.6 | 99.1 |
| Export and import | | | | |
| Export of agricultural goods, mln. USD | 26.8 | 56.8 | 39.4 | 69.4 |
| Specific weight in total export, in percent | 2.67 | 3.5 | 3.9 | 111.4 |
| Specific weight in agricultural value added, in percent | 2.32 | 2.6 | 2.4 | 92.3 |
| Import of agricultural goods, mln. USD | 179.3 | 386.1 | 366.4 | 94.9 |
| Specific weight in total import, in percent | 8.17 | 7.5 | 9.7 | 129.3 |
| Specific weight in agricultural value added, in percent | 15.5 | 16.8 | 22.5 | 133.9 |

Source: NSS and authors' estimates

As shown in Table 21, the outcome vis-à-vis the SDP targets underperformed in the reporting period. In particular:

- The actual agricultural sector value added in current prices achieved only 87.4 percent of the target in 2010. The sector's real growth was lower, reaching only 75.2 percent of the target. These developments were mainly caused by the 16 percent decline in the agricultural sector in 2010.
- Agricultural goods exports reached only 69.4 percent of the target: while the SDP aimed to increase the annual volumes of agricultural goods export to \$56.8 M in 2010, the actual volume amounted only to \$39.4 M.
- As compared with 2006, the weight of agricultural goods export in agricultural added value in 2010 it increased only by 0.08 percentage points in 2010, while the weight of agricultural goods' import for the same period increased by about 7 percentage points from 15.5 percent

²⁰ For the number of employed, labour productivity and growth of labour productivity rates the actual data of 2009 is presented.

to 22.5 percent. This statement highlights the fact that the agricultural sector's competitiveness recorded a significant decline during the reporting period.

- While labour productivity increased by about 23 percent from 2006 to 2009, this was mainly caused by higher inflation and an approximately 10 percent reduction of employment in the agricultural sector.

Activities undertaken under SDP policies

The following activities were undertaken by the GoA under the SDP policies in the agricultural sector:

- About \$27 million worth of loan proceeds have been provided to 765 agricultural enterprises within the scope of IFAD and WB loan programs for the development of agricultural infrastructure and the modernization of agricultural goods production. These funds have been used to upgrade and build capacity in operational enterprises, while new agroprocessing enterprises, manufacturing units, and workshops have also been established.
- Through the Rural Finance Facility Project, loans have been provided by commercial banks to increase of the availability of credit to agricultural enterprises. At the same time, the government subsidized the interest rates of some agricultural loans and imported and distributed highly reproductive seeds of wheat, oats and corn. The government also granted partial subsidies of fertilizers, as well as other measures to complement the lending program.
- The projects under the agricultural production subsidy system continued during the reporting period. In 2008-2009, about 3.2 billion AMD was allocated from the state budget to subsidize agricultural producers.
- Modern irrigation technologies were introduced in horticulture (drip irrigation, spray irrigation), the area with high added value cultured plants was expanded, and highly productive livestock cattle were imported and provided to enterprises operating in livestock breeding areas under favorable terms to develop cattle breeding.

Issues of SDP review

Taking into account the challenges faced by the agricultural sector, there is a need to review SDP agricultural policies, as well as the targets. In particular:

- The SDP agricultural targets should be revised, taking into consideration the recent developments in the sector (e.g. the drastic decline in 2010, higher than projected inflation, etc.)
- The agricultural sector SDP policies should also be revised, shifting the focus on raising the sector's competitiveness and productivity.

2.2 Infrastructure

2.2.1 Potable water

Reforms of the potable water system under the SDP were aimed at increasing the reliability and efficiency of the system, reducing water losses, and improving the quality of the water supply and sanitation services.

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During the SDP implementation period, significant improvement was recorded in the availability of centralized water supply, especially in the rural areas. The data shown in Table 22 reflects that the centralized water supply availability in the rural areas had improved by 8.8 percentage points compared to 2007, reaching 93.6 percent in 2009.

The share of households using «imported» water was reduced drastically, by 6 times. If in 2007, 1.7 percent of households were utilizing «imported» water, in 2009, only 0.3 percent of households were using it. All these households are located in the rural areas. This problem has been successfully addressed by 2009 in urban locations.

Table 22. Availability of potable water in 2007-2009 (%)

| Main source | Total in the country | | | In the urban areas | | | In the rural areas | | |
|-----------------------------|----------------------|------|------|--------------------|------|------|--------------------|------|------|
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| Centralized water supply | 94,1 | 97,0 | 97,5 | 98,8 | 99,4 | 99,6 | 84,8 | 92,4 | 93,6 |
| Up to 1 hour | 0,5 | 0,7 | 0,4 | 0,3 | 0,2 | 0,2 | 0,9 | 1,9 | 1,0 |
| 1-5 hours | 31,5 | 31,3 | 30,0 | 33,3 | 31,2 | 26,8 | 27,5 | 31,4 | 36,5 |
| 6-12 hours | 23,6 | 28,7 | 17,5 | 26,2 | 32,5 | 19,3 | 17,5 | 20,5 | 13,8 |
| 13-23 hours | 6,3 | 5,7 | 3,8 | 7,4 | 5,9 | 4,9 | 3,9 | 5,3 | 1,4 |
| 24 hours | 38,1 | 33,6 | 48,3 | 32,8 | 30,2 | 48,8 | 50,2 | 40,9 | 47,3 |
| Well, spring | 2,1 | 1,2 | 1,6 | 0,2 | 0,1 | 0,2 | 5,7 | 3,2 | 4,3 |
| Private water supply system | 0,9 | 0,6 | 0,5 | 0,2 | 0,2 | 0,2 | 2,2 | 1,2 | 1,3 |
| «Imported» water | 1,7 | 1,1 | 0,3 | 0,4 | 0,2 | 0,0 | 4,1 | 3,0 | 0,6 |
| Other sources | 1,2 | 0,1 | 0,1 | 0,4 | 0,1 | 0,0 | 3,2 | 0,2 | 0,2 |

Source: Household Integrated Living Conditions Survey 2007, 2008 and 2009.

According to survey results, the average daily duration of water supply in 2009 was improved by 1.6 hours, reaching 14.7 hours. With the rate of average daily water supply duration maintained, meeting the targets set by the SDP, which is to achieve an average daily water supply of 16 hours, appears realistic.

Table 23 represents shows the average daily potable water supply duration in 2007-2010 according to company suppliers.

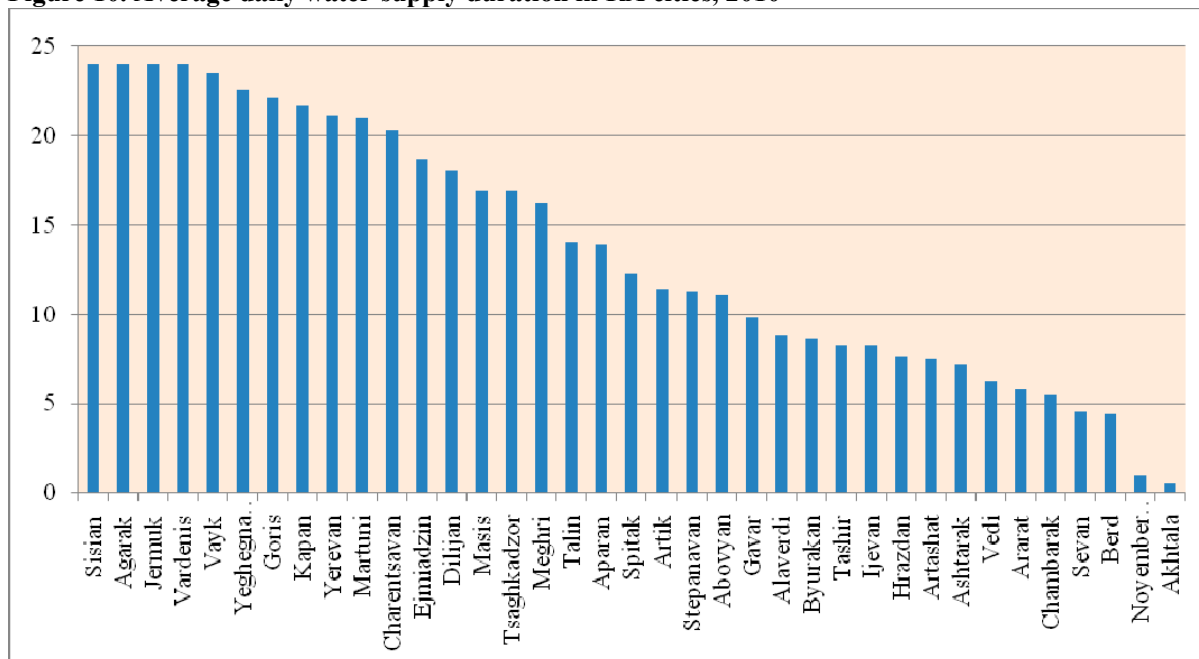
Table 23. Average daily potable water-supply due to drinking water companies, hour/day

| | 2007 | 2008 | 2009 | 2010 | 2010/2007, % |
|--------------------------------|------|------|------|------|--------------|
| Yerevanjur | 17.4 | 17.8 | 20.4 | 21.1 | 121.3% |
| Armenia water-sewerage company | 11.0 | 12.0 | 12.7 | 13.7 | 124.5% |
| Shirak water-sewerage company | 7.3 | 7.7 | 9.2 | 10.4 | 142.5% |
| Lori water-sewerage company | 6.0 | 8.5 | 9.6 | 10.7 | 178.3% |
| Nor Akunq | 14.2 | 17.8 | 22.3 | 22.4 | 157.7% |

Source: Activities Report of State Committee of Water System 2010

Currently, the duration of water supply varies widely across regions. In 15 of 36 cities serviced by the Armenian water-sewerage company, the average daily water supply in 2010 was less than 10 hours. Figure 10 illustrates the average daily water supply duration in 2010 in different cities.

Figure 10. Average daily water-supply duration in RA cities, 2010



Source: State Committee of Water System

The average daily water supply in the rural areas is also highly uneven. In the rural areas under the Armenian Water Sewerage company's service, the average daily water supply duration reached 9.5 hours, while in about 20 percent of served rural areas, the average daily water supply duration was only 1 hour or less.

There was also improvement in the potable water bookkeeping system, particularly, in the service areas of potable water supplier companies. The number of consumers with water-meters increased significantly. In 2007, 519 000 consumers had water-meters; in 2010, this figure increased by 88 thousand (about 17 percent) and reached 607 000.

Financed by loans from various international organizations, investments were made in the rehabilitation and improvement of water-supply and water-removal systems, in particular

- Under the EBRD loan project, 23 kms of sewerage lines were constructed in Sevan, Jermuk, Gavar, Martuni and Vardenis. This is the first time that project estimation documents were developed for the construction of the new /Gavar, Martuni, Vardenis/ treatment stations.
- The implementation of the Hrazadan water-supply system improvement was launched with WB financing.
- With the support of KfW, water-supply improvement programs were continued in the Lori and Shirak regions.
- Through ADB financing, projects on water-supply systems improvement were undertaken in 9 cities and 40 rural communities. Overall, 280 kms of new waterlines were constructed.

Issues for SDP review

Taking into account the sufficient progress on average daily water-supply duration, the relevant targets do not need to be revised in the subsequent years. At the same time, in order to support the measures to address the unevenness of average daily water-supply duration across regions, new targets are needed in the SDP for specific groups of areas.

The review of SDP sector policies should also address the regional unevenness of provided services.

By setting targets for individual group of areas, there could be a need to re-assess overall sector investments.

2.2.2 Irrigation water

In 2012 the SDP envisaged expanding the irrigated land area by 30 percent, as compared to 2006, bringing the total to 160 000 hectares.

The data in Table 24 illustrate that the expansion of irrigated land has been moving slowly, threatening the achievement of the SDP targets.

Table 24. Irrigated landpieces and volume of provided water 2007-2010

| | 2007 | 2008 | 2009 | 2010 |
|---|-------------|-------------|-------------|-------------|
| Irrigated landpiece, 1000 Ha | 125,6 | 128,9 | 128,1 | 128,8 |
| Volume of provided water, mln m ³ | 523,8 | 576,7 | 412 | 396,5 |
| Water discharge intensity, 1000m ³ /Ha | 4,17 | 4,47 | 3,22 | 3,08 |

Source: State committee of water system

Compared to 2006, the irrigated land area increased by 4.7 percent and reached 128.8 thousand hectares in 2010. In order to meet the SDP target, the irrigated land area needed to increase by 24%.

Water discharge intensity for each hectare has recently decreased. In 2007, water discharge was around 4.17 thousand m³. In 2010, this declined by 26 percent, falling to 3.08 m³. The decrease of water discharge intensity was caused by climate change and the introduction of efficient irrigation technologies in the farms.

In the reported period, projects to increase irrigation system reliability and efficiency continued to be implemented. These projects were undertaken under the WB irrigation rehabilitation emergency loan project and the MCA irrigation component.

SDP issues to be reviewed

Taking into account the challenges facing the fulfillment of the SDP targets on irrigation, the targets should be revisited and more realistic ones set.

The GoA's mid-term strategy on the provision of state assistance to the water consumers' union should also be considered.

2.2.3 Transport

The SDP envisaged increasing the volume of public investment in roads, particularly in ongoing maintenance and in achieving higher spending efficiency to prevent the accelerated depreciation of the roads network and to ensure faster, easier, and more secure transportation.

State expenditures in 2007-2010 allocated for the maintenance and exploitation of road networks are presented in Table 25.

Table 25. State budget expenditures on roads 2007-2010

| | 2007 | 2008 | 2009 | 2010 |
|---------------------------------------|-------------|-------------|-------------|-------------|
| State budget expenditure, million AMD | 44243 | 41901 | 57792 | 32540 |
| GDP ratio, in percent | 1,40% | 1,17% | 1,84% | 0,93% |

Source: State budget performance reports.

The above-mentioned data show that during the first years of SDP implementation, particularly in 2009, state budget expenditures on roads showed an increasing trend. However, the trend reversed drastically in 2010, as a result of the economic recession in 2009 caused by the financial crisis. Despite the recorded decline in 2010, the state budget expenditures to GDP ratio remained close to the SDP target (1 percent of GDP in 2012).

The investment programs under donor financing have also continued, in particular

- Lifeline roads improvement program under WB financing,
- ADB North-South road corridor project,
- ADB Rural roads project:

Measures were also taken to increase the efficiency of state expenditures in the road sector, in particular:

- By GoA degree N 1419, 04.11.2010, a new order of road maintenance and use was adopted. The new order introduces the performance based method, which would enable a more efficient arrangement and implementation of road maintenance and use. More importantly, it stipulates that only fulfilled works are paid for.
- Works insurance mechanisms for road construction were developed and introduced. These mechanisms will reduce the risk to the state in case of poor quality construction.
- To make the procurement of road construction projects more transparent, NGOs and media representatives are now included in evaluation committees.

SDP issues to review

In reviewing the transport sector's SDP policies, more emphasis should be placed on the cost effectiveness of state investment programs.

Simultaneously, new transport sector investment programs should be mentioned in SDP implementation (ADB North-South road corridor project).

2.2.4 Energy sector

The SDP emphasized four directions for the development of the energy sector, meeting growing internal demands, and securing Armenia's energy security and independence:

1. Maximum utilization of own resources, especially renewable energy,
2. Further development of nuclear energy,
3. Diversification of sources of energy and regional integration,
4. Fostering of energy efficiency in every consuming industry.

Activities fulfilled under the SDP policies

1. Utilization of own resources and renewable energy in particular

In the reporting period, the GoA continued implementing small HPP development policy.

Thus, as of March 1, 2011, 101 small HPPs are producing energy. The aggregated installed capacity is now 129.47Mw and energy production of about 409.9 M Kw/hour. During the SDP implementation period -- after 2008 -- 41 small HPPs were commissioned with an aggregate installed capacity of 54Mw and an energy production of 177.84 M Kw/hour.

As of March 1, 2011, construction licenses were issued to 74 small HPPs with an installed capacity of about 140,6 Mw. Forty small HPPs with an installed capacity of 48 Mw were issued licenses after 2008.

When the GoA adopted the “Small HPP development scheme” (2009), the government envisaged developing some 108 additional small HPPs with an aggregate designed capacity of 134 Mw.

For the complex rehabilitation of the Vorotan HPP, a Euro 51 M Loan and Project Agreement was signed by the RA Ministry of Finance, KfW Bank, and the “Vorotan HPPs Complex” CJSC (October 20, 2010).

At the same time, under the TA between the RA and the IBRD, geological and geophysical exploration was launched at the “Gridzor” and “Karkar” geothermal platforms.

On October 15, 2010, the “Construction-Concession-Exploitation on exchange basis (BOOT) of Meghri HPP” agreement was signed by the GoA and the Iranian “Tavan Ab Araz Company.” The agreement requires the investing company to cover the financing related to the construction and exploitation of Meghri HPP. The installed capacity of the HPP would be 130 Mw and the annual energy output would reach 800 M Kw/hour. The construction must be completed within 5 years, and in the subsequent 15 years, the produced energy would be transported to Iran by a 230 Kv transmission facility which should also be constructed by the investor.

2. Further development of nuclear energy

A RA law “On RA new nuclear power unit(s)’ construction” was adopted in October 27, 2009.

By Decree N 1458 (December 3, 2009), the Armenian-Russian joint company (“Metsamorenergoatom” CJC) was founded, which is open to other investors.

On August 20, 2010, “A cooperation agreement between the RF Government and the GoA on the construction of new NPP generation units in RA” was signed. The agreement passed all the internal ratification procedures both in Armenia and Russia.

A feasibility study on new nuclear power-generation unit construction was completed. Currently, negotiations are being held with the investors. Seismologic and volcanic studies of the potential nuclear power-generation unit’s platform were also accomplished. Public hearings are being conducted in Armavir on the topic of new nuclear power-generation unit construction in the RA. According to the provision of ESPOO convention, neighboring countries were notified by RA Ministry of Foreign Affairs and Ministry of Nature Protection.

“Metsamorenergoatom” CJC received a license to choose a platform for the construction of the new power-generation unit.

Currently, activities are being undertaken by the Russian party to elaborate a clear time-table for financing, which would jumpstart the design activities and procurement of equipment.

3. Diversification of energy resources supply and regional integration

In the reporting period, the construction of the Iran-Armenia gas pipeline was accomplished. On May 13, 2009, regular gas supplies from Iran and energy deliveries from Armenia started, according to the agreed volumes and regimes.

“ArmRusGazprom” CJSC launched the rehabilitation of underground natural gas storage. The capacity of the gas storage was increased by 1.8 times and, as of 2010, the actual volume of the stored gas is 132.7 M m³. This capacity is envisaged to increase to 140 M m³.

Improvements were also made in the transmission network, which are crucial for strengthening the reliability of the energy system and the facilitation of regional cooperation. Particularly,

- In September 2010, the rehabilitation of 17 110 Kv substations under the Japanese government support was accomplished.
- In October 2010, the first stage of the SCADA communication system was accomplished.
- For the rehabilitation of the Gyumri 2 sub-station on January 30, 2009, KfW, RA Ministry of Finance, and the “High-voltage power networks” CJSC (implementing unit) signed the “Rehabilitation of Gyumri 2 sub-station” Loan and Project Agreements.

4. Promotion of energy efficiency in all energy consuming industries.

The RA Ministry of Energy and Natural Resources under the Armenia-EU Association Agreement is currently discussing with the EU the directives and bylaws in the energy sector, including ensuring energy efficiency.

2.2.5 Social Protection

Targeted social policy is the second strategic priority of SDP. The SDP envisages the implementation of highly targeted policies and monitoring of social assistance, social security and insurance. With this consideration, the SDP targeted a sharp increase of public expenditures on social protection. According to the SDP targets, as compared with 2007, the state expenditures on social protection should double by 2010, increase by 4.1 times in 2015 and 6.7 times in 2021. These targets also considered the costs of the introduction of a mandatory funded pension system starting in 2010, which was eventually postponed to 2014. Despite the complex budget situation caused by the crisis, the nominal value of the SDP short-term targets on the social protection budget expenditures in 2008-2009 were fulfilled by 96-97 percent (Table 26). But in 2010-2011, they were only fulfilled by 81-83 percent (without the costs of introduction of the funded pension system), and in 2012, according to the MTEF, they would be fulfilled only by 63 percent.²¹

²¹ Taking into account the GDP decline, caused by the crisis, which had not been projected by SDP, the mentioned expenses and a greater share in GDP than it had foreseen by SDP.

Table 26. Comparison of actual and SDP target indicators on financing the social protection sector, 2008-2012

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2015 |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|-------|
| State expenditures on social protection in nominal terms, billion AMD | | | | | | |
| Actual | 212.6 ^a | 243.6 ^a | 244.2 ^a | 271.9 ^b | 267.2 ^c | ... |
| SDP target | 219.2 | 253.6 | 295.4 ^d | 335.1 ^d | 424.6 ^d | 611.5 |
| Actual/SDP target, % | 97.0 | 96.1 | 82.7 | 81.1 | 62.9 | ... |
| GDP/state expenditures on social protection, in percent | | | | | | |
| Actual | 6.0 | 7.8 | 7.0 | ... | ... | ... |
| SDP target | 6.0 | 6.1 | 6.3 | 6.3 | 7.2 | 7.8 |
| Of which 1. Pension security in nominal terms, billion AMD | | | | | | |
| Actual | 154.9 ^a | 177.6 ^a | 178.5 ^a | 198.7 ^b | 198.3 ^c | ... |
| SDP target | 158.4 | 182.5 | 217.4 ^d | 251.0 ^d | 316.7 ^d | 469.6 |
| Actual/SDP target, % | 97.8 | 97.3 | 82.1 | 79.2 | 62.6 | ... |
| 2. Other social protection programs in nominal terms, billion AMD | | | | | | |
| Actual | 57.7 | 66.1 | 65.7 | 73.2 | 68.9 | ... |
| SDP target | 60.8 | 71.2 | 78.0 | 84.1 | 107.9 | 141.8 |
| Actual/SDP target, % | 94.9 | 92.7 | 84.2 | 87.0 | 63.9 | ... |

^a Source: Actual expenditures of RA state budget 2008-2010

^b Source: RA Law on State budget, 2011

^c Source: MTEF 2011-2013

^d Source: SDP target indicators for 2008-2012 illustrated in the Table, do not include the costs of introduction of a funded pension system.

The same trends are observed when comparing actual state expenditures on the pension system and the SDP targets. These expenditures have the largest share in total social expenditure, accounting for 72 percent.

SDP progress in social protection will be analyzed in greater detail below.

2.2.5.1 Social Assistance system

Based on the SDP priorities, the social assistance priorities are the family benefit, one-off allowance during childbirth, under-2 years childcare allowance, and disabled people and disabled children family care allowance programs. These became the priorities in the SDP, given that a relatively slower rate of poverty reduction is observed in families with children, disabled members, and disabled children. Taking into account the growth of poverty, and in particular child poverty, in 2009, more importance was therefore given to these programs.

The family benefit system (hereinafter, FBS), as one of the elements of the social assistance sector and an important factor for poverty reduction, is the most targeted and efficient program in the system, for the purpose of improving the living standards of the poor and thus overcoming poverty and inequality in the country. SDP policy has targeted increasing the average size of the family benefit, increasing targeting of the system, and maximizing the inclusion of the poor in the system. The SDP short-term policy aims to provide benefits to all poor families in 2012, align the number of beneficiary families with the number of poor families, along with increasing the system's targeting and participation of the poor in the system.

To reach these targets, the SDP foresees an increase of public expenditures on the family benefit program, and the permanent reduction of poverty and the number of poor families in the country. But due to the crisis, the SDP forecasts on the rapid reduction of the number of poor families did not become a reality in the short-term – poverty and the number of poor families increased in 2009. Therefore, there was also an increase in the potential number of “beneficiary” families of the family benefit system. However, the number of families applying for and registering/documenting in the

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system did not increase and, in fact, it was continuously declining (even in 2009 when the poverty level increased). Thus, in 2005, the poverty level in the country was 29.8 percent, while families registered in FBS was around 25 percent of RA families. In 2008, 21.5 percent of RA families were registered in the FBS, in 2009 19.2 percent (when poverty increased to 28.7 percent and almost fell back to 2005 levels), and in 2010 18 percent. Therefore, a significant part of poor families are not registered in the system, even as maximizing participation of the poor remains a priority of the SDP.

Table 27. Comparison of actual and SDP-targeted values of main indicators of the family benefit system for 2008-2012

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---------------------|---------------------|---------------------|---------------------|---------------------|
| Public expenditure on family benefits, mln drams | | | | | |
| Actual | 28,838 ^a | 29,146 ^a | 30,878 ^a | 35,497 ^b | 35,690 ^c |
| SDP target | 29,761 | 32,757 | 36,963 | 40,927 | 46,967 |
| Actual/SDP target, % | 96.9 | 89.0 | 83.5 | 86.7 | 76.0 |
| Number of families registered/documented in the system and beneficiary families | | | | | |
| Actual – families registered in the system ^d | 165,394 | 146,500 | 138,000 | ... | ... |
| Actual – number of beneficiary families | 121,160 | 107,492 | 105,005 | ... | ... |
| SDP – number of beneficiary families | 116,204 | 114,000 | 114,000 | 114,000 | 114,000 |
| Actual/SDP target, % | 104.3 | 94.3 | 92.1 | ... | ... |
| Average monthly benefit per family, drams | | | | | |
| Actual ^d | 21,100 | 23,560 | 26,850 | ... | ... |
| SDP target | 21,090 | 23,658 | 26,695 | 29,558 | ... |
| Actual/SDP target, % | 100.0 | 99.6 | 100.6 | ... | ... |

^a Source - 2008-2010 actual expenses of RA state budget

^b Source - Law on 2011 RA state budget

^c Source – 2011-2013 MTEP

^d Source – Ministry of Labor and Social Affairs of RA

At the same time public expenditures on FBS are increasing, though slower than targeted by the SDP. Therefore taking into account the drastic decrease in the number of beneficiary families (despite increasing poverty), actual indicators of the average amount of the family benefits have increased, consistent with the SDP targets (see Table 27).

The SDP aims to bring the level of targeting of the FBS to 78 percent by 2010, and starting from 2015, to 90 percent. As per the results of the 2009 standards of living survey by the RA NSS, around 77 percent of the recipients of the family benefit are from the poorest 20 percent of the population. Thus, this target of the SDP was achieved. The RA Government has worked seriously in this direction during 2008-2010. In particular, efforts were aimed at increasing the effectiveness of data collection in the public benefits system, improving and combining the FBS and other related databases, which will become the basis for periodic monitoring of FBS targeting. As a result, it is now possible to monitor the different economic activities of beneficiary families and identify beneficiary families that are not satisfying the FBS criteria.

Taking into consideration rising poverty in 2009, the social policies under the SDP, including the FBS, are facing many challenges. The FBS related policy should be retained in the long-term, though in the short-term and perhaps also in the medium-term its, approaches should be revised to increase direct social assistance to the poor and to maximize the involvement of the poor in the FBS. Currently ensuring a greater involvement of the poor in the FBS is problematic, based on previously cited data. There should also be revised target indicators of the number of poor and beneficiary families and the benefit amount used as a base in the SDP, given poverty trends and drastic changes of the MCB value.

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Other social assistance programs considered important in the SDP are the programs of one-time benefit for child birth and under 2-years child care benefit. SDP policies developed for these have been set and implemented close to the provided level.

In the case of the one-time benefit for child birth, given the scarce budget resources as a result of the crisis, public funds provided for this have not risen at the rate envisaged by the SDP. Thus, the average amounts of this benefit have not increased at the rate envisaged by the SDP. Taking into consideration the demographic situation in the country and the importance of special state attention on the single-time benefit for birth and especially the birth of the 3rd and following children, the continuous implementation of the SDP policy in this field is very important.

In case of under 2-year old children care, public expenditures have even exceeded SDP targets due to a more rapid rise in the number of beneficiaries than foreseen. This is explained by an increasing birthrate during the last 2 years, in particular among working mothers. In 2010, the actual number of beneficiaries of this benefit was close to forecasts of SDP for 2018. Thus, even in case of provision of more public funds, increasing the average amount of the benefit by the rate envisaged by the SDP would be impossible, given the scarcity of budget funds. Nevertheless, even in terms of a worsening of the standards of living as a result of the crisis, the improvement of the demographic situation in the country should be maintained as a priority direction in the long-term. Thus, the SDP policy in this direction should be continued by adjusting the target indicators based on a more rapidly increasing number of beneficiaries.

Table 28. Comparison of actual and SDP-target values of indicators of one-time benefit for child-birth and under 2-years old child care for 2008-2012

| | 2008 | 2009 | 2010 | 2011 |
|--|--------------------|--------------------|--------------------|--------------------|
| Public expenditures on single-time benefit for child birth, mln drams | | | | |
| Actual | 1,351 ^a | 5,066 ^a | 4,721 ^a | 4,675 ^b |
| SDP target | ... | 4,136 | 4,719 | 5,094 |
| Actual/SDP target, percent | ... | 122.5 | 100.0 | 91.8 |
| Average amount of benefit, drams | | | | |
| Actual, for first and second child ^d | ... | 50,000 | 50,000 | 50,000 |
| SDP target | ... | 50,000 | 56,000 | 58,000 |
| Actual/SDP target, percent | ... | 100.0 | 89.3 | 86.2 |
| Actual, for third and following child ^d | ... | 430,000 | 430,000 | 430,000 |
| SDP target | ... | 430,000 | 480,000 | 496,000 |
| Actual/SDP target, percent | ... | 100.0 | 89.6 | 86.7 |
| Memorandum item – number of beneficiaries | | | | |
| Actual ^d | ... | 45,823 | 43,033 | ... |
| SDP forecast | ... | 43,446 | 45,672 | 47,649 |
| Public expenditures on benefit for under 2-years old child care, mln drams | | | | |
| Actual | 221.7 ^a | 1,860 ^a | 2,567 ^a | 2,340 ^b |
| SDP target | 217.9 | 1,311 | 1,634 | 1,817 |
| Actual/SDP target, % | 101.7 | 141.8 | 157.1 | 128.8 |
| Average amount of benefit, drams/month | | | | |
| Actual ^d | ... | 18,000 | 18,000 | 18,000 |
| SDP target | ... | 18,000 | 22,422 | 24,936 |
| Actual/SDP target, % | ... | 100.0 | 80.3 | 72.2 |
| Memorandum item – number of beneficiaries | | | | |
| Actual ^d | 4,488 | 7,114 | 9,844 | ... |
| SDP forecast | 4,500 | 6,000 | 6,000 | 6,000 |

^a Source - 2008-2010 actual expenses of RA state budget

^b Source - Law on 2011 RA state budget

^d Source – Ministry of Labor and Social Affairs of RA

2.2.5.2 Pensions

The SDP considers pension policy to be one of the top priorities of the authorities for the medium- and long-term. To achieve the medium-term goals, the Government mostly relied on parametric reforms and increased budget allocations to the sector, while the achievement of longer-term goals (that might go even beyond the time horizon of SDP) is predicated on the expected results of systemic reforms in the sector, which are currently under way.

Table 29 below summarizes the primary objectives and targets of the SDP for pension policy.

Table 29. Summary of primary medium-term objectives, instruments, and targets of pension policy

| Objectives | Main instruments | Medium-term targets |
|--|--|---|
| <ul style="list-style-type: none"> ▪ Reduce the risk of poverty for labor pensioners and keep them away from poverty ▪ Narrow the gap between the well-being of pensioners and workers | <p>Increased budget financing, that will be mostly channeled to increase base pensions</p> | <ul style="list-style-type: none"> ▪ Average labor pension is equal to at least 100 percent of the minimum consumption basket by 2012 ▪ Base pension is equal to at least 100 percent of the poverty line by 2015 |

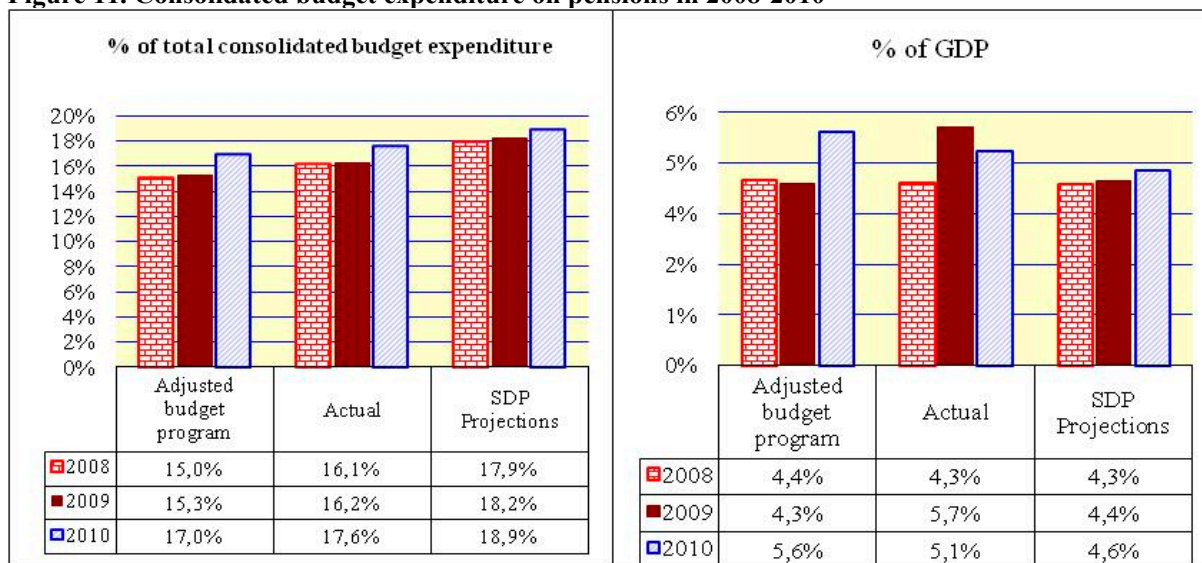
Source: Sustainable Development Program.

Although these objectives have been reflected in annual and medium-term budget documents and have guided the public expenditure policy of the Government (that considers social protection, particularly pensions as one of the top priorities), the actual results remained below the target.

Analyzing public expenditure on pensions, the following conclusions can be made (Figure 11):

- In 2008-2010, the share of public expenditure on pensions in the total consolidated budget expenditure showed an increasing trend both for the adjusted budget program and the executed budget indicators, reflecting the priority given to this category of expenditure and the clear commitment of the Government towards achieving the targets. However, those shares were below the corresponding indicators projected by the SDP mostly due to the changed structure of budget expenditure (especially in 2009) and the relative increase of expenditures on economic services to mitigate the impact of the economic crisis.
- The expenditures on pensions-to-GDP ratio generally increased as well (to 5.1 percent in 2010 from 4.3 percent in 2008) and actual indicators for 2009 and 2010 were even higher compared to those projected by the SDP, although this difference can be mostly explained by the lower than projected level of GDP.
- And finally, budgeted pensions in 2008-2010 were executed in full with no delays, despite the difficulties arising from the financial crisis.

Figure 11. Consolidated budget expenditure on pensions in 2008-2010



Note: For consistency with the SDP, public expenditures are classified in accordance with the IMF 1986 GFS Manual.
Source: National Statistical Service, Ministry of Finance of the Republic of Armenia.

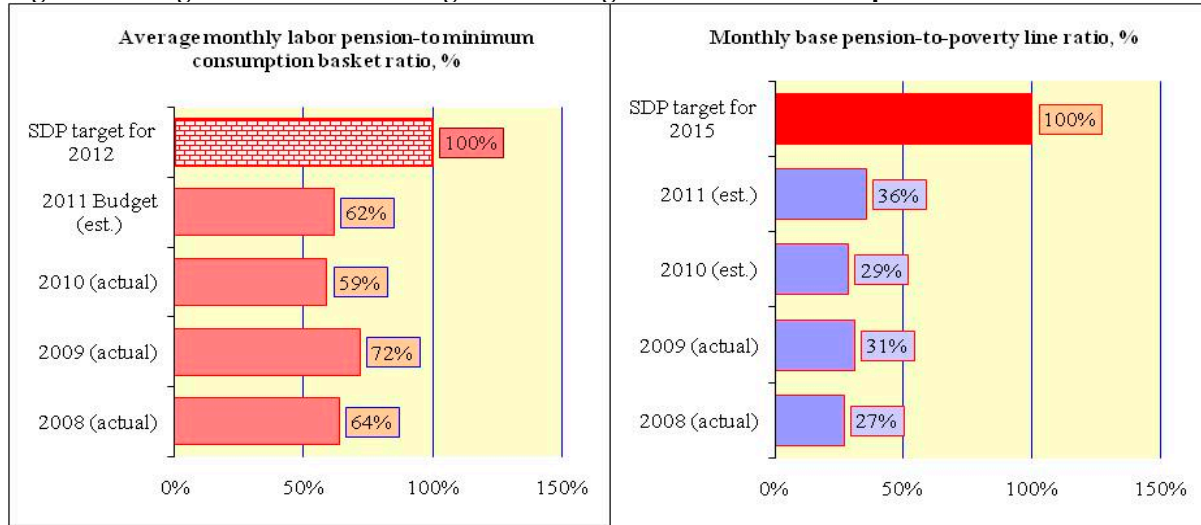
The increase in expenditure on pensions (particularly labor and social pensions) in 2009 and in the last months of 2010 was mostly attributable to the increased size of the monthly base pension (to 8,000 drams in 2009 and 10,500 drams starting November 2010 from 6,800 drams in 2008) and the increased size of the increment to base pension per each worked year of a pensioner (to 450 drams starting 2009 from 395 drams in 2008).

During 2009-2010, the authorities took actions aimed at reforming the sector as envisaged by the SDP. Particularly,

- In December 2010, the National Assembly of the Republic of Armenia approved a package of laws ensuring the implementation of longer-term reforms in the pension sector. According to the approved package, the funded pension pillar will be introduced in 2014 and, according to the draft 2012- 2014 MTEF projections, this will lead to an additional 18 billion drams in state budget expenditure²²;
- According to the newly approved Law on State Pensions, the length of work experience required to qualify for labor pension will be increased to 10 years in 2016 from 5 years currently;
- The length of work experience required to qualify for labor disability pensions was also revised;
- A draft concept note aimed at changing the approach to disability from invalidity to functional disability was developed and is currently being deliberated by the Government,
- Actions were also taken to improve the management information systems in the sector.

²² The SDP projected the introduction of the funded pension pillar starting in 2010. However, the authorities decided to defer the introduction until 2014, given the additional financial burden that the introduction of the system might cause both on the population on the one hand, and on the budget on the other hand.

Figure 12. Progress towards achieving the SDP targets on labor and base pensions



Notes: 1. For the minimum consumption basket, indicators in Q2 prices (as published by NSS) have been used. 2. Poverty line refers to the one published by the NSS using the methodology applied in the ILCS for 2004-2008. 3. The level of the consumption basket for 2011 and for the poverty line for 2010 and 2011 are estimated adjusting the actual (and/or estimated) level of corresponding indicator for the previous year by the consumption price index. Source: Ministry of Finance, Ministry of Labor and Social Issues, National Statistical Service.

In particular, the average monthly labor pension indicator, after the increase recorded in 2009, declined in 2010. Nearly the same pattern was also observed in the case of the base pension-to-poverty line indicator.

The following two main factors are behind this unfavorable pattern:

- First, limited fiscal space as a result of the economic crisis did not allow for an increase in budgetary allocations to pensions to a larger extent in 2010, and
- Second, the much higher increase in food prices than expected led to a higher level of the minimum consumption basket than projected in the SDP.

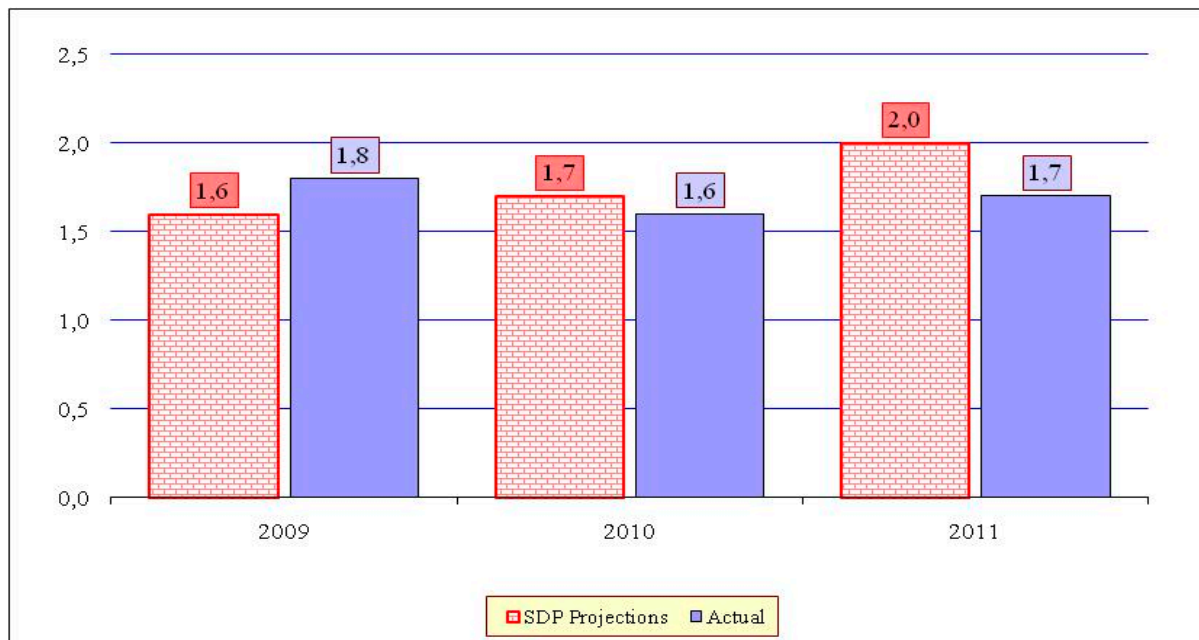
2.2.6 Healthcare

In healthcare, the main targets of the SDP continue to be increasing the level of accessibility and availability of healthcare services and the improvement of quality. Special targets were set on increasing the level of accessibility to key services on a territorial basis and on the consumption of healthcare services by groups according to different living standards.

Public health care has been especially emphasized by the World Health Organization, with the objective of improving public health and welfare. In 2008, the Minister of Health of the Republic of Armenia, along with 52 other countries, signed the Tallinn Charter “Healthcare System, Health and Welfare.” All WHO European region countries have recognized as a universal value the right to human health care. For that reason, all member countries will aim at improving their healthcare systems, with the goal of providing accessible healthcare services to the population, based on healthcare needs of each.

In 2009, public expenditure in the healthcare sector has not been steady. The financing of the healthcare system has also been affected by the economic crisis. In particular, in 2009, health expenditure in the state budget was only 85 percent of the budgeted amount. Actual expenditures were less than planned by 9.9 bln drams.

Figure 13. Percentage of state budget expenditures in GDP (2009 and 2010 actual, 2011 planned)



Source – SDP, Ministry of Finances of RA.

In 2010, the state budget actual expenditures differed from the SDP target by 26.0 bln drams, and the approved state budget in 2011 differed from the SDP target by 40.8 bln drams.

The share of healthcare expenditure in GDP deviated from the 2011 target by 0.3 percent (the actual share was 1.7 percent instead of the target 2.0 percent). With actual economic growth below the projected trend, public expenditures were directly affected, but not with the provision of healthcare services but with a cut in capital expenditures.

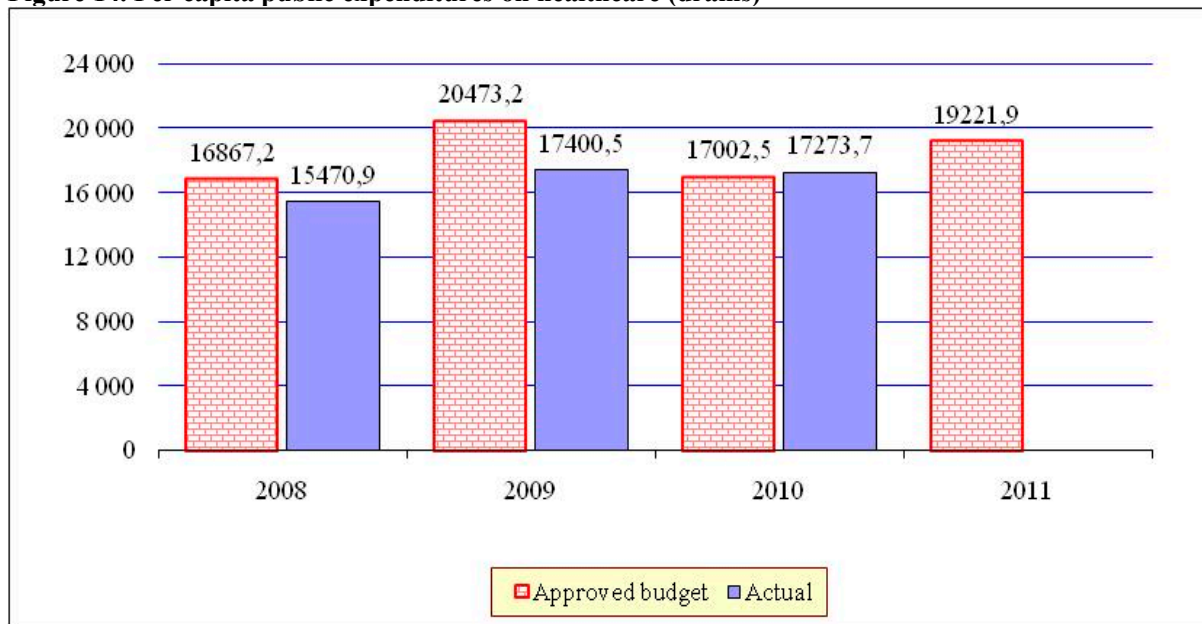
Table 30. State budget expenditures in the healthcare field in 2008-2011

| | 2009 | 2010 | 2011 | 2009 | | 2010 | | 2011 |
|---|------|------|-------|--------|--------|--------|--------|--------|
| | SDP | | | Budget | Actual | Budget | Actual | Budget |
| Consolidated budget expenditures in the healthcare field, bln drams | 66.1 | 81.2 | 103.3 | 66.1 | 56.2 | 55.2 | 56.1 | 62.5 |
| GDP percentage | 1.6 | 1.7 | 2.0 | 2.1 | 1.8 | 1.6 | 1.6 | 1.7 |
| Against state budget expenditures, percent | 6.6 | 7.1 | 7.9 | 7 | 6 | 5.9 | 5.9 | 6.2 |

Source – SDP, Ministry of Finances of RA.

The 2009 actual indicator of per capita public financial allocations for healthcare was 17.4 thousand drams. In 2010, this remained close to the same level; and, in 2011, the planned indicator is 19.2 thousand drams.

Figure 14. Per capita public expenditures on healthcare (drams)



Source – SDP, Ministry of Finances of RA.

In 2011, the average monthly calculated salary of medical staff members (territorial therapists, pediatricians, family doctors) involved in the ambulatory-hospital system is projected to be 84,700 drams as compared with 77,000 drams in 2010, and the average monthly calculated salary of medical staff members is planned to be 54,250 drams as compared with 49,300 drams in 2010.

In 2011, the hospital medical staff members monthly salary will increase to 71,300 drams from 62,000 drams in 2010, and the average monthly salary of medical staff member will also go up to 56,400 drams from 49,000 in 2010.

Starting from 2011, there will be a large-scale policy towards the improvement of emergency medical care service guaranteed by the state. In particular, new criteria have been approved for financing of emergency medical care services and for the compensation of employees, supported by new procedures of urgent medical care measures to be undertaken by emergency medical care doctors in life-threatening situations.

In 2011, healthcare expenditures have increased by around 1.6 times from 2006.

Within the healthcare system, priority is given to primary health care, but expenditures on this have deviated from the target.

Table 31. Sectoral trends of healthcare expenditures in 2009-2011

| | 2009 | 2010 | 2011 | 2009 | | 2010 | | 2011 |
|--|---------|-------|-------|--------|---------|----------|---------|---------|
| | Project | | | Budget | Actual | Budget | Actual | Budget |
| Expenditures on the provision of PHC services within the total expenditures on healthcare, percent | 40-45 | 40-45 | 40-45 | 39.0 | 36.4 | 38.1 | 35.9 | 38.2 |
| Deviation from target, percent | - | - | - | 1-6 | 3.6-8.6 | 1.9- 6.9 | 4.1-9.1 | 1.8-6.8 |

Source - SDP projections, Ministry of Finances of RA.

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Giving importance to primary health care, the RA Government adopted the “2008-2013 Strategy of Primary Health Care for the Population of the Republic of Armenia and Its Implementation Measures”, which aims at guaranteeing accessible, quality, effective, and cost-efficient medical service.

The main issues of primary health care continue to be healthcare quality, management methods, prevention of non-infectious diseases at the primary health care level, the application of professional knowledge received by family doctors, and the establishment of independent family medicine practices.

In the second quarter of 2011, work is planned to summarize the results of performance based financing and of the application of work-incentivizing remuneration.

The selection by the population of doctors providing primary healthcare services and registration for their services are being realized. As a result, around 90 percent of the population is registered. With complete registration, there will be a transition from financing by the population attached in the PHC field to financing by the registered population (currently financed by registered and attached populations).

One of the priorities of the SDP is maternal and child healthcare, aimed at reaching the targets set in the Millennium Declaration. The Government has undertaken a specific policy in this direction, in particular, through direct public investment.

During 2009-2011, the “Delivery assistance state certificate introduction program” was successfully implemented. Investments within the framework of the program were 5.9 bln drams in 2009 and 5.7 bln drams in 2010, and 6.9 bln drams are planned in 2011. Implementation of the program enabled the doubling of resources related to childbirth. The reimbursement provided by the state to medical institutions against these services has become significantly closer to the real cost. And the salaries of medical workers have also increased significantly, which has had considerable impact on the reduction of shadow costs in hospitals and the provision of virtually free and accessible delivery assistance services for the population.

Thanks to the introduction of the delivery assistance state certificate, there was a significant improvement of early registration of pregnancies for pre-delivery control, noticeably increasing the number of births.

Maternal mortality was reduced by 20 percent in 2009 and by 70 percent in 2010, and maternal and child traumatism was reduced by around 20 percent.

Table 32. Targets and actual child and maternal mortality indicators

| | 2006 | 2008 | 2009 | 2010 | 2008 | 2009 | 2010 |
|--|--------|-----------|------|------|--------|--------|--------|
| | Actual | Projected | | | Actual | Actual | Actual |
| Child mortality (under 1-year old) per 1000 live births | 13.9 | 12.0 | 11.5 | 10.9 | 10.8 | 10.4 | 11.3 |
| Child mortality (under 5-year old) per 1000 live births | 15.8 | 14.1 | 13.5 | 12.8 | 12.1 | 11.9 | 13.5 |
| Maternal mortality (average for 3 years) per 100,000 live births | 24.0 | 18.5 | 14.5 | 14.0 | 38.8 | 27.0 | 8.9 |

Source – SDP, Ministry of Healthcare of RA.

In six regions of the Republic, the services of a “mobile gynecologist” were introduced to conduct studies, consult with women, and, in some necessary cases, organize referrals. The necessary resources have also been provided to establish 18 “maternity schools.”

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As per the order of the Minister of Health of the RA, several clinical guidelines and criteria have been approved in 2009-2011, ensuring the quality of medical services for mother and child.

In accordance with the provisions of the “2010-2015 National Strategy of the health and development of children”, based on the positive experience with the introduction of the delivery assistance and the objective of ensuring continuity of health care provision, the “children health state certificate” was introduced in 2011 within medical institutions providing hospital services for children, and the “Child Health Passport” for mothers within the system of primary health care.

The Government made a significant investment in the program; in 2011, the “medical care services for Children” program received 6.4 bln drams against 3.1 bln drams in 2010.

For the purpose of the management of financial flows in medical institutions, making expenditures predictable for the population, improving the quality of medical services, as well as increasing the salaries of medical institution staff, starting from 2011, co-payments as an alternative financing source were introduced within the framework of “emergency medical care services” and “medical care services for gynecological diseases” programs.

In 2011, the Government of the Republic of Armenia implemented serious reforms in emergency medical care service under which the emergency medical care service has received 88 cars, and processes for provision of modern communication equipment and software packages have been provided to the system.

The Government is implementing programs to fight and prevent the spread of infectious diseases. Emphasis is given to programs to fight tuberculosis, HIV/AIDS, and malaria. Tuberculosis remains a serious issue for public health and continues to be a burden to the healthcare system of the Republic of Armenia.

To reduce the mortality rate of the population from the most widespread non-infectious diseases (blood circulation system, substandard neoplasm, endocrine system, etc.), the Government of the Republic of Armenia approved “the concept of prevention, early diagnosis, and treatment of the most wide-spread non-infectious diseases” and lists several measures to tackle non-infectious diseases.

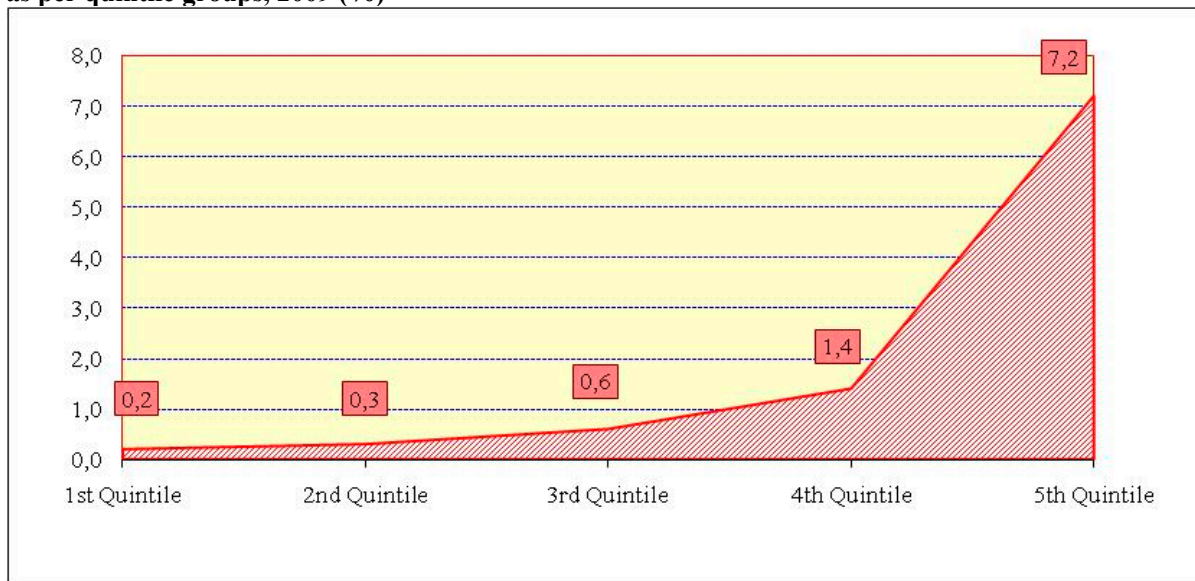
Starting from 2010, reporting forms were introduced to control quality efficiently. This will enable the overseeing of diagnostic and treatment measures applied towards each patient, development of registers of 3 of the most widespread diseases (hypertension, blood circulation system and diabetes), and the prevention of complications of these diseases with the use of information technologies (MIDAS-3 system).

To regulate the activities of local pharmaceutical companies, the Government of RA approved “Proper Medicine Manufacturing Rules.”

Despite the efforts of the government and state policy in the healthcare system, the level of access to healthcare services of the population remains low, especially in rural areas and among the poor.

As per the results of 2009 ILCS, in case of sickness, 30.5 percent of the population applies for medical consultation or treatment. The population of Yerevan did it more often (36.2 percent) than the population of other cities (33.5 percent) and the rural population (22.2 percent). The likelihood of applying for treatment has differed by poverty level. In case of sickness, 35.3 percent of the non-poor applied for medical consultancy or treatment, but only 21.4 and 1.2 percent of the poor and the extremely poor, respectively, applied for medical consultation or treatment.

Figure 15. Share of expenditures on healthcare services within the total consumption of the population as per quintile groups, 2009 (%)



Source – 2009 ILCS.

The distribution of expenditures on healthcare within the total consumption is presented per quintile groups in Figure 15. The share of expenditures on healthcare services in the total consumption of the population for the richest (5th quintile) quintile group is much higher than in the poorest (1st quintile), 7.2% against 0.2%. The consumption of healthcare services in the extremely poor quintile is less than 1/25 of the average consumption of those services, and the consumption of healthcare services in the richest quintile exceeds the average consumption of those services by 4.2 times.

2.2.7 Education

Public education is the program priority of the SDP for the education field. In the public education field, the program has targeted: the improvement of quality of general secondary education; the development and introduction of a productive, united system of supervision and knowledge assessment, comparable with European criteria; ensuring equal accessibility of quality secondary education for all layers of the population at all levels of secondary school, especially at high school levels; and the continuous improvement of effectiveness of the system and improvement of management. For realization of these targets of the SDP, the Government has undertaken large-scale measures.

For the purpose of realizing public policy on general education, ensuring quality of education, and improving educational legislation, in 2009 there were adopted RA laws on General Education and State Agency of Education, and a State Agency of Education has been established.

For the purpose of introduction of the new system of education quality assessment and supervision, the concept of knowledge assessment has been approved, and the assessment and testing center has been established. In 2007, the united examination system for school graduation and university admission was introduced. In 2008, the united examination system for school graduation and university admission was partially introduced—for 6 subjects, and starting from 2009 – for all subjects.

For the introduction and development of information technologies in the general education field, the national center for educational technologies has been established, which aims to introduce and continuously ensure information and communication technologies in secondary schools. As a result,

the number of school computers has increased, so that the number of students per computer has been lowered. In 2008 this indicator was 38 students per computer, in 2009 – 36, and in 2010 – 30.2. In high school, this indicator is 20 students per computer, which is comparable with indicators of European countries. Currently 944 schools (64% of all schools) are involved in the “Internet Network of Armenian Schools.” Electronic libraries have been established in all secondary schools of the Republic. A distance learning program has been piloted. The concept of computer skills training in elementary school has been approved, and a program originating from it, a pilot manual for teachers, and electronic interactive training materials have been developed. For the purpose of project implementation, 7 schools have been selected, and in 2011, 5 others were added to the list.

For the purpose of improving the effectiveness and quality of high school, a strategic program of the establishment of the high schools system has been developed. Currently, there are 91 high schools, which work separately. These have been rebuilt and refurbished, and teachers have passed special professional training. In accordance with principles of the program, subject programs have been amended and criteria of high schools established. In 2011, it is planned to complete the network of high schools by increasing the number of involved to 104.

Starting from 2005, 20% of teachers are retrained annually, ensuring a 5-year cycle of retraining of all teachers. At the same time, in accordance with SDP policy, salaries of teachers have been increased. In 2009, the average calculated monthly salary of teachers was 116.3 thousand drams, increasing by 57% in comparison with 2007. Given the decline of GDP and the maintenance of teacher salary levels, in 2009, the annual salary of teachers exceeded the annual level of GDP per capita by 44%, so that the ratio of teacher annual salaries and GDP per capita exceeded the SDP targeted value, 1.4 against targeted 1.1-1.3. In 2010, teacher salaries were maintained at 2009 levels, and the ratio of teachers annual salaries and GDP per capita was 1.3. In accordance with SDP policy, it is planned to increase the average calculated monthly salary of teachers to 117.5 thousand drams in 2011, 117.6 thousand drams in 2012, and 126.2 thousand drams in 2013.

The SDP prioritizes improvement of effectiveness of the system as a result of general education system reforms. In particular, SDP policy is implemented in this direction. Structures of classes have been revised by bringing them closer to normative indicators. In 2008-2010, the ratio of pupils to teachers and pupils to non-teachers in secondary schools was increased to 14.5 and 24.1; in 2007 those indicators were 14.0 and 23.2, respectively. In the medium-term, it is planned that pupil/teacher ratios will remain at 14.5, and pupil/non-teacher ratios will remain at 23.9-24.0. Systems of retraining and certification of the principals of general education institutions have been introduced. In 2011, around 500 principals of general education institutions will be retrained.

A new order of teacher attestation has been adopted, which enables differentiated financing and development of incentives for further professional improvement. The teacher attestation system will be introduced from 2011; attestation of around 20 percent of teachers of general education institutions will be conducted, and extra payments to teachers receiving ratings will be provided. These measures will greatly promote improvement of general education quality.

The main activities in preschool education have been implemented in accordance with the 2008-2015 strategic program of preschool education reform in the Republic of Armenia. Within the framework of the strategic program, special importance is given to the issue of effective preparation of the preschool “senior” age-group – 5-6 year old children – for elementary education.

It is planned by the strategic program to make preschool education mandatory for all preschool senior age children by ensuring the gradual increase of coverage to 75 percent by 2013, and to around 91% by the end of 2015. For this purpose, the RA Government has approved the necessary legal package with financial assessment and calculation of the preschool senior age-group children

by decree 1427-N of November 4, 2010 on “Financing of Expenditures on Organization of Education of Preschool Senior Age Children.

For the purpose of assisting the field and ensuring accessibility of preschool education services in different regions of the RA, resources have been allocated for implementation of pilot projects with application of cost-effective models. Within the framework of this project, in 2009, 22 preschool groups were run in the Lori and Shirak regions, which included 538 children. In 2010, 328 children accessed the services. In 2010, alternative methods of preschool education organization were introduced in the Ararat and Aragatsotn regions of the RA. As a result, 1,084 children were involved in school preparation groups.

During recent years, activities were conducted towards organization of education of children with special needs in secondary schools, with the aim of their complete integration into society. Currently, inclusive education is conducted in 65 secondary schools. It is planned to increase the number of such schools by 15 each year.

For the purpose of creating a sufficient basis for this initiative, a new order of financing of the organization of education for children with needs for special conditions of education has been piloted in Tavush region. In accordance with this order, funds provided for children with needs for special conditions of education in schools, subordinated to the region, implementing inclusive education, have been redistributed among other schools working in the region by adding an assistant teacher position in each school. In case of success, this order will be applied in the whole Republic.

As a result of system reforms, instead of the previously active 52 special schools, currently 23 special secondary education institutions are active in the Republic. A Yerevan center of medical, psychological and pedagogical assessment has been established with two branches in Stepanaban and Kapan. Operation of this center helps limit the entrance of children with social needs into special schools, as well as promotes the organization of quality education for children with needs for special education conditions.

For the implementation of educational policies foreseen by the SDP, financing of the sector is planned to increase. It is expected to consistently increase the ratio of public expenditures on education to GDP, aiming to reach a 4% of GDP target indicator by 2015. Policies conducted should also aim to ensure a permanent increase of the share of expenditures on education in the consolidated budget. The economic decline, the reduction of GDP, and the narrowing of resource availability of the budget have limited the possibility to maintain the volumes foreseen for nominal values of education funding. Actual data shows that during 2009-2011, education funding has increased more slowly than planned. At the same time, within the consolidated budget, the share of education funding has remained almost at the same level, and the SDP target of steadily ensuring its 14 percent share of consolidated budget expenditures starting from 2012 will not be realized. Policy foreseen in the SDP is conditioned on the successful reforming of education, in particular in the field of secondary education. Although nominal expenditures allocated from the consolidated budget for education have not been as targeted in the SDP, in percent of GDP, SDP targets have been ensured (see Table 33). Nevertheless, one of the challenges for the Government is maintenance of education expenditures at 4% level of post-crisis GDP by 2015.

Table 33. Comparison of actual and SDP targeted values of education expenditures made from consolidated budget in 2008-2012

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|--------------------|--------------------|--------------------|--------------------|-------|
| Education expenditures made from consolidated budget, bln drams | | | | | |
| Actual | 113.5 ^a | 121.0 ^a | 111.9 ^a | 126.5 ^b | ... |
| SDP target | 110.9 | 135.1 | 156.0 | 179.1 | 211.4 |
| Actual/SDP target, % | 102.3 | 89.6 | 71.7 | 70.6 | ... |
| Education expenditures in GDP, % | | | | | |
| Actual | 3.2 | 3.9 | 3.2 | ... | ... |
| SDP target | 3.0 | 3.2 | 3.3 | 3.4 | 3.6 |
| Education expenditures within consolidated budget, % | | | | | |
| Actual | 11.8 | 11.1 | 11.0 | 11.4 | ... |
| SDP target | 12.6 | 13.5 | 13.6 | 13.7 | 14.3 |

^a Source – 2008-2010 actual expenditures of RA state budget

^b Source – RA law on 2011 state budget

2.2.8 Environment

2009-2010 environmental developments have mainly been implemented within the framework of SDP priorities and in accordance with the second National Environmental Action Plan approved by the RA Government.

In 2009-2010, there have been recorded positive shifts in several directions indicated in the SDP; in particular these have been related to:

- Enlargement and improvement of environmental legislation and the sub-legislative base;
- A sustainable tendency of Sevan Lake level rising has continued (2007 – 55 cm, 2008 – 6 cm, 2009 – 38 cm, 2010 – 47 cm). On December 31, 2010, the level of lake water was 1899.70 m.
- Still insufficient, but a progressive rate of increasing of state funding of the field. Despite the negative consequences of the global and financial crisis, budget financing of environment has had a growth trend, which has been especially visible in the 2011 state budget. The 2011 state budget allocation for nature protection was 8.8 bln drams, nearly 33 percent more than in 2010 (in 2009, the sum of environmental and nature use payments did not exceed 6.2 bln drams).²³

Despite this record of progress, environmental issues mentioned in the SDP remain and should be kept within the list of priority issues of the Government. During the coming years, it will be especially important to possibly reduce environmental risks in parallel with Government efforts aimed at returning to a high rate of economic growth. In particular these relate to:

- Environmental risks brought about by a progressive rate of enlargement of the mining sector, conditioned by international prices of metals,
- Illegal logging risks conditioned by increasing gas prices,
- Dangers threatening underground water resources conditioned by rapid development of sectors using those.

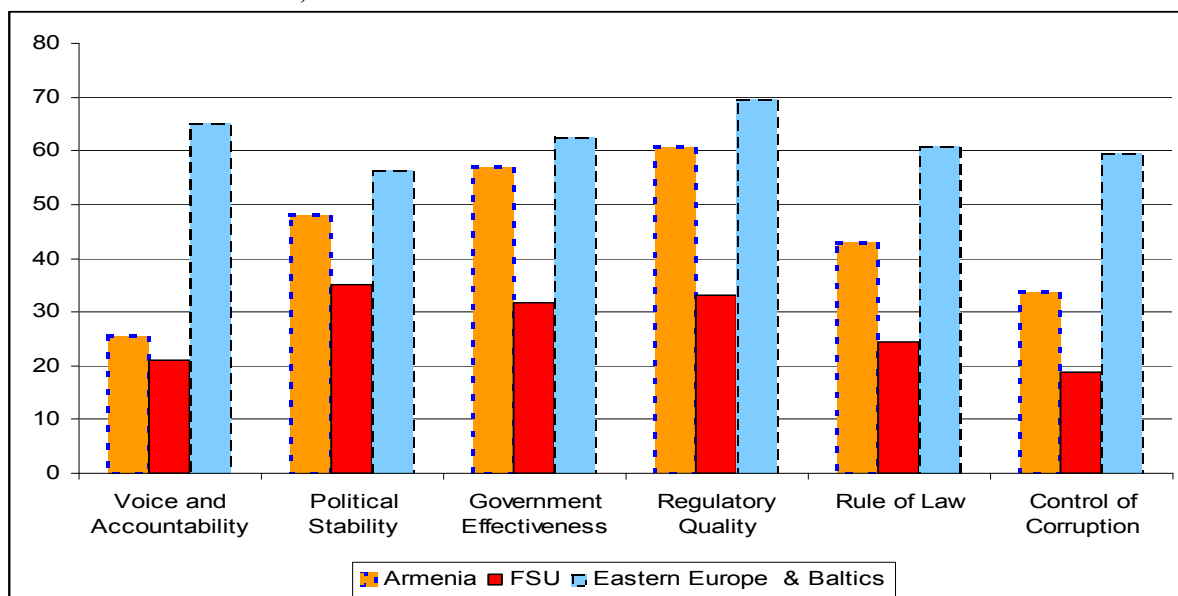
²³ Armenia is still significantly away from developed European countries in terms of share of public expenses on environment within GDP.

2.2.9 Institutional reforms

2.2.9.1 General assessment of public administration system

In general, comparing administration indicators of Armenia with those of CIS countries, Armenia is quite ahead, although it lags behind respective indicators of Eastern European and Baltic states.

Figure 16. Comparison of Armenia, CIS, Eastern European and Baltic states with regard to administration indicators, 2009



Source - WB

At the same time, to make Armenia competitive in the region and enable it to neutralize advantages of neighboring countries in terms of favorable geographic location or availability of natural resources, it is necessary to reach European levels of public administration and institutional reform quality.

Among the most prioritized directions of administrative system reform set by the SDP are structural and functional changes of the administration system, increasing effectiveness of the public/civil service, improvement of the judicial and public financial administration system.

2.2.9.2 Anti-corruption policy

Until 2007 there was an established methodology maintaining 59 corruptive criminal case statistics, but taking into account international practice and the fact that only offenses related to official abuse may be considered corruption, the number of was reduced to 22 in 2007. Since then, the number has reached 31, taking into consideration provisions of the UN Convention Against Corruption, according to which several additional types of crime also have a corruption nature, including inducing to bribe, false testimony, and provision of false conclusion.

Despite the reduction of the number of corruption-related criminal cases, if in 2007, all authorized bodies of the RA investigated 120 criminal cases of corruption, in 2008 materials were prepared for 524 cases of that nature, of which criminal cases were opened for 390; in 2009, materials were prepared for 771 cases, of which criminal cases were opened for 390; and in 2010, materials were prepared for 895 cases of corruption, of which 385 criminal cases were opened.

In accordance with the anti-corruption strategy of the RA and its 2009-2012 implementation program, a working group was formed, sub-groups established and work programs developed.

Within the context of those measures, there has been established a special investigation service independent from all bodies, which is called to investigate exclusively senior employees of legislative, executive and judicial bodies and persons conducting special state service, with regards to their official position, complicity, or criminal cases on crimes made by them. Respective law determines that prosecutorial supervision and procedural governance over criminal cases investigated by that body are conducted solely by the Attorney General of Armenia.

Another important direction of the anti-corruption strategic program of the RA is the involvement of civil society in fight against corruption (see SDP, Item 517). In this regard, in 2009, an order of participatory cooperation between the prosecution and NGOs was approved, which has determined principles, framework, plans, mechanisms, and assessment and implementation of that partnership. Centers of interest protection and assistance – CIPAs – have been involved in the cooperation, NGOs established for the purpose of fighting corruption, and unions involved in public polls.

For the purpose of effective organization of the fight against corruption, seminars, meetings, and reports in “Prosecution’s school” SNCO have been organized with respective programs for staff of CIPAs and other NGOs.

As a result of works implemented by the RA Police and other public and legislative bodies in 2008-2011, several legislative and sub-legislative documents have been developed and approved, and numerous anti-corruption measures have been conducted.

2.2.9.3 Judicial system

It has been planned by the SDP to enlarge the range of provision of free legal assistance of independent lawyers financed by the state, taking into account the needs of socially vulnerable groups of the population. Thereby, if in the first stage of reforms, free legal assistance has been foreseen for specific categories of civil cases, in the second stage, its enlargement is foreseen for subjects of specific categories.

Another important amendment proposed by the SDP is clarification of the status of experts in criminal, civil and administrative lawsuits, aimed at ensuring equal opportunities of expertise for both sides of lawsuits. This provision will be reflected in the new Code of criminal lawsuit, a draft of which is in the development phase.

Improvement of witness and victim protection institutions and introduction of effective measures are also foreseen in the new Code. The issue of protection of persons who have suffered from crime is also foreseen by several new documents developed in 2008-2010 (the 2010-2012 Schedule of national program of organization of struggle against trafficking, the Program of 2009-2012 measures of the RA anti-corruption strategy and its implementation).

The RA criminal lawsuit concept (approved in 2010) provides the institution of agreement process, the necessity of introduction of which is mentioned in the SDP. The purpose of the agreement process is conducting accelerated investigations in case of absence of dispute regarding the guilt of defendants. The agreement process may be applied only in cases related to non-major and medium-gravity crimes. The only basis for application of this type of process is submission of respective mediation by the defendant within the phase of preliminary court hearings.

Provision of technical assistance to interested parties is important for development of the commercial arbitrage institute (SDP, Item 500), which is currently actively realized by the assistance of the World Bank. The guideline of Commercial arbitrage may be found on the web-page of the Ministry of Justice of RA (www.moj.am).

Another priority and urgent policy measure defined by the SDP has been increasing salaries of judges. The official salary rate of a judge of Court of the first instance of the RA has been 220.0 thousand drams in 2008, which has doubled from December 2008, and in 2009-2011, it was increased at a slower rate (Compared with 2008, in 2011 the increase has been only 12%). This policy measure is one of the important steps of the anti-corruption strategy of the Government, which should also promote development of the fundamental principle of courts' independence.

A summary of data on judicial system financing is presented in Table 34.

Table 34. Indicators of RA judicial system financing in 2009-2011 (%)

| | 2009 | 2010 | 2011 |
|--|-------------|-------------|-------------|
| Delivery of total expenditures of judicial system | 93.6 | 98.1 | - |
| Share of judicial system total expenditure within the state budget | 0.7 | 0.6 | 0.6 |
| Ratio of per capita expenditures on judicial system and GDP per capita | 0.0020 | 0.0017 | - |

As it may be seen from the table, the share of judicial system total expenditures within the state budget has remained constant (in 2010 it decreased compared to 2009), the same may be said regarding the indicator characterizing per capita expenditures of the judicial system. Despite doubling of this indicator during recent years, it is still behind respective indicators of several Eastern European countries, the Baltic states and the RF for 2004.²⁴

In 2009-2011, several technical assistance measures were implemented by the “Judicial system reforms” program, as a result of which there have been introduced:

- Courts automation system,
- The “SRS Femida” recording system,
- Public information booth and monitors,
- “DataLex” portal [www@datalex@am](http://www.datalex.am),
- Courts archiving administration system.

Increasing effectiveness of maintenance of public order, public security and the fight against crime

In 2008-2011, the process of reforms of the Police of the Republic of Armenia continued in the following fields:

- **Road traffic security:**
 - 1) The initiation of of state registration of rental right of vehicles by the ownership, pledge and leasing agreement was introduced, which has solved several issues (protection of ownership rights of citizens, increasing of effectiveness of searching of vehicles involved in crimes or other offenses, reduction of risks of banks and credit organizations).
 - 2) The location of technical inspection was liberalized (currently it is implemented in any technical inspection station, regardless of registration location of vehicle).
 - 3) Patrols of road police conducting mobile service are already using respective laptops, which enables identifying in place the conformity of vehicle data with registration data,

²⁴ See SDP, page 198

information regarding reconnaissance, as well as having insurance agreement of coupon by the vehicle.

- 4) The system (technical solutions and software) of GPS locators has also been introduced controlling movement of road police vehicles.
 - 5) Repositories of traffic accidents, administrative offenses, vehicles and driving licenses registration have been finalized and are already used in road police.
 - 6) Construction of the Yerevan city examinational autodrome and administrative building is in process, which will realize implementation of the one-stop shop principle within the process of provision of drivers licenses, including both theoretical and practical driving examinations, as well as receiving of drivers licenses in the same location. The process of registration of vehicles has been significantly simplified by application of the “one-line” principle.
 - 7) For organization of RP service in accordance with international criteria, introduction of automated systems of speed control (radars, cameras) in Yerevan and other major cities of the Republic, as well as on highways, and starting from 2011, establishment of an offenses recording center, for which respective terms of reference have already been developed.
 - 8) In terms of continuous increasing of intensity of traffic in the Republic, a decreasing of the number of traffic accidents has been recorded during the past 3 years, which is directly related with effective reforms conducted in the field.
- ***Passport and visa system:***
 - 1) There have been set deadlines for inputting personal data of the population in the state register, as well as for provision of reference to the population from the state register regarding registration (November, 2010). As a result, the concept of de-registering has been nullified, and deadlines provided for registration actions have been reduced.
 - 2) New working methods have been introduced related with getting /discontinuing/ citizenship, exiting and entering of foreigners, in particular the principle of “one hall” for audience of citizens. Deadlines for conducting of passport actions have been clarified.
 - 3) For the purpose of ensuring accessibility of RA, laws on Foreigners and on Citizenship and sub-legislative acts originating from those RA legislation related to the field have already been put on the refreshed web-site of RA Police “police.am” in Armenian, English and Russian. Besides that, newly-adopted legal acts related with the field are periodically put on the newly-created official web-site of the Passport and visa department of the RA Police “passportvisa.am” and sent to the Ministries of FA and Diaspora of RA.
 - 4) An information portal has been established in PV department of RA Police (090007007 phone number). By calling this phone number, citizens may receive comprehensive information regarding legislation and responses to individual questions regarding the PVD field in Armenian, Russian and English.
 - 5) The process of getting or discontinuing RA citizenship has been simplified, the period between submission of application by an individual and adoption of RA President’s decree regarding citizenship shortened, and the list of documents submitted for getting or discontinuance of citizenship reduced. Besides that, while submitting applications, citizens will now get a number of their application, based on which they may receive comprehensive information regarding the status of their applications on the official web-site of PVD “passportvisa.am.”
 - 6) A hotline service has been introduced in PVD from 2010, based on alarms received, on which during just 2010 there were conducted around 30 service investigations.

- 7) Using off-budget funds of PVD, the building of the RA Police PVD Nor-Nork division has been reconstructed, which enables organizing service of citizens in accordance with international criteria. At the same time, there have been installed payment terminals in all divisions of Yerevan, which has made significantly easier the issue of payment made by citizens and thereby has excluded corruption risks. Reconstruction of other passport divisions is planned in regular order.
 - 8) Due to an absence of necessary financing, introduction of biometric passports of RA citizens and ID cards was not introduced in 2009. Its implementation is planned starting from September 2011, for which there have been developed respective legal acts, and necessary organizational measures have been implemented. At the same time, within the framework of introduction of biometric passports, procurement and installation in border crossing points of passport scanning and checking equipment are planned.
- ***Structural and organizational activities.***
 - 1) According to the RA Government decision number 367-NG of April 7, 2011, the Transport division of the RA Police was abolished, and its functions were transferred to the territorial units of the RA Police, and the State Protection division. At the same time, corresponding actions are currently being taken, aiming at clarifying the functions of the other structural units of the RA Police, and eliminating redundancies.
 - 2) All the necessary legal acts for introduction of a special civil service system in the structure of the RA Police have been adopted. A number of RA Police departments have made a transition to the system of special civil service since April 2011. In the future, a number of other services will also undergo a step-by-step transition towards the special civil service system.
 - 3) Starting from March 1, 2011, a principle of narrow specialisation (specialized service) of the criminal investigation service has been introduced in all the departments and units of Yerevan city. It will allow the operative staff to concentrate on detecting particular types of crimes, increasing their professionalism.
 - 4) Necessary organizational and legal activities are being undertaken in order to integrate the databases of the law enforcement bodies in the RA, and other related parties, into a single environment, in order to establish a uniform database, which is planned to be introduced by the end of 2012.
 - 5) In the framework of organizational, structural and functional reform in the RA police troops, a step by step transition from a compulsory military service to a contract-based service is being implemented, and is planned for introduction in 2012.
 - 6) A single specialized convoy service has been identified for the courts and bodies implementing criminal proceedings, in order to ensure adequate execution of the arrested and detained individuals convoy function.
 - 7) An important undertaking in raising the efficiency of managing government funds in the system of the RA Police was the introduction in 2009 of an internal administrative procedure of organization and implementation of budget planning and execution process in accordance with the structure of the management system. Moreover, significant changes have been made in the area of financial planning. In 2010, for the first time, the RA Police budget has been drafted and submitted in a program-budgeting format as well. Introduction of new budgeting principles from the one hand will provide for an opportunity to significantly improve the efficiency and expediency of programs implemented by the police, and, from the other, will substantially increase the public control over the programs

implemented in the system from now on, since each program or measure will have its corresponding quantitative and qualitative indicators.

- ***Public order management.***

- 1) The weapons, personal protection gear and special means of the departments involved in public order management have been significantly upgraded. Nevertheless, in order to raise the standards of the public order management to the international level, it is necessary to ensure provision of weapons, personal protection gear and special means that correspond to the modern technical requirements, as well as staff retraining.
- 2) The guard patrol service of the Yerevan Police Department has been fully reorganized, which allows for the possibility to increase the patrol service prescribed by the current regulation, the ratio of vehicle versus non-vehicle services, and their quantities. Consequently, a transition from a two-shift to a three-shift arrangement has been made, adding a night shift, and greatly increasing the number and the structure of vehicle and non-vehicle routes.
- 3) In the framework of the activities aimed at ensuring efficient public order management, it is planned to reorganize the external division and create a patrol service on the basis of the road police and the guard patrol services. At the same time, it is planned to establish modern external service warrant management centers, and to introduce modern surveillance systems in public areas and heavy transport crossing points.
- 4) Taking into consideration the efficiency of the neighborhood (community) policing model, introduced with the assistance of the OSCE on a trial basis in the Arabkir administrative district of Yerevan, it is planned for 2012 to establish community policing divisions on the basis of the crime prevention, investigatory and juvenile affairs divisions of the Yerevan city territorial administration. The draft of the RA Government decision “On approving the charter of RA Police community policing service” has already been prepared and put into circulation.

- ***Building-up Public Confidence in the Police.***

- 1) In order to strengthen police-public relations, and ensure transparency of activities, the official website of the RA Police www.police.am was updated.
- 2) In order to ensure effective mechanisms for proper record of crime reports, and quick response and follow-up processes, a modern “AVAYA” system has been introduced. A concept on establishing a quick response center in the framework of the Yerevan city administration has been developed.
- 3) Steps are being taken in the direction of establishing a consolidated system of registering and following citizens’ applications and complaints in the RA Police bodies and units.
- 4) A system of modern criteria for evaluation of the RA Police bodies and units work efficiency has been developed, taking into consideration public opinion on policing activities.

2.2.9.4 Reforms in public finance and public expenditures management

Developing and adopting a comprehensive strategy for public finance management was one of the most important activities projected by the SDP. It was implemented in 2010, and includes the following core directions of reform, implemented by the RA Government.

1. Introduction of principles and formats of program budgeting

During the past few years, and at present, measures are being taken in the direction of introduction and strengthening of a separate program budgeting methodology framework. In particular, monitoring of non-financial program indicators is being implemented, and quarterly reports are being submitted to the Ministry of Finance, a fully independent “programmatic” classification has been introduced and integrated with the other operational classification systems, a program structure has been developed on the basis of program restructuring, unification and aggregation along the lines of PB classification system and methodology.

Moreover, development of “program passports” is in progress, which would become an important tool in connecting the sectoral policy and budgeting. Already in the trial period, the passports have revealed some logical inconsistencies between the declared policy and budget resource allocations. This is yet additional evidence of the low level of sectoral administration divisions’ participation in budget planning.

Viewing the public finance management reforms from this perspective, it should be mentioned that 2009-2011 were the years of strengthening the PB reforms and introduction and application of budget planning, monitoring and reporting tools.

By 2013, it is planned to also bring into accordance the budget system legislation, which currently does not create obstacles, but does not encourage the application of modern program planning and budget-reporting methodologies. It is projected that as a result of this, budget-related information will be presented to the public mainly in the program format, which would allow for the possibility to learn and control the efficiency of budget spending, evaluate the implementation level of the declared objectives, get acquainted with the budgetary results through the use of non-financial indicators, etc.

2. Reforms related to the state budget execution (Treasury)

Establishment of a budgetary commission has improved the planning of financial flows in the process of state budget execution. The commission, which is headed by the Chief Treasurer, and also includes as its members the representatives of the Central Bank and State Revenue Committee, is responsible for issuing monthly cash forecasts (which are broken down into weeks) based on four variables: receipts, payments, debt issuance and payment arrears. Due to the efficient work of the commission, the monthly projections are now close to actualized expenses.

The Treasury started to provide direct access to its systems to program managers to record transactions and perform budget control. A pilot project has been already started in the Yerevan Municipality. This approach, which is strongly related to the program budgeting principles, will significantly raise the flexibility and efficiency of the project managers’ work.

The Treasury is taking steps to interface the database of the budget department with its own database. This would allow the budget department to use the latest budget vs. expenditure data in the budget review process, and, thus, be able to suggest timely budget planning corrective measures.

The Treasury has already developed a strategy and a technical specification for the introduction of a fully-integrated system based on a Government financial management information system, which is projected by the second generation reform program of the Treasury.

ANNEXES

Annex 1. Measures aimed at reforming of tax policy:

Regarding measures undertaken towards possibly excluding legal possibilities for avoiding taxes, and improvement of taxation mechanisms through simplification and clarification of tax legislation provisions:

For the purpose of fighting against using softer taxation terms established for small and medium businesses through artificial disintegration of large businesses, a package of legislative drafts has been developed, which has been adopted by the National Assembly of the Republic of Armenia.

For the purpose of assisting small and medium businesses, there have been numerous amendments to effective taxation legislation (an unprecedented high threshold of non-taxing by VAT has been set – 58.35 mln drams of annual turnover, procedures of tax registration and recordings have also been simplified, statements submitted to tax bodies have been shortened, simplified and united, etc).

For the purpose of enlargement of application of the framework for most simplified, privileged regimes for economic entities with small turnover volumes, reduction of frequency and unification of deadlines for submission of statements for some tax types, a package of legislative drafts has been developed, which has been adopted by the National Assembly of the Republic of Armenia.

Regarding measures undertaken towards replacement of alternative taxation systems established for individual types of activities by common system of taxation:

In accordance with Laws of the Republic of Armenia HO-126-N on Making Amendments and supplementations to the Law of the Republic of Armenia on Excise tax and HO-130-N on Nullification of the Law of the Republic of Armenia on Fixed fees for petrol and diesel adopted by the National Assembly of the Republic of Armenia on October 7, 2010 import and further realization of petrol and diesel have been transferred from the system of fixed fees to the common taxation system.

In accordance with Laws of the Republic of Armenia HO-126-N on Making Amendments and supplementations to the Law of the Republic of Armenia on Excise tax and HO-128-N on Nullification of the Law of the Republic of Armenia on Fixed fees for tobacco production adopted by the National Assembly of the Republic of Armenia on October 7, 2010 starting from January 1, 2014 taxation of tobacco production will be conducted by the terms of the common taxation system.

In accordance with the Law of the Republic of Armenia HO-148-N on Making amendments and supplementations to the Law of the Republic of Armenia on Fixed fees adopted by the National Assembly of the Republic of Armenia on May 11, 2011 starting from January 1, 2011 six types of activities (retail of petrol and diesel, parking lots (in case if there are installed systems registering exiting and entrance of vehicles), industrial fishing, organization of computer games, organization of baths and showers, organization of billiard games) shall be transferred from the system of fixed fees to the common taxation system.

On measures performed with regard to ensuring the required level of the tax/GDP ratio through improvement of tax administration aimed at reduction of shadow activities.

The tax policy developed and implemented by the RA Government in recent years has been focused on improving tax policy and increasing the effectiveness of the tax collection process to ensure increase the level of state revenues.

Particularly, relevant amendments were made in the current tax legislation to increase the efficiency of the struggle against the shadow economy and the tax collection process. In connection with these amendments, since 1st January 2010:

- a) The institute of tax representation was introduced for large taxpayers
- b) The “excise warehouse” regime was introduced for taxpayers considered as excise taxpayers.

In the framework of the fight against non-commodity document circulation and non-documented transactions, an electronic tax invoice system was introduced on 1 January 2011. Application of this system enables the tax authorities to control the tax invoicing process in real time, hence minimizing the cases of non-commodity document circulation and non-documented transactions.

Application of the mentioned control systems will enable the tax bodies to execute more efficient tax control over goods provided and volumes of works implemented by the taxpayers, prices and documentation of the mentioned transactions.

At the same time, to improve the tax/GDP indicator and to reduce arrears accumulated during preceding years, the RA law on “Defining privileges with regard to tax and other mandatory payments for organizations and private entrepreneurs” was adopted by the RA National parliament on 26 May 2010 and is already submitted to the President’s endorsement.

On measures performed with regard to introduction of tax payers’ effective self-assessment system simplification and improvement of reporting procedures.

To raise the self-assessment level of taxpayers, a system of electronic submission of reports, calculations, information and other documents to the tax bodies was introduced.

The procedures of providing official clarifications on provisions of tax legislation were revised to ensure uniform application of tax legislative provisions. In particular, the RA Government Decree 1007-N dated 29 July 2010 on “Approving the procedure of providing clarifications on provisions of legal acts regulating matters related to taxes, duties, and other mandatory payments” stipulates that all the clarifications provided by the RA SRC on taxes, duties, and other mandatory payments shall be preliminarily agreed with the Ministry of Finance of the Republic of Armenia.

The tax appeals system was improved. Particularly, an interagency Appeals Council was set up by the RA Government Decree 1361-N dated 21 October 2010 on “Establishing Appeals Council and approving the procedure of reviewing the decisions of the appeals committees of tax and customs authorities.” The Appeals Council considers complaints (appeals) reviewed but rejected or partially satisfied by appeals committees.

On activities carried out with regard to introduction of the risk-based audit system.

To introduce risk-based audit system, it was defined by the RA Government Decree N 1487-N dated 17 December, 2009 on “Applying the selection system of taxpayers subject to verification of relations with state budget based on risk criteria”, that the selection of taxpayers subject to verification of relations with state budget is being carried out based on risk criteria from 1 October, 2010.

To introduce a system of refund and (or) set-off of VAT and excise tax amounts to the disciplined taxpayers without examination, the criteria were defined by the GoA Decree N 1758-N dated 30 December 2010 on “Establishing criteria based on which the taxpayer is considered risky in terms of refund or set-off of VAT and excise tax amounts without examination or check.” The taxpayers selected on the basis of these criteria may benefit from the aforementioned simplified procedures of set-off or refund of VAT and (or) excise tax.

On activities carried out with regard to simplification of customs legislation and procedures.

To simplify customs procedures, the list of documents required for customs control during import and export procedures was reduced by the RA Government Decree N 636-N dated 29 May 2009 on “Making amendments in the GoA Decree N 1779-N, of 21 November 2003 on defining the lists of documents and data required for executing customs control and procedures for providing to the customs authorities.”

On activities carried out with regard to increasing the efficiency of control in customs administration system.

To increase the effectiveness of customs control and necessitated by simplification of customs procedures, the RA Law HO-25-N was adopted on 22 December, 2010 on “Making amendments in the Customs Code of the Republic of Armenia.” The law regulates provisions of applying principles of selectivity during the execution of customs control, risk management system when selecting types of control, and anticipates defining the nature of risk management systems and risk assessment criteria. The methodology of the risk assessment criteria is defined by the authorized body of the RA Government (RA Ministry of Finance), based on which the superior customs authority approves risk assessment degrees.

List of adopted laws and/or other normative-legal acts, development of which derived from provisions stipulated in the SDP

To establish a relatively low administrative burden on small business, for supporting the principle of fair taxation, effective tax administration mechanisms were established as a result of works carried out by the tax authorities not impeding the development of small business, namely:

The legislative framework for small business was simplified:

- Mechanisms of simplified tax were stopped, meanwhile a threshold is established and taxpayers whose turnover is below the defined threshold are exempted from the VAT;
- In order to improve taxation mechanisms for small business, the number and frequency of reports to be submitted to tax authorities were reduced, simplified calculation of income tax (tax on profit) is defined, and small business was exempted from additional paperwork (e.g. registry books of commodity supply and revenues);
- A new institution of license payment was introduced for some categories of self-employed, which stipulates simplified administrative mechanisms for individuals engaged in defined types of activities. By legislative amendments in 2010, the list of activities subject to license payment taxation was enhanced, and individual entrepreneurs were given opportunities to operate within the framework of license payments,
- A unified deadline was defined for the submission of accounts and reports to tax authorities (this legislative provision is valid also for large business);
- Due to legislative amendments, the principle of a one-stop station was introduced, according to which from April 2011 taxpayers obtain TPRN (Taxpayer’s Registration Number) at agencies of state registry and in the RA Central Bank, thus eliminating the mandatory requirement of registration at tax authorities. This means that when a taxpayer obtains state registration, he/she automatically is considered registered at tax authorities (this legislative provision is valid also for large business).
- The below-presented legal acts were approved in the framework of actions targeted at: simplification of customs legislation and customs procedures, enhancement of control over the implementation of requirements of the customs legislation, enhancement of the implementation

of mechanisms of self-declaration in the customs system and improvement of customs control related to the latter.

- RA Law (HO-25-N, 22.12.2010) on “Amendments and additions to the RA Customs Code” legally specifies processes of introduction of risk management systems during electronic and customs control of customs declaration. More flexible procedures on customs control were defined for transportation means that are registered under the customs regime of temporary import. Legal bases were clarified for customs privileges provided to individuals arriving to Armenia for permanent residence.
- Pursuant to the RA Law (HO-227-N, 08.12.2010) on “Amendments and additions to the RA Law on Licensing” the number of types of activities subject to licensing was reduced, as well as customs mediation was not subject to licensing. GoA Decree No:423-N of 24.03.2011 on “Amendment and additions to the GoA Decree No:844 of June 22, 2002” was approved to implement provisions of the RA Law HO-227-N of 08.12.2010.
- GoA Decree No:313-N was approved on 31.03.2011 on “Additions to the GoA Decree No:236 of 24 March 2001, according to which omission of electronically paid customs declarations was made by marking the omission also in TWM system, which allows for monitoring the period of customs documents preparation. GoA Decree No:587-N of 12.05.2011 on “Amendments in the GoA Decree No:230 of 19 April 1999” stipulated that the payment of customs fees shall be verified also by electronic notification sent from the commercial bank to the declaration automatic system in customs authorities, which is reflected in the customs declaration.
- Order No:75-N of the RA SRC was approved on 28.02.2011, which defined 2 days as the period required to provide permission to calculate the customs value of goods transported through customs border by the method of the price of the transaction, provided that all documents required by the RA customs legislation are submitted.
- The 2011-2013 program of RA SRC on reforms in customs system was approved, which is targeted at: compliance of the customs legislation with EU standards; simplification of circulation for customs documentation preparation, enhancement of the self-declaration system and development of the customs mediator institution, implementation of actions aimed at the reduction of corruption risks within customs authorities, automation of customs procedures at the state border using electronic technology system, enhancement of automatic information system in the area of risk management during customs controls, development and improvement of the system of pre- and post-omission customs control, and improvement of mechanisms to combat contraband and violation of customs rules.

Efficient administrative mechanisms are defined for taxpayers

- Regulations were approved in 2009 with regards to visiting newly-created taxpayers to provide them support and services;
- Procedures concerning the transfer of taxpayer registration from one tax inspection to another were clarified, peculiarities of tax registration in the cases of reorganization of organizations were regulated;
- In the framework of improvement of the business environment, effective policies were implemented to reduce the documents submitted to tax authorities. Hence, the number of 57 applications and references required only by tax authorities was reduced in 2011, to avoid unnecessary waste of taxpayer’s time, bringing to the minimum the contacts with tax authorities.

Progress Report on Implementation of the Sustainable Development Program (Year 2009-2010)

The tax authorities thoroughly implemented measures stipulated in the strategic program, as well as in the 2009-2012 program of the anti-corruption strategy approved by the GoA to limit corruption risks and to establish a fair and just working environment within the tax authorities. The main actions to achieve the objectives were:

The system of encouraging and promoting the career of tax servants based on performance evaluation was introduced in 2010.

The system of appeals against tax authorities was improved, the transparency of outcomes is ensured (decisions of the Appeal Commission are published in the official web-site of tax authorities), procedures to propose members of the Appeal Commission of tax authorities were revised in 2008, and working regulations of the Appeal Commission were defined. An Appeal Council was established by the GoA Decree No: 1361-N of 21.10.10, regulations to discuss the decisions of Appeal Commissions of superior tax and customs authorities by the Appeal Council were approved. The main goal of the Appeal Council is to facilitate the unified and correct use of provisions of the tax and customs legislation or other legal acts regulating the tax and customs relations.

Based on relevant legislative-basis regulations, conditions and the time-schedule to submit electronic tax reports to tax authorities were defined; RA SRC developed and approved a concept paper on the introduction of e-management, aiming at the introduction of a unified e-management system, based on advanced information technologies.

Pursuant to the approved time-table, from 1 January 2010, 27 reports were entered into the system of electronic reports, the number of electronic reports as of 30.12.2010 was 70.000. The number of taxpayers submitting electronic reports was 4,085 as of 30.12.2010. The service centre for electronic reports has been operating since 2010.

Meanwhile, activities are carried out to introduce mechanisms ensuring the provision of electronic reminders/notifications to the taxpayers.

RA SRC defined as a priority changing the attitude of society and the business community towards the tax and customs authorities – by changing the image of tax collector bodies into bodies providing support and modern services to taxpayers. With regard to this, service centers for taxpayers were established within the SRC system. In 2010-2011 such centers were opened in Arabkir and Vanadzor. It is envisaged to create service centers for taxpayers also in the other regions. The strategy to provide services to taxpayers was elaborated, which defines the regulations and types of services provided by service centers to taxpayers.

Procedures were approved regulating the provision of clarifications by tax authorities to written, oral or electronic requests. The procedures regulate the provision of individual clarifications to organizations and individuals regarding their rights and obligations, the existing taxes and mandatory payments, calculation and payment procedures of taxes and mandatory payments and other questions. Clarifications are provided by tax authorities within the framework of tax administration.

53 terminals were installed in tax (regional) inspections of the RA SRC, customs points, customs offices, as well as in service centers for taxpayers to inform the taxpayers about the changes in the tax and customs legislation and to advise on the preparation and submission of electronic reports.