

Republic of Armenia: Poverty Reduction Strategy Paper

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REPUBLIC OF ARMENIA

POVERTY REDUCTION STRATEGY
PAPER

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Government of the Republic of Armenia

LIST OF ABBREVIATIONS

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

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INTRODUCTION

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

THE PRSP DEVELOPMENT PROCESS

6. The Poverty Reduction Strategy Paper has been developed with the support of scholars, experts, public and political figures, and all those who are interested in eradicating poverty in Armenia. The PRSP development process is not similar to any other program developed previously, since it includes the participatory approach as one of its most important components. This is one of the most important guarantees for the successful implementation of the PRSP.
7. Decision No. 267 of the Prime Minister initiated the development of the PRSP on May 15, 2000. Based on this decision, a **Steering Committee** (SC) was founded, headed by the Finance and Economy Minister and consisting of representatives from line ministries dealing with social and poverty issues, standing committees of the Armenian National Assembly, National Statistical Service, political parties, NGOs and the donor community. The main responsibility of the PRSP SC was to organize and to coordinate the development of the Interim¹ and later, of the full-fledged PRSP.
8. For the day-to-day management of the PRSP development the PRSP **Working Group** (WG) under the direct supervision of the SC was established on April 14, 2001, where, as in the case of the SC, governmental, non-governmental as well as international organizations were represented. The PRSP WG was responsible for the day-to-day management of the PRSP development process, drafting the final document, providing information on various components of the program and ensuring its transparency. It also organized the participation of the population at large and the donor community in developing the PRSP. It incorporated their comments in the document, and submitted the final document to the PRSP SC.
9. The work on the full-fledged PRSP started in November 2001, when a team comprised of WG members and independent experts prepared the PRSP **Terms of Reference** (TOR). The TOR defined priority PRSP objectives and targets for political, social, economic and governance development. It also identified the main directions for policies and specified the relevant rules regulating the PRSP development process. The PRSP TOR were widely discussed within central, regional and local governments, NGOs, scholarly and educational institutions, the mass media, and the international and donor communities. Numerous publications, radio and TV programs, information booklets, analytical bulletins, round tables, club discussions, seminar-workshops, and other events were organized on the main concepts of the PRSP TOR.
10. Parallel to discussions on the TOR, about fifty independent experts, who were selected through an open competition announced by the SC, developed the PRSP. In accordance with the TOR, the experts were divided into the following five **Expert Groups** (EG):
 - (i) Poverty assessment and analysis;
 - (ii) Methodology and methodological issues;
 - (iii) Social strategy;
 - (iv) Economic strategy;
 - (v) Governance, participation and monitoring.
11. The Medium Term Expenditure Framework (MTEF) was developed by the government parallel to the PRSP's development. Since it was necessary to harmonize and coordinate the PRSP and MTEF documents, a special expert group was formed. It actively participated in discussions on the draft PRSP and provided numerous comments and suggestions. As a result of the work of this group, a number of measures proposed in the draft PRSP were incorporated in the 2003-2005 MTEF and the necessary funds were allocated in the 2003 state budget. This made it possible to start the implementation phase as early as 2003.
12. Expert groups finalized their work in September-October 2002 and the Steering Committee circulated the draft PRSP for discussion among all stakeholders. In the subsequent three months, a large number of comments and suggestions resulting from discussions were received. The results of processing these

¹ The Interim PRSP was developed by the government and widely discussed by the public and approved in March 2001 as a guideline for developing the Full-fledged PRSP. See www.gov.am

comments and suggestions revealed that they mainly referred to defining priorities in the document and in its structure. It was also considered necessary to harmonize the PRSP with programs being implemented in the country through support from the donor community. An Expert PRSP Consolidation Group was set up on February 12, 2003, in order to consolidate and finalize the Document, incorporating all the received comments and proposals. The expert group completed its work in May 2003.

ORGANIZING THE PRSP PARTICIPATORY PROCESS

13. With the objective to publicize the PRSP development and to organize public participation, the NGO Institute for Human Rights and Democracy and the Analytical Informational Center for Economic Reforms, CJSC, of the Government of Armenia were selected through an open competition organized by the SC.
14. Throughout April-November 2002, these agencies organized and implemented (i) public discussions with the participation of representatives of society, deputies of the National Assembly, local governments and the press; (ii) seminars in all regions of the country with the participation of society, the private sector, central, regional, and local governments; (iii) preparation, publication and dissemination of information and analytical materials for the public, including through the Internet²; (iv) TV and radio programs; (v) articles in the provincial and national press; (vi) public opinion surveys; and (vii) public awareness campaigns in communities, various representative groups of the population, educational institutions, etc. A PRSP Internet site³, including information on the participatory process, has been set up and is regularly updated.
15. At the same time, the development of the PRSP participatory process was not limited to activities of the above-mentioned agencies selected through the competition. In accordance with the tripartite agreement signed (on June 17, 2002) by the Government of Armenia, the World Bank and the UNDP, a list of measures for the development of the PRSP participatory process was approved. The coordination and implementation of these measures was done by the joint UNDP/GoA “Creation of a Social Monitoring and Analysis System” project. Experts developing the PRSP also conducted activities related to the Participatory Process.

CIVIL SOCIETY PARTICIPATION

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

² See www.gov.am/en/gov/iprsp, www.undp.am/pubs/pover/index.html

³ See www.gov.am/en/gov/iprsp

Armenia. Yerevan had the broadest involvement in the participatory process, followed by Sheerak, Lori and Gegharqooneeq. NGOs involved in the PRSP participatory process in Gyumri and Vanadzor organized numerous discussions. Gegharqooneeq was also one of the most actively involved provinces, where events were organized jointly with NGOs in the town of Martuni and with representatives from provincial schools in Shorja. Discussions were organized in Ararat, Gegharqooneeq, Vayots Dzor and other provinces with the support of the staff of Monitoring and Analysis Units. Discussions on specific issues, such as agriculture, employment and education, were conducted in Syooneek, Lori and Vayots Dzor provinces. Experts from the groups for the development of social policies initiated a discussion in Lori province. Events organized in the provinces revealed that there is a significant lack of information there, especially in rural areas, and many people are left out of discussions and the decision-making processes due to a lack of awareness about these possibilities, a lack of information and knowledge, and poor communication.

20. **Participation of community governments** The PRSP SC initiated the dissemination of the draft PRSP to all communities of the country for comments and recommendations. Almost half of the communities responded by discussing the document and by coming up with a large number of recommendations, which were summarized and further passed on to Expert Groups. A number of representatives from community governments participated in a three-day workshop on the issues of community governments.
21. **Participation of the non-governmental sector of society** Within the framework of the joint UNDP/Government of Armenia project “Creation of a Social Monitoring and Analysis System” a study of social groups in Armenia was conducted in the spring of 2000. This study revealed that despite some differences in the level of societal development in Yerevan as compared to provinces; and differences between urban and rural areas, some progress was achieved in this respect. In particular, various organized groups, such as NGOs, Water Users’ Associations, specialized centers, business centers, etc., were being formed especially in provincial centers and small towns, as well as in some villages. Out of more than 20 types of social organizations, the following were the most active in the participatory process: (i) NGOs; (ii) scholarly and educational structures; (iii) mass media; (iv) private sector; (v) trade unions; and (vi) community governments.
22. **NGOs**, (being one of the more developed groups of society), were actively involved in the PRSP’s development. NGOs submitted their comments and recommendations on the draft PRSP throughout all the stages of the PRSP’s development. Some NGOs discussed the draft within their organization, as well as with their beneficiaries and other NGOs active in the same field. NGOs were actively involved in topic discussions, as well as in all public and group discussions. A number of NGOs organized their own discussions or were actively involved in events organized by the group responsible for the participatory process (e.g. Women's Council of Martuni, "Millennium Association for Educational Studies", "Education for Sustainable Development" NGO, “Asup” NGO, “Support to Universal Management of Quality” NGO, “Burg” Youth Environmental Center, Association of Sheerak NGOs, “Versia” Analytical-Information Center). In discussions related to other topics, numerous NGOs emphasized poverty issues and included the PRSP on their agendas (e.g. Women's National Council, “Mush-2”, “Vega”, “Araza”).
23. **Scientists and university lecturers** directly participated in the PRSP discussions and development in a number of directions, including direct involvement in the elaboration of the program as members of the Working Group and Expert Groups. Representatives from scholarly and educational institutions were involved in numerous events organized within the framework of the participatory process. Higher educational institutions (Yerevan State University, Medical University, Brusov Foreign Languages Institute, Pedagogical Institute, Engineering University) have provided consultancy to experts developing the PRSP.
24. **The mass media** is also one of the most developed groups of society. It was actively involved in PRSP activities. The mass media covered all the large-scale public discussions and a number of specialized discussions. A number of newspapers and radio stations, as well as some TV channels, broadcast various presentations on PRSP issues and related intensive discussions. A number of representatives from the mass media presented their comments and recommendations on the PRSP.
25. Representatives from **trade unions** have participated in a number of club discussions. Numerous heads

of sectoral trade unions participated in the discussion on “Trade Unions and the PRSP Participatory Process”. A number of heads of sectoral trade unions presented their recommendations on the draft PRSP.

26. **Participation of political parties** Deputies and experts of the National Assembly were actively involved in both the PRSP SC and EGs. At the same time, deputies were invited to, and actively participated in, seminar and topic discussions and round-tables. A discussion of the draft PRSP with opposition political parties was organized in Yerevan on November 28-29, 2002, with the participation of deputies from the opposition parties in the National Assembly and representatives of various political parties.
27. **Participation of the private sector.** The private sector also contributed to the PRSP development through its representatives in the PRSP WG and EGs. At the same time, three round-tables were organized especially for associations of businessmen, farmers and industrialists, to discuss the PRSP economic policies.
28. **Participation of international organizations.** International organizations were very active in the PRSP through provision of consulting and financial support to those who coordinated and developed the PRSP. The donor community provided joint comments on the TOR and the drafts of PRSP. Seminars were organized by donor organizations to provide technical assistance to PRSP experts and the Working Group (UNDP, WB, GTZ). A number of organizations (WB, UNHCR, DFID, CRS, OXFAM GB, AED, and others.) provided support in organizing the participatory process events and have referred to the PRSP in their projects. They have also emphasized the importance of the participation of societal groups in the discussions on various projects.
29. **Participation of the Diaspora.** Organizations representing the Diaspora participated in joint discussions on the PRSP. The NGO Center of the Armenian Assembly of America provided support in organizing discussions in the area of education.

PUBLIC AWARENESS AND FEEDBACK

30. Information provision on the PRSP already started during the development of the Interim PRSP. Mass media coverage, through the provision of information and special programs, however, became more intensive later during the development of the full-fledged PRSP. A number of national newspapers dedicated pages to the PRSP and more than 100 articles were published in various national and provincial papers. Programs were broadcast by the national radio and other radio stations. A number of radio discussions were organized, during which listeners had the opportunity to participate in live discussions and Q&A sessions. TV programs about the PRSP were broadcast by Prometevs, Armenia, Abovyan, Yerevan, and Gavar TV channels. Some included live interviews with experts. Reports were also broadcast by MIR TV station. A number of interviews on the PRSP took place and the main seminars organized within the framework of the PRSP were covered by the Public TV's "Dzeragir" program. Information on the PRSP is presented in the PRSP Development Process section of the Government's web page, as well as on other web-pages created by NGOs efforts⁴. A number of 2002 issues of the “Hayatsk Tntesutian” bulletin were devoted to the PRSP. Advisory, analytical booklets on a number of topics directly referred to, or touched upon, the PRSP. The informational-participatory brochure for the general public titled “What is the PRSP?” was published with a print run of 2500 copies.
31. Various mechanisms were used for collecting recommendations and incorporating them in the PRSP, including recording comments and recommendations brought up during discussions, using e-mail for receiving comments and sending them further to PRSP experts and the Working Group, conducting surveys, collecting information on social and economic conditions in communities, collecting recommendations by fill-in forms during discussions. Information on the level of incorporation of the recommendations in the PRSP was disseminated by publishing the recommendations in “Hayatsk Tntesutyan” bulletin, posting summaries of discussions to participating organizations by e-mail, sending the experts’ responses to organizations that had originally submitted the recommendation, direct discussions between experts and organizations submitting recommendations, as well as providing

⁴ See www.forum.am, www.hra.am

opportunities for discussing individual recommendations.

CONSTRAINTS, RESULTS AND FUTURE STEPS RELATING TO THE PARTICIPATORY PROCESS

32. A number of **constraints** to the participatory process emerged. Overcoming them needs urgent action and the implementation of long-term policies. These constraints include: a lack of faith in the implementation of the PRSP; difficulties of accessing information (small number of copies of the press and their not being affordable for the poorer groups of the population); a “Soviet” mentality, specially among middle-aged and senior citizens; the low level of institutional development of society; lack of knowledge on fundamental democratic values and their alienation in communities; the inactive mid-level governmental structures; the prevalent reluctance in the attitude of governmental bodies toward public participation; frustration and disappointment resulting from difficult social conditions, little or no hope for the future resulting from the lack of possibilities to overcome difficulties; little knowledge on participatory community governance, inadequate skills among some community governments, few or no initiatives from the public.
33. Quantitative **results of the participatory process** are the following: more than 100 written recommendations were received. These were mainly incorporated in the draft PRSP. More than 1800 people participated in events organized within the framework of the participatory process. Overall, about 700 recommendations were recorded based on questionnaires completed at the end of discussions. Although it is difficult to produce a numerical assessment of the incorporation of recommendations, it can be stated that about 40 % of the recommendations received have been included in the PRSP, and about one-third were taken into account at least in part.
34. Topic seminars, round-tables, discussions, surveys of public opinion in provinces and communities took place. In order to discuss urgent issues of the PRSP’s development, and so as to present the intermediate results of the work of experts to representatives from society, governmental structures (including provincial and community governments), and the donor community two large-scale seminars at the Writers House in Tsaghkadzor were organized for more than 100 participants (March 9-11, 2002, July 23-25, 2002). On June 28-30 and September 27-29, 2002 two topic seminars “Poverty Reduction Issues in Armenia and Community Governments” and “Social Partnership: Actors, Developments” were also conducted at the Writers House in Tzaghkadzor. Later, on August 12-28, 2002, the PRSP SC initiated expert discussions with specialists from relevant ministries and agencies at the Ministry of Finance and Economy, and on September 6, with specialized NGOs as well.
35. Besides large-scale seminars, awareness campaigns were carried out with 14 round-table sessions, 7 club discussions, and 4 public discussions. These were organized in the framework of more than 120 organizations of 80 communities in Yerevan and 9 provinces. In total, 12 issues of “Hayatsk Tntesutyanyan” bulletin were devoted to the PRSP (18000 copies), 5 joint publications of regional newspapers, 12 informational booklets (22800 copies), two journals, as well as 18 special pages and more than 100 articles in the press were published. Some 23 TV programs (total duration of 13 hours), 17 radio programs (a total of 6 hours), 3 live radio discussions and 2 live TV discussions were broadcast. Furthermore, 2 surveys with 1000 respondents each were conducted in Yerevan and in 35 communities of 7 provinces.
36. **Achievements of the Participatory Process.** Due to the participatory process, the PRSP tends to become a program developed not by the authorities, but by the participation of the public and independent experts. Due to the participatory process, an atmosphere of dialogue has been created from top to bottom. Through awareness campaigns, meetings, and discussions, the public and the organizations representing it, have directly participated in the development of the PRSP.
37. Through information provided by the mass media and the dissemination of printed materials and informational booklets, meetings, discussions with expert groups, TV and radio debates, the public was informed on the process of the PRSP’s development and poverty issues. A framework of cooperation and partnership has been formed between participants of the PRSP awareness building and participatory process. It is very important to maintain and further deepen this framework during the next stages: PRSP implementation, monitoring and evaluation.
38. At the same time, this completed phase of the participatory process was a valuable experience and

provided for a number of lessons based on the work done. During discussions, the interaction of various groups dealing with the same set of problems revealed that this exchange of experience is very important both in itself and for the coordination of future activities. In this regard, the exchange of information on data, experience, and implemented projects regarding a specific area, region or problem was a significant achievement and a signal pointing to the necessity of further activities in this direction.

39. **Further steps.** As a first step after the approval of the program, it is planned to organize and implement PRSP informational activities. The necessary mechanisms for public participation in the PRSP implementation, the monitoring of its results and its social impact will be developed. It is expected that societal organizations and groups will establish partnerships with the government. During the implementation of the PRSP, societal groups will contribute their potential for the implementation and monitoring of the PRSP policies, programs and sub-programs at both the national and community levels. Awareness-building activities will be conducted in order to ensure the participation of vulnerable groups of the population in the PRSP's implementation. Mechanisms for social partnership will be developed so that the institutional framework for cooperation between the state and civil society organizations and groups is established both for the PRSP and other purposes. Broad discussions will be organized for the exchange of opinions and experiences among government bodies, the donor community, and social organizations. Surveys of opinions of the poor and vulnerable groups, as well as of societal representatives will be conducted. The participation of organized groups of society in the PRSP review activities will be broadened, and their involvement in decision-making for effective implementation of the PRSP will increase.

SECTION 1. POVERTY SITUATION ANALYSIS

CHAPTER 1. DEFINITIONS OF POVERTY AND EVALUATION METHODOLOGY

40. The evaluation of poverty evaluation derives from its definition. Modern definitions are based on the concept of poverty as a multidimensional issue. According to the World Bank⁵, poverty is manifested as:
- (i) *Lack of opportunity*: Low levels of consumption/income, usually relative to a national poverty line. This is generally associated with the level and distribution of human capital, social assets and physical assets, such as land. Market opportunities determine the returns on these assets. The variance in the returns to various assets is also important.
 - (ii) *Limited capabilities*: Little or no improvements in health and education indicators among a particular socio-economic group;
 - (iii) *Low level of security*: Exposure to risk and income shocks, which may develop at the national, local, household, or individual level.
 - (iv) *Empowerment*: Empowerment is the capacity of poor people and other excluded groups to participate, negotiate, change, and hold accountable those institutions that affect their well-being.
41. On the basis of the above definition, poverty here is considered as the impossibility to meet minimum biological, social, and cultural needs. “Biological needs” should be perceived as meeting minimum food and personal hygiene needs, as well as minimum seasonal clothes, a residence and the affordability of a minimum consumption of water, heating and electricity. “Social needs” include health, education, job, and minimal social life (marriage, birth, and death-related ceremonies), interaction with judicial systems together with relevant material capacities, stability of intra-household relations and the accessibility of minimum information (press, television, radio or other mass media), as well as socializing with other people (telephone, transport, other means of communication), and possibilities to participate in public events. “Cultural needs” include a minimal affordability of spiritual and cultural activities (not in the context of subjective demands and perceptions, but rather by objectively-defined groups, such as a minimal participation in traditional ceremonial life, opportunities to read, listen to music, etc.).
42. A person will be defined as being “poor” or “non-poor” based on the combination of the three groups mentioned above. Meeting the exclusively material (biological) needs should be considered to signify a widening of the social opportunities of a person and a reduction of poverty. The majority of poverty studies undertaken – both in Armenia and other countries – are nevertheless anchored to indicators of “biological needs”, partially covering health and access to education. In the main, they exclude other social needs, and socio-cultural factors.
43. Poverty, being a multidimensional concept, requires the development and introduction of a system of indicators for its assessment. The Poverty Assessment Indicators System (PAIS) will be developed and introduced as the basis for poverty monitoring methodology. The development of PAIS will start in 2004. This should allow the assessment of various aspects of poverty at national and regional levels, as well as the description of poverty among vulnerable groups of the population. Thus, an integrated picture of poverty should emerge and changes may be better monitored. PAIS will specify the following in a coordinated manner:
- (i) definitions and characteristics of various types of poverty;
 - (ii) poverty assessment indicators and methods for their calculation;
 - (iii) sources for collecting data on poverty indicators and the mechanisms for their regular reception;
 - (iv) types and frequency of studies on different aspects of poverty;
 - (v) organizations and institutions responsible for conducting studies and collecting indicators;

PAIS will be the core of the comprehensive strategic program for PRSP monitoring, analysis, and impact assessment. It will be developed for the management, monitoring and coordination of PRSP

⁵ PRSP Sourcebook. Overview, WB, 2001.

implementation (see Section 5 of this document).

44. Sample household surveys (hereinafter, household surveys) serve as the basis to evaluate the depth of poverty, to measure various poverty indicators, as well as to monitor poverty programs. With the support of the World Bank, the National Statistical Service (NSS) carried out three such surveys in Armenia, in 1996, 1998/99 and 2001⁶. The 1998/99 and 2001 Surveys generated a time-based series of poverty indicators based on the same methodology of poverty evaluation. This ensures consistency of the indicators in time and comparability with other countries. Furthermore, it may be applied from the perspective of the evaluation of poverty-reduction trends.
45. In the absence of PAIS, the elaboration and evaluation of the PRSP is necessarily based on the NSS methodology, with the primary emphasis placed on the evaluation of the material aspect of poverty.
46. According to the latter, the basis for evaluating the poverty of a country's population reflects two absolute poverty thresholds: the estimation of the poverty food threshold and the general poverty threshold. Both are construed on the actual food expenses of households. The minimum level of food consumption is considered to be the quantity of actually consumed food containing 2100 kilocalories per day per capita⁷, while the value of the minimum food basket is considered to be the financial resources necessary to acquire such food. The value of the minimum food basket, adjusted with the coefficient of expenditures for commodities and services, serves as the consumption basket, or, as mentioned earlier, the general poverty threshold.
47. On the basis of these two poverty criteria, the population of Armenia (households) is divided into three major groups in terms of poverty: (i) the very poor, whose current average per capita expenses are lower than the poverty food threshold; (ii) the poor, whose current average per capita expenses are higher than the poverty food threshold, but lower than the general poverty threshold; and the non-poor, whose current average per capita expenses are higher than the general poverty threshold. In addition to the poverty level indicator, there are others such as: depth of poverty, degree of poverty, distribution of incomes, expenses and consumption by decile and quintile groups, as well as the Gini coefficient. The depth of poverty describes how far below the poverty threshold⁸ the households are situated. The degree of poverty shows the number of the poor at the lowest level of poverty⁹. Distribution by decile or quintile groups is an indicator of the direct measure of inequality. It shows the ratios amongst decile or quintile groups, or their share in the total. The Gini coefficient shows the inequality of income distribution among the population. The closer this coefficient is to 1, the higher is the degree of income polarization of the population.

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

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

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

⁹ The degree of poverty is calculated as the arithmetical average of the squares of the depth.

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

2.1. EVOLUTION OF POVERTY AND CONDITIONING FACTORS OF POVERTY

2.1.1. POVERTY AND INEQUALITY IN SOVIET ARMENIA

48. During the last 20 years of the Soviet Union, and, consequently Soviet Armenia, poverty and inequality had not been important political or economic issues.
49. According to the 1988 data, only 20 % of the population in Armenia received salaries lower than the poverty threshold. This was set at 78 rubles per month per capita (equivalent to USD 87¹⁰), while the average monthly monetary income was 134.4 rubles per capita (USD 149.9¹¹). The composition of the income sources was the following: 76% salary, 11% formal transfers, 13% income generated from the sale of agricultural produce and other incomes. Expenses were distributed in the following way: 41% for the acquisition of food, 28% to buy non-food products, and 9%¹² to purchase services. Taking into account the peculiarities of the Soviet economic and political system (high level of social spending and low variances in salary rates), the inequality level was one of the lowest in the world, with the Gini coefficient estimated at 0.27 in 1987-1990¹³.
50. The reasons for the substantial increase in the poverty rates and in the number of the poor in 1998-1991 were primarily a consequence of non-economic factors. The devastating December 7, 1988 earthquake – besides taking thousands of lives, created a huge number (some 400.000¹⁴) of people who were left without shelter, property, and the basic means of existence. This coincided with the immigration of some 360 000 refugees. They fled from Azerbaijan into Armenia as a consequence of the Karabakh conflict. The vast majority of these refugees added to the number of people in desperate need of social protection. The consequences of the conflict were not limited to the problems of the refugees. More than 100 populated areas in a number of bordering regions were annihilated because of bombing from Azerbaijan and more than 70 000 people left their homes: thus becoming the group of internally displaced persons¹⁵.

2.1.2. REPUBLIC OF ARMENIA: SYSTEMIC CRISIS AND POVERTY

51. At the beginning of the 1990s, the newly independent Armenia entered a period of radical changes that involved political, social, and economic systems – exacerbated by an unprecedented energy crisis. From 1990 to 1993, GDP shrunk by more than twice. In 1993, it was only 46.9% of the 1990 level: the largest decline in GDP among the CIS countries. Due to the transportation blockade, the tangible reduction of fuel imports, and the closure of the Armenian Nuclear Power Plant, electricity production in the same period decreased by 58%.
52. As a consequence of the deep economic crisis some 645 000 jobs were cut in the non-agricultural sector

¹⁰ The official exchange rate at the time was 0.9 USD for 1 ruble. For the purpose of comparison it should be mentioned that in the Soviet Union 12%, on average, of the population had incomes lower than the minimum subsistence level. The share of the “population with low living standards” in Armenia was 1.5 to 6 times “above” 11 USSR Republics. Only in 4 Central Asian Republics was this indicator higher than in Armenia.

¹¹ Estimated on the basis of data in the “Հնչիւնն Եւ Ծննդն Եւ 1990 թիւով”, Yerevan, pp. 179, 189.

¹² “Republic of Armenia. Interim Poverty Reduction Strategy Paper.2001”, p. 4.

¹³ Source: *Հանրապետության մասին տվյալները 1990-1999 թվականներին: Հանրապետության մասին տվյալները 1990-1999 թվականներին*, 2001, թ. 125.

¹⁴ In 1989-1990, the majority of the earthquake survivors were paid substantial compensations through the Savings Bank network of the Soviet Union. This, as well as a large-scale Earthquake Zone Rehabilitation Program, funded from the Central Budget of the Soviet Union up until its dissolution, caused the increase in income poverty and, in parallel, gave rise to property poverty and inequality in the earthquake area. However, tangible reductions in the Earthquake Zone Rehabilitation Program after the dissolution of the Soviet Union and the freezing of Savings Bank deposits (half of which were made up of these compensations) brought about an unprecedented impoverishment of the earthquake area population. This was in addition to the deep economic crisis of 1992 and the subsequent years. Up until the present, the level of poverty in the towns of the earthquake zone is the severest in Armenia.

¹⁵ In contrast to the earthquake area, the inflow of refugees and the problem of internally displaced people immediately resulted in greater income and property poverty because of restrictions faced by relevant aid programs. Presently, refugees and internally displaced people represent one of the least protected and poorest layers of the Armenian population.

of the economy¹⁶. In agriculture, however, from 1991 to 1992, as a result of land privatization, the number of jobs increased by almost twice and, subsequently, productivity fell more than twice, enabling a huge segment of the population to survive the economic crisis. At the same time, the entire agricultural sector was at a subsistence level, drastically decreasing the share of agricultural products for sale.

53. In contrast to the Soviet period, the reasons for the prevalent spread of poverty during the period of economic crisis were of an economic nature and were preconditioned by the unprecedented economic decline. Having caused the widespread impoverishment¹⁷ of the population, this decline drastically widened income inequality as well¹⁸.
54. The economic and energy crises, and the accompanying transportation blockade, made the socio-economic and living conditions of the population practically unbearable: driving hundreds of thousands people to leave the country expecting to find jobs, relatively better living conditions and social protection in foreign countries¹⁹. The 1991-1993 period left deep scars in the psychological and historical memory of the part of population that stayed in the country.

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

55. Economic growth in Armenia restarted in 1994. It has continued to the present at quite a high rate, averaging 6.68% in 1994-2002. The main growth factor has been the start of large-scale financial inflows from two sources in the environment of economic and stabilizing social activities: macroeconomic stabilization, and the adoption of a liberal model of economic and trade regulation. The two sources of financing were official foreign and international assistance, which averaged some 7% of GDP, extended mainly through grants and concessional loans, as well as a substantial inflow of unofficial money transfers. These averaged around 8-9% of GDP. Those who had migrated from Armenia, in the 1980s and 1990s, to work abroad on a temporary basis, made unofficial money transfers.

2.1.3.1. Economic Growth and Poverty

56. According to official statistics, up to 2001, employment did not increase as a result of economic growth²⁰. In the 1990-1993 economic crisis, after a substantial increase of employment in agriculture, the situation stabilized in the range of 550 000 to 580 000 employed persons, while each percent of growth in the non-agricultural sector in 1994-2001 coincided with a 0.6 percentage point decrease in employment. The main reason for this was that economic growth in Armenia has not been broad-based and has been concentrated in a few developing clusters, which were linked to grant investments or concessional loans (for example, construction), import substitution (for example, food processing and, to some extent, light industry), or the export of goods, the raw materials for which are mainly imported for processing and finishing (jewelry, and diamond processing).
57. On the other hand, employment remains relatively stable in the inflated and poorly paid social infrastructure. This factor does not allow for the proportionate increase of remuneration of employees in this sector, since the swift and substantial increase of budget resources allocated for the maintenance of

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

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

¹⁸ Shrinkage of income and radical changes in income structure, brought about by the economic crisis, meant that the Gini coefficient was 0.606 in 1994 (in 1987-1990 it was 0.27) (See: *Wider World Inequality Database*).

¹⁹ According to the General Board for Civil Aviation of Armenia, in 1992-1994, more than 600 000 people migrated from Armenia. According to the 2001 Census data, the population of Armenia was 3,002 million people as of October 2001. According to the NSS data, the population of Armenia by the end of 2001 was 3800 million (See: *Statistical Yearbook of Armenia, Yerevan, 2002, p24*). Thus, in 1998-2001, some 800000 people migrated from Armenia.

²⁰ In Armenia, as in other CIS countries, employment statistics do not consider shadow employment and self-employment, which are mainly in the services sector. The statistics also substantially overestimate the employment rate in the agricultural sector, calculated as the number of household members in agriculture.

this sector and household consumption directed at this sector, is objectively impossible to assess.

58. As a result, new jobs created in developing clusters did not exceed absolute reductions in non-competitive sectors of the economy. Redundancy measures have been undertaken primarily in large and medium size industrial enterprises inherited from the Soviet Union.
59. Despite the above-mentioned employment trends recorded during the previous years, according to the preliminary data for 2002²¹, employment in 2002 increased by 17 000 people compared to 2001, or 1.34%. In other words, 1 % economic growth in 2002 resulted in an increase of employment by 0.1038 percentage point.

2.1.3.2. Economic Growth and Poverty Reduction

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

Table 2.1. Poverty and economic growth in 1996 and 1998

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

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

61. Poverty in Armenia, and particularly the number of very poor, also declined in 1999-2001, according to the data in Table 2.2. The most favorable changes took place in Yerevan, where the fraction of the poor decreased by 18.89 % (against a national average of 9.23 %), accompanied by less inequality of incomes and expenditures. The relevant Gini coefficients decreased by 9.66 and 18.89 % respectively. This is primarily explained by the concentration of economic activities in Yerevan and hence the greater opportunities for income generation compared to other parts of the country. In 2001, Yerevan (where 33% of the country's total population and half of the total urban population resides) produced approximately 50% of the industrial output, 80% of the registered retail turnover, and 76.3%²² of services.

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

²² See Armenia 2002 Statistical Yearbook, Yerevan 2002, p. 88.

Table 2.2. Poverty in 1998/99 and 2001*

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

* *Estimations made per capita.*

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

*** *Gini coefficients of income concentration are calculated for the households that showed current income.*

Source: 1998/99 and 2001 household surveys.

62. In other cities, a certain reduction in poverty and inequality took place: the fraction of the poor decreased by 8.06 % and the income concentration Gini coefficient decreased by 14.82 percent. However, more limited chances to find jobs and generate income, or engage in agricultural activities in places other than Yerevan and rural areas, are the main reasons for the tangibly higher poverty rates in other cities. The lowest degree of poverty and inequality reduction is in rural areas, where the proportion of the poor decreased by only 4.18 % (against the national average of 9.23 %), while inequality remains evidently higher than in urban areas. Low rates of poverty reduction are a consequence of unfavorable dynamics of prices for sales of agricultural produce. In 2001, it was 84.7% of the year 1997, while the consumer price index was at the level of 102.9%²³ from 1997. In other words, a relative deterioration of the conditions for producing and selling agricultural produce took place. A high level of income distribution inequality is preconditioned by large and persistent differentiation²⁴ between agricultural produce for sale and productivity. This particularly depends on climatic conditions and the size of land parcels, as well as on a limited potential for income diversification and involvement in non-agricultural activities as compared to urban areas.
63. The major specifics of poverty dynamics during 1999-2001 pertain to changes in its structure. The number of the very poor decreased by 30.16 percent. Such a decrease in the number of the very poor basically refers to two factors, one of them being the introduction of a family allowance system in 1999

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

²⁴ *Gini coefficient for concentration of production of agricultural produce and proceeds on sales thereof in 1998/99 and 2001 totaled 0.728 and 0.734 respectively. The tiny volume of agricultural produce for sale and the consumption of one's own production, are the major factors of poverty and inequality in rural areas.*

(see Table 2.3) and the second is economic growth, which resulted in an increase of incomes generated from hired employment and self-employment. The above-mentioned increases, as well as the volume of family allowances, however, have not been sufficient to exceed the poverty threshold and a substantial share of the very poor moved up to the category of the poor. Taking into account that during 1999-2001, the family allowance budget decreased from 21.1 billion drams to 16.09 billion drams, and that the number of households eligible for benefits decreased from 226.5 thousand in 1999 to 173.3 thousand in 2001, the major factor for the reduction in the number of the very poor should be the increased wages as a result of economic growth. Evidence for this is the fact that during 1999-2001, despite a stricter scoring formula, the degree of proper targeting of allowances has not essentially increased. On the contrary, inclusion error (share of non-poor receiving family benefits) in 1999 totaled 22.9%, and in 2001 it was 32.1%. However, family allowances together with other social transfers constituted a substantial share of household incomes. Thus, in 1998/99, these constituted 71.4% of total income of the poorest 10% of the population (of which all benefits represented 12.5%), 45.5% of the next 10% (of which 18.7% are all the benefits), 35% of the third decile group (and 12.9% of total benefits). The 2001 situation is as follows: social transfers were as high as 57.7% (including 18.7% benefits) of total incomes of the first 10% of the poorest population, 48.4% of the next 10% (including 15.3% benefits), and 52.9% of the third decile group (including 8.6% benefits)²⁵. According to the 2001 Integrated Household Survey, 1 % growth in the targeting level for family allowances in the four poorest decile groups, where money incomes were lower than the poverty food line, will reduce poverty at the national level by an average 0.163 percentage points, and the number of the very poor will be reduced by 0.66 percentage points.

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

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

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

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

64. As Table 2.4 below shows, a substantial increase was recorded with respect to employment income of the very poor, which is a direct result of economic growth. The 1998/99 and 2001 household surveys show that the number of paid jobs has not increased²⁶ in the economy, however, self-employment²⁷ has increased. Official statistics services are not in a position to collect comprehensive information on this factor²⁸. During 1999-2001, the incomes of the population, especially of the very poor, including income from work, increased at rates that are tangibly higher than the average. In contrast to the reduction in the number of hired employees, the employment of poor and very poor people in this period did not decrease. The growth of self-employment among the poor and the very poor is almost twice as high as that among the non-poor. This trend, at various rates, has been observed at the national level, in Yerevan, in other cities, and rural areas.

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

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

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

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

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

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

65. However, the gap between employment incomes and employment rates of the poor and the non-poor still remains very large despite the substantial decrease that took place in 1999-2001, as shown in Table 2.5 below:

66. The impact of economic growth on poverty reduction during 1999-2001 is presented below in quantitative terms: economic growth in this period was 119.8 % of the 1998 level, of which GDP in agriculture was 111.9% and growth in the non-agricultural sector was 123.4% of their respective levels in 1998. The poverty rate during the same period decreased by 9.23 percentage points, including 15.26 percentage point in urban areas (18.89 percentage points in Yerevan, and 13.02% in other cities) and 4.18 percentage points in rural areas. Thus, 1 % of economic growth results in 0.468 percentage points of poverty reduction. In the agricultural sector, 1% growth of GDP resulted in 0.35 percentage points poverty reduction in rural areas, while 1% growth of GDP in the non-agricultural sector led to 0.65 percentage points of poverty reduction in the urban population, including 0.804 in Yerevan and 0.554 in other cities.

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

	1998/99			2001		
	1	2	3	1	2	3
	Poor	Non-poor	1/2	Poor	Non-poor	1/2
Total Armenia						
Total monthly income, dram	2806	19358	0.145	4381	22865	0.191
Income from hired work per employee, dram	5754	18126	0.317	11269	29485	0.382
Income from self-employment, per capita	5698	25759	0.221	8570	32685	0.262 2
Number of hired employees, thousand people**	175.3	315.0	0.556	175.5	297.1	0.59
Number of self-employed, thousand people	26.9	96.3	0.279	77.4	96.8	0.799
Including: Yerevan						
Total monthly income, dram	3969	19666	0.201	5689	23.543	0.241
Income from hired work per employee, dram	7090	19497	0.363	12395	37202	0.333
Income from self-employment, per capita	5261	22059	0.238	12521	42170	0.296
Number of hired employees, thousand people	95.7	143.1	0.668	69.2	126.5	0.547
Number of self-employed, thousand people	19.2	36.7	0.524	26.8	33.6	0.796
Other cities						
Total monthly income, dram	2538	16526	0.153	4075	18013	0.226
Income from hired work per employee, dram	6234	20535	0.303	11602	20293	0.571
Income from self-employment, per capita	5422	22331	0.242	7924	18053	0.438
Number of hired employees, thousand people	64.4	109.3	0.589	61.5	107.6	0.571
Number of self-employed, thousand people	5.87	32.2	0.182	28.5	40.5	0.704
Rural areas						
Total monthly income, dram	2293	21059	0.109	3657	27820	0.131
Income from hired work per employee, dram	7515	19919	0.377	9841	25512	0.385
Income from self-employment, per capita	5444	61834	0.088	7744	38277	0.202
Number of hired employees, thousand people	21.4	41.7	0.513	44.7	60.8	0.735
Number of self-employed, thousand people	6.0	17.6	0.343	21.7	23.2	0.938

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

** Employment indicators are calculated by extrapolating the survey results over the whole population. They do not coincide with official statistical data. Employment in agriculture is not taken into account.

Source: 1998/99 and 2001 integrated household surveys.

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

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

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

Source: 1998/99 and 2001 integrated household surveys.

2.1.3.3. Economic Growth and Inequality

68. Despite a certain decrease from 1999 to 2001, inequality in Armenia, and particularly income inequality, is still at a very high level. This is rather dangerous for the stability of the population. Inequality was 0.535 in 2001 (0.593 in 1999), which is one of the highest indicators in the world²⁹. As in other CIS countries, and in contrast to Western and Central European transition countries, the degree of inequality of consumption expenses is tangibly lower than in the case of incomes, with Gini coefficients of 0.372 in 1999 and 0.344 in 2001³⁰. The reasons for such discrepancies in Armenia in 1998/99 and 2001 may be found in the increasingly proportional distribution of expenses. Consumption expenditures of the 1st to the 6th decile groups totaled 6,973.5 drams in 1999; the average money income was 3,135 drams. In 2001, these indicators were 7,269 drams and 5,163 drams respectively. The indicators of the 7th to the 9th decile groups were 15,798 drams and 11,883 drams respectively, and, in 2001, 16,325 drams and 16,396 drams. The indicators of the 10th decile group in 1999 were 37,013 drams and 53,539 drams, and 37,645 drams and 56,547 drams in 2001. Thus, incomes and expenditures were consistent only in the 7th to 9th decile groups. In the 1st to the 6th deciles, expenditures substantially exceeded incomes. In the 10th

²⁹ The estimates of inequality and income polarization in this document are based on official statistical data, which don't cover the actual processes of income creation, distribution and redistribution. Furthermore, the factors that will influence the main demographic indicators in the near future have not been carefully analyzed. Consequently, it is planned to pay greater attention to these questions during future revisions and updates of the PRSP. (See Section 5, Chapter 13)

³⁰ As a rule, such discrepancies between incomes and expenditures exist in countries with a large shadow economy with high shadow incomes – Armenia being one such country. See *Հավանական ծավալները և սեփական հարկը* և *Հավանական ծավալները և սեփական հարկը*. *Հավանական ծավալները և սեփական հարկը*. 2001, Վանդու II, Հեղինակ 3.

decile, incomes were higher than expenditures³¹. Income inequalities are primarily preconditioned by a reduction of incomes generated from hired employment and social transfers. These changed both in volume (drastically reduced absolute rates of wages, pensions and benefits) and structure (drastic increase in the unequal distribution of wages) as compared to Soviet Armenia. The number of recipients of incomes from hired employment has tangibly decreased. Other incomes, including property and business activity related incomes, including informal transfers, are distributed very unevenly. The growth of their share of total income leads to a growth in inequality. The reduction in inequality during 1999-2001, is primarily preconditioned by the faster growth of employment income as shown in Table 2.1. In addition, inequality in Armenia is related to the place of residence. In both 1998/99 and 2001, inequality in rural areas was higher than in Yerevan and other cities, mainly because of the disproportionate distribution of income generated on the sales of agricultural products – the main source of income for rural residents. Inequality reduction in rural areas during 1999-2001 took place because of a shrinking share of income from the sale of agricultural products and its substitution by hired employment and self-employment incomes. These were substantially more equally distributed.

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

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

³¹ This situation does not have a clear explanation, and without additional surveys, it is impossible to state which indicator is more reliable, expenditure or income. Most probably, the actual inequality is lower than shown by the income inequality indicators. Concurrently, however it may be higher than the ones shown by expenditure inequalities.

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

Source: 1998/99 and 2001 integrated household surveys.

2.2. DESCRIPTION OF POVERTY AND SPECIFIC FEATURES

69. Despite a certain reduction in poverty and inequality during 1999-2001, poverty in Armenia remains widespread, with approximately half the population being poor. The income concentration Gini coefficient persists at a socially tense value higher than 0.5. Poverty has special features depending on territorial, seasonal, gender, and age differences – as well as on the size of families, their education level, and vulnerability.
70. The territorial differences in poverty levels in Armenia reflect the existence of favorable conditions for agriculture, the number of border regions, and the relationship to the earthquake zone (for the urban population). Thus, in 2001, the poorest population was in rural regions having the most unfavorable conditions for agricultural activities, or which had suffered the consequences of the Artsakh conflict. Thus, in 2001, the highest poverty levels were recorded in the Provinces of Gegharqooneeq, Aragatsotn and Tavush (62.2%, 60.3% and 59.7% respectively – while the national average was 51.9%)³². The next area is Sheerak, where the poverty level was 57.8%³³.
71. Poverty in Armenia is clearly of a seasonal nature, as shown in Table 2.1. Incomes and expenditures reach their highest values in the 4th quarter and their minimum level is in the 1st quarter. If it were more evenly distributed, it would generally correspond to the dynamics of economic activity in the country. This situation is true for 1998/99 as well. This factor should be considered when designing and implementing economic (and especially social protection) policies. Given the clearly manifested seasonal nature of poverty, it is appropriate to carry out reforms, particularly those that might have a negative impact on the living conditions of the population over the second half of the year.

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

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

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

72. The poverty analysis in terms of gender and age shows that women are more frequently below the poverty threshold than men, but the risk of poverty for women is not much higher than that for men. The picture is different in case of households headed by women (see Table 2.2). Such households are much more (33%) vulnerable to falling into extreme poverty than other households. The main explanation lies

³² Share of rural population in Gegharqunik province in 2001 was 63.2%, in Aragatsotn it was 72% and in Tavush 60%. Most of Gegharqooneeq is at 1900 meters above sea level, while three-quarters of Aragatsotn is more than 2000 m above sea level. The bordering areas that suffered most as a consequence of the Artsakh war are located in Tavush (See: Provinces of Armenia in Figures, 1998-2001, Yerevan, 2002).

³³ Preconditioned by an extremely restricted number of employment opportunities and the highest unemployment rates.

in the lower rate of employment among women as compared to men³⁴. Hence, the absence of a man as head of the household increases the vulnerability of falling below the poverty threshold.

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

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

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

73. Despite the widely held opinion, the risk of pensioners (and especially of households with members who are pensioners) to fall into poverty in Armenia, as in other CIS countries, is not higher than the risk attributed to the rest of population (Table 2.3). The basic explanation for this is the fact that despite the insufficiency of pensions in absolute terms, these are more equally distributed than other incomes of the population. They represent a stable source of income for a predominant share of the elderly. The availability of other sources of income would reduce the vulnerability to poverty for the vast majority of pensioners.

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

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

Source: NSS Integrated Household Survey 2001.

74. Among the age groups that are the least protected are minors, whose level of poverty in 2001 was substantially higher than in all other groups (Table 2.4). The levels of poverty for those of working age and the elderly are almost the same. The risk of inclusion of children in poverty, however, is 18% and 17.7% higher than that of the working age and elderly people, respectively. In addition, the high risk for the age group between ages 30 and 39 to fall into poverty is very typical, since this group suffers the greatest unemployment risks and faces the highest vulnerability to unemployment.

Table 2.11. Poverty by age groups in 2001*

Age group	Poverty, %		Relative risk, %		% of total population	% in poor population	
	Total	Very poor	Total	Very poor		Total	Very poor
Up to 7 years	58.1	19.8	+14.1	+23.75	9.16	10.36	11.15
7-16	57.2	19.8	+12.3	+23.75	21.32	23.74	25.94
Children, total	57.47	19.8	+12.9	+23.75	30.48	34.10	36.09
17-22	50.3	15.6	-1.7	-2.5	11.26	11.03	10.8
23-29	47.1	14.8	-7.4	-7.5	11.04	10.12	10.04
30-39	53.5	17.6	+5.1	+10.0	14.2	14.79	15.36
40-49	47.4	14.0	-6.8	-12.5	13.41	12.37	11.53
50-59	39.3	9.6	-22.8	-40	5.58	4.27	3.29
Total working age population	48.68	14.96	-4.36	-6.5	55.5	52.58	51.03
60 and above	48.8	13.8	-4.1	-13.75	14.02	13.32	11.89
Total	50.9	16.0	0	0	100	100	100

³⁴ According to the Integrated Demographic and Health Survey of 2000, the rate of employment for women between 15 and 49 years of age was 32% (46.7% for men). See: Armenia: Demographic and Health Survey, Yerevan 2001.

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

Source: NSS integrated household survey 2001.

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

Table 2.12. Poverty and size of household (h/h) in 1999 and 2001

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

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

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

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

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

Source: NSS Integrated Household Survey 1998/99.

77. Sample surveys also show a direct correlation between level of education and exposure to poverty. This correlation is clearly manifested in the case of people who have higher education. The risk of falling into poverty and extreme poverty for this group has substantially decreased in 1999-2001, taking into account that the number of the very poor has drastically decreased as well. To a certain extent, exposure to poverty among people with secondary vocational education has also shrunk. As to people with secondary and elementary education, their exposure to poverty increased in 1999-2001 – more sharply for the latter. These processes are mainly preconditioned by the fact that if work-force redundancy measures are instituted, they will first affect people without professional qualifications. Furthermore finding a new job for a person with secondary or elementary education is much more difficult than for those with a professional education. Note that the greatest risk of poverty is present for people with a secondary education. Once again, this is related to the lack of a profession/qualification, as well as to the fact that

people with secondary education constitute more than half of the officially registered unemployed³⁵.

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

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

* 18 years old and above.

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

78. In addition to the above-mentioned factors preconditioning poverty in rural areas (unfavorable conditions for involvement in agricultural activities and small quantities of agricultural production for sale) it is important to consider the size of plots, access to credit, and the conditions of the roads leading to the principal markets. According to the results of the 2001 integrated household survey, the larger the plot-size, the smaller the poverty risk. Only a small share of rural households makes use of borrowed funds, i.e. only 18%, of which 58.7% are non-poor households, 32.6% poor and 8.7% are very poor rural households. Concerning roads, it should be mentioned that their absence or their poor condition substantially restricts the mobility of the rural population, increases costs, and tangibly limits job opportunities outside a rural community. According to the Survey of Poorest Communities in Armenia³⁶, it is significant that a distinctive feature for the poorest rural communities is the bad road links with provincial centers and other communities.
79. The relationship between residential conditions and poverty is clearly manifested among people residing in hostels (populated primarily by refugees) and temporary shelters (populated primarily by refugees and earthquake area residents). The share of the poor and the very poor population is higher than the average national figures: 34.5 and 37.9% in 2001 in hostels, and 44.6 and 7.7% in temporary shelters.
80. Concerning access to utilities, the differences among households are a function of the place of residence (rural or urban), rather than to purely poverty factors (except for heating issues). Thus, in 2001, 41.6% of households residing in urban areas had decent residential conditions (kitchen, cold water, bathroom and toilet), while in rural areas only 14.2% of households had such conditions.
81. According to the results of the 2001 integrated household survey, 94.2% of households had heating, including 99.8% in rural areas, and 91.5% in urban areas. Central heating was made available to 9.7% of urban households and 1.2% of rural households. Households without central heating, used wood (56.5%), electricity (17.9%), gas (7.2%), and oil (1.7%). Heating for 1.7% of households was provided by individually owned heating systems.
82. Centralized drinking water supply services were provided to 85% of households, but 29% of households had only 2 hours of water per day, 30% had water for 3-4 hours, 11% had it 5-6 hours, 5% had it for 7-10 hours and 18% had a 24-hour drinking water supply. Of the households having a centralized water system, 94.2% were in urban and 64.7% were in rural areas. Springs or wells supplied 7% of households, 6% received water delivery services, and 1% had their own water supply system.
83. The results of the poverty analysis presented above, enables us to identify the following major poverty categories:
- (i) Multi-member households, especially households with many children;

³⁵ In 2001 people with school-level (only) education made up 56.9% of the officially registered unemployed. See: Armenia. Social Snapshot and Poverty. Statistical and Analytical Report. Yerevan, 2002, p. 44.

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

- (ii) The unemployed and employees with low wages (including employees of the education, culture and arts sectors);
 - (iii) Refugees and post-conflict groups, especially those residing in hostels and temporary shelters;
 - (iv) Those single pensioners and disabled persons who have no sources of income other than their pensions.
84. **Children:** The risk of poverty largely depends on the structure of a household and the number of dependants in it. Households having children below 7 years of age, or with 3 or more children are among the most exposed to the risk of poverty. Very poor households are more burdened (by a factor of 1.5) with children than non-poor families. The presence of a child strains a family's expenses in terms of ensuring an education for the children (education is considered to be one of the most important human development factors). The largest portion of expenses related to a child's education is born by the household³⁷. According to the 2001 integrated household survey, the average monthly expense per pupil is 2600 drams.
85. **Unemployed:** Unemployment and poverty are closely linked. According to the Sample Labor Force Survey conducted by the NSS in 2001, unemployment constituted 32.8% of the economically active population³⁸, more than triple the officially registered unemployment statistic. Regression analysis shows that an unemployed member aggravated the depth of poverty of the household by 12.6% (in 2001). In 2001, the relative risk of extreme poverty in a household headed by an unemployed was 70%, which is the highest among all age and social categories. The risk of poverty was 8.9%.
86. Concurrently, one fifth of the employed is very poor. Moreover, poverty studies identified that 45%-47% of the employed population is poor. According to the methodology of the International Labor Organization (ILO), the employed who receive low wages and are not able to maintain the minimum needs for their families and dependants, should be considered part of the hidden unemployment category. The employed poor are primarily represented in the sectors of education, culture and arts. Their average monthly wage has for years lagged two or more times behind the national average.
87. **Refugees:** A specific study³⁹ of vulnerable groups within the population of refugees and local Armenians identified at least three types of poverty. The indicators describing refugees are substantially worse than those of local people. Thus, the human poverty indicator was 1.7 times lower, the extreme poverty indicator was 1.4 times lower, and the subjective self-perception indicator was 1.2 times lower than similar indicators for the local group. The most hopeless conditions exist for refugees living in temporary shelters. Every fifth member of the group is seriously ill, 60% are chronically ill, or single, or physically challenged. It means that the extremely harsh conditions of refugees set the picture of poverty, both in a particular location and in the country as a whole. In-depth studies of refugees have also identified that the persistence of poverty is not only preconditioned by the fact of being a refugee (loss of flat and property, moral and psychological shock, etc) but also by even more pronounced increase in their vulnerability because of the unsolved poverty problems accumulated over many years.

2.3. HUMAN POVERTY IN ARMENIA

88. As in almost all transition economies, poverty and inequality in Armenia are issues⁴⁰ largely preconditioned by material (income) factors. The characteristics of human poverty and inequality per se are different from those peculiar to developing countries. Table 2.15 shows that social and demographic indicators during the transition period have not substantially deteriorated. This holds, in particular, for the life expectancy indicator that should have dropped in view of the drastic increase of poverty and inequality after regaining independence.

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

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

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

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

Table 2.15. Armenia: main social and demographic indicators

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

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

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

¹Calculations are based on the number of the actual population.²Countries of Eastern Europe only.

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

89. The relatively mild impact of the drastic increase in poverty and inequality on a number of major demographic and social indicators during transition, and the relatively good position of Armenia in terms of the human development index of the UNDP⁴¹ (international comparisons are presented in Table 2.16) are explained by the sufficiently developed social infrastructure inherited from the Soviet Union. Though inefficient, obsolete, and under-financed, it is, nevertheless, in working condition.

⁴¹ Relative to per capita GDP level.

90. The number of births decreased twice during 1989-2001. The decreases are preconditioned by the drastic decline in living standards during the transition and reflect the increase in expenditures related to delivery and the bringing up of children. The trend of a reduction in the average size of families is further evidence of the above and was recorded in all three integrated surveys.
91. The increase in the mortality rate is not related to economic developments and reflects the current aging of the population. It has not influenced life expectancy, which has shown stabilization trends in the current period.
92. Another matter of concern is the reduction of the number of pupils in the school-age education network. This reduction is particularly pronounced in the higher grades (9 and 10), while the proportion of pupils in the lower grades (1 to 8) remains stable and constitutes about 97%.
93. While maintaining quantitative education and health sector indicators comparable with OECD countries, Armenia is substantially behind these countries. Developing and other transition economies, in terms of relative volumes of financing⁴² in terms of absolute amounts per capita in Armenia is 5.45 times lower than the average indicator in East-European and CIS countries, 55.1 times lower than the average of OECD countries, and 2.5 times lower than the average in developing countries (for health sector, these indicators are 10, 137 and 2.91 times respectively). Under such circumstances of substantial under-financing, these sectors could not survive in the existing volumes if funded only from state resources. The volume of officially recorded co-financing by population of higher education only, constituted 0.73% of GDP in 2001 and was twice more than that of state financing. Financing of the health sector by population in the first quarter of 2002 totaled 23.613 billion⁴³ drams, or 1.74% of GDP in 2002 (1.5 times more than the volume of state financing in 2001).
94. Maintaining such levels of state financing for education and health sectors jeopardizes the possibility to address issues related to the UN's declared human development concepts and adopted by our country. Moreover, shifting the financial burden on the population will aggravate the fundamental problem of human poverty. Results of several surveys⁴⁴ undertaken in Armenia showed that 31% of households are not able or can barely survive the incremental expenses needed for education. Among poor children, 7% do not attend public schools. Of those who are ill, 70% do not have access to health services.
95. The above situation is evidence of the limited capacity for the Government to effectively implement redistribution and social functions.
96. **Qualitative Description of Poverty:** The qualitative approach to the study of poverty addresses human behavior, a description of behavior of the poor in particular, and examines its social, cultural, political and economic components⁴⁵. Qualitative studies of poverty in Armenia⁴⁶ identify the following matters for particular concern:
- (i) Increasing social stratification, distrust – by the poor and middle class – of the rich, and the state and local authorities;
 - (ii) Changes in intra-household relations in poor families mainly based on the impossibility of many men to sustain the functions of head of the family. Other changes that affect these relationships are based on the risks of falling into poverty and its impact on family stability. These cause a reduction in the number of marriages and births, an increase in the age at which people marry, as well as a distortion – because of mass migration – of the normal ratio between the sexes;
 - (iii) Weakening of the traditionally strong intra-family ties and the lowering efficiency of informal

⁴² *Relative volumes of financing: financing/GDP.*

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

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

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

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

mutual assistance arrangements, particularly for the elderly and refugees;

- (iv) Withdrawal of the poor from social life and participation in ceremonies. This gives rise to the perception of being isolated from society: one of the most dangerous socio-psychological consequences of poverty.

SECTION 2. PRSP GOALS AND MAIN POLICY DIRECTIONS

CHAPTER 3. PRSP GOALS

3.1. POVERTY AND INEQUALITY REDUCTION

97. PRSP measures aimed at ensuring sustainable and high economic growth and the implementation of efficient social protection policies are expected to result in poverty reduction at the following rates: to 41% in 2005; to 29.1% in 2010; and to 19.7% in 2015, down from the 2001 level of 50.9%. At the same time, the population of the very poor will make up 14.2% in 2005, 10.6% in 2010 and 4.1% in 2015, down from the 2001 level of 16%.
98. In 2005, the internationally recognized indicators for the measurement of poverty, i.e. the number of people with daily expenses below 1, 2 and 4 US dollars⁴⁷, will equal 13.8%, 35.9%, and 68.3% respectively. In 2010, the respective figures will be 4%, 20.5%, and 42.1%. In 2015, they will drop to 2.7%, 6.8% and 27.6% respectively. In 2001, these figures were 29.4%, 58.6% and 81.5%.
99. Such a reduction in the poverty levels will largely depend on increasingly high growth rates of employment incomes and of social transfers (pensions and benefits) to the poor.
100. Main indicators of poverty reduction are presented in Table 3.1 below.

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

	2001	2003	2004	2006	2009	2012	2015
GDP per capita, thousand drams ¹	391.5	489.1	532.8	631.5	808.3	1005.7	1244.2
GDP per capita, USD ¹	704.8	834.2	904.2	1061.0	1338.0	1639.9	1998.6
GDP per capita, PPP USD ²	2 382.1	2 819.5	3 056.2	3 586.1	4 522.3	5 542.8	6 755.4
Number of poor, % of total population	50.9	46.2	43.7	37.9	30.8	26.3	19.7
<i>Including number of very poor, % of total population</i>	16.0	15.2	14.7	13.5	11.4	8.6	4.1
Number of population having less than 1 USD income per day ³ , % of total population	29.4	23.7	17.9	10.0	4.3	3.4	2.7
Number of population having less than 2 USD income per day ³ , % of total population	58.6	52.0	43.4	31.9	24.3	14.1	6.8
Number of population having less than 4 USD income per day ³ , % of total population	81.5	76.6	72.8	64.0	52.5	33.5	27.6
Number of under-weight children, % of total number of children below the age of 5	3.0 (2000)	2.9	2.8	2.7	2.3	1.8	1.4
Number of under-height children, % of total number of children below the age of 5	13.0 (2000)	12.5	12.0	11.5	9.5	8.0	6.0
Memorandum Item							
<i>Number of de facto population⁴, thousand people</i>	3 002.6	3 013.8	3 020.5	3 038.1	3 074.2	3 125.7	3 196.0

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

Source: NSS data, PRSP projections.

101. Inequality will also decrease in the program period. The Gini coefficient of income concentration in 2005 will be 0.491, in 2010, 0.466, and in 2015, 0.446 (It was 0.535 in 2001).
102. The reduction of inequality will mainly depend on the reduction of income inequality resulting from the income policies of the government (correspondence of the minimum wage to the poverty food threshold and ensuring an increase of remuneration to employees in social infrastructures and public administration), and an increase in pensions and a substantial improvement in benefit targeting.
103. The main target indicators with respect to income inequality reduction are presented in the Table 3.2.

⁴⁷ These amounts are calculated using the relative USD PPP in Armenia, which in 2001 was 3.38. It also assumes that this value remains unchanged between 2002 and 2015, i.e. at the level of 2001. The meaning of 3.38 PPP is that the purchasing power of 1 US dollar in Armenia equals the purchasing power of 3.38 dollars in the US.

Table 3.2. PRSP main indicators of inequality reduction

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

Source: NSS data, PRSP projections.

3.2. HUMAN POVERTY REDUCTION

104. As shown in the PRSP poverty analysis section, the level of human poverty in Armenia is substantially lower than that of material poverty. Human development, however, is comparable to economically far more developed and richer countries. To this end, maintaining the human poverty potential and its further strengthening, and reducing the currently more tangible manifestations of human poverty, are the priorities of the PRSP.
105. Fulfilling these priorities will be contingent upon two principal factors, measures to enhance the efficiency of relevant structures and an increase in public spending.
106. The main objective for the education sector is to improve the quality of education and enhance the access to it. The expected results of the programmed measures are:
- (i) By 2015, increase the school-life expectancy for 6-year old children to 12.3 years, up from 11.6 years estimated for 2003⁴⁸;
 - (ii) The completion rate (ratio of number of graduates to respective number of entrants) for general schools will reach 85% in 2015 (it was 65% in 2002)⁴⁹.
107. The main objectives for the health sector are to upgrade the quality of and enhance the access to health services, particularly for the poor. The expected results of the programmed measures are:
- (i) Reduction of child mortality: mortality rate for the under-5 group will decrease to 10 per 1 000 live births from 15.9 registered in 2002. Infant mortality will decrease to 8.5 per 1 000 live births from 13.4⁵⁰ of 2002;
 - (ii) Reduction of mother mortality from 34.4⁵¹ per 100 000 live births in 2001 to 10 per 100 000 live births in 2015.
108. Target indicators of human poverty are presented in Table 3.3 below:

⁴⁸ The indicator is estimated within the limitation of the 6 to 21-years old group.

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

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

⁵¹ This indicator is calculated as the average over three years on the basis of the NSS information.

Table 3.3. Main target indicators of human poverty reduction

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

* Aged between 6 and 21 years old.

** Three-year average.

CHAPTER 4. POVERTY AND INEQUALITY REDUCTION POLICY PRIORITIES

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

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

CHAPTER 5. THE PRSP AND THE MILLENNIUM DEVELOPMENT GOALS

121. Target indicators for reducing poverty, including extreme poverty, as set in the PRSP are fully compatible with the targets envisaged in the Millennium Development Goals⁵²: to reduce the number of people living on less than 1 USD per day to half, by the year 2015 (compared to 1990). In other words, the number of people living with less than USD 1 per day should be reduced to 14.5 % of the total population. Armenia will achieve this indicator by 2005,⁵³ and in 2015 this indicator will be 2.7 percent.
122. According to the PRSP projections, Armenia will exceed the MDG projected average indicator for Europe and Central Asia (8.7 % of the population living on less than 2 USD per day) by 2015⁵⁴. In 2015, it will amount to 6.8 % in Armenia.
123. These indicators can be achieved only through stable and rapid rates of economic growth. It is planned that in 2003-2015, the annual GDP per capita growth will be 5.1 %, instead of the 3.6 % projected for poverty reduction by MDG.
124. Armenia currently is not developing programs to eradicate hunger⁵⁵. Nevertheless, facts pointing to malnutrition are alarming, particularly those indicating the large share of children with below normal weight and height. In 2000, these indicators for Armenia were as follows:⁵⁶
- (i) the share of children with below normal weight was 3 % on average, with substantial regional variation: from 0.7 % in Yerevan up to 9.3 % in Kotayk Province;
 - (ii) the share of children with below normal height was 13 % on average, with substantial regional variation: from 8 % in Yerevan up to 32 % in Gegharqooneeq Province.

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

125. The second MDG goal deals with universal enrolment in lower grades of school by 2015, was, in effect, already achieved during the early years of the Soviet Union. In 2001, the enrolment of children aged 8-15 in the educational system was 98.7 percent, whereas the literacy rate among the population aged 15-24 was 99.8 percent⁵⁷. According to the PRSP projections these levels will be maintained.
126. The third MDG goal is to promote gender equality and women's empowerment. This is a multi-factor issue. Women have formal equality and a higher level of education (a characteristic of Armenia and a number of other CIS countries) than men. In 2001, the ratio of girls to boys in school was 1.02 and in the tertiary educational system, the ratio was 1.2. While having comparable poverty levels (see Table 2.9), women, nevertheless, lag behind men in their average salaries, earning about 69 % of men's salaries in 2001⁵⁸. This fact, in the absence of formal discrimination, is explained by the smaller share of women in areas of activity with high incomes and their large share in the social services sector, where salaries are noticeably lower. According to the PRSP projections, a high enrolment level in the educational system among women will continue in 2003-2015. Differences in incomes will decline due to an increase in salaries of workers in the social sector. On the other hand, the government will promote wider involvement of women in income-generating activities, particularly small businesses,

⁵² *Millennium Development Goals, 2000.*

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

⁵⁴ *Millennium Development Goals, 2000, p. 5.*

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

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

⁵⁷ *Human Development Report, UNDP, 2003, p. 200.*

⁵⁸ *Human Development Report, UNDP, 2003, p. 311.*

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

127. The maternal and infant mortality projections presented in Table 3.3 ensure the achievement of the fourth and fifth MDG goals, namely, by 2015 compared to 1990, reduce the under-5 mortality rate by two-thirds, (this indicator amounted to 23.8 in 1990), and also reduce the maternal mortality rate by three-quarters, (this indicator in 1990 was equal to 34.8 per 100 000 live births)⁵⁹.
128. The sharp increase in the financing of health care projected within the PRSP will provide for more effective countermeasures against socially dangerous diseases, particularly HIV/AIDS, malaria, and tuberculosis. It will aim to prevent the spread of HIV/AIDS, almost totally eradicate mortalities from malaria and sharply reduce tuberculosis mortalities, and thus achieve the 7th and 8th targets of MDG.
129. In the environmental sector, it is planned to maintain and increase the country's forest resources.
130. Projections of indicators on access to drinking water presented in Table 3.3 are also in line with the relevant MDG target.
131. At present, people living in temporary shelters (earthquake zone and refugees) constitute 5.1 % of the entire population. According to PRSP projections, by 2015 their numbers will amount to 1% to 1.5 % of the population, and the issue will be totally solved by 2020 (MDG target 11).

⁵⁹ *Average for 1988-1990.*

SECTION 3. POVERTY REDUCTION STRATEGY

CHAPTER 6. SECURING ECONOMIC GROWTH AND ITS ACCOMPANYING REDUCTION OF POVERTY

6.1. THE PRSP MACROECONOMIC FRAMEWORK

132. The comprehensive solution to poverty and the reduction of inequality depends mainly on economic growth. High economic growth will, in the long run, necessarily result in employment expansion and in increase of wage incomes, the main source of income of the population. Concurrently, being the primary source for government revenues, it will enlarge the capacity of the government to redistribute incomes.
133. Starting in 1994, continuous economic growth (average of 6.68 % per annum) has been recorded in Armenia. Nevertheless, as of 2002, it has still been impossible to restore the income levels prevalent in the first three years of transition. Should these rates be maintained, however, in 2005 it would be possible to double the GDP level of 1994, and exceed the 1990 level.
134. Economic developments in recent years give ground to think that the stable and favorable macroeconomic environment together with the microeconomic and structural changes supported by external assistance, may ensure high rates of economic growth in the coming decade, at an average of 5.5% to 6.5% per annum. The baseline scenario for macroeconomic projections rests on SAC-5 and PRGF programs implemented by the Government in cooperation with the World Bank and the IMF. It calls for a consistent and comprehensive implementation of agreed policies and measures.
135. The following developments are projected for the main macroeconomic indicators:
- (i) Real GDP in the program period will show stable growth trends. A GDP real growth rate of at least 7% is projected for 2003. In 2004-2008, the annual GDP growth will be 6%, while by the end of the program period, it will stabilize at a level of 5% per annum;
 - (ii) Consumer prices will stabilize, with average annual increases of 3% throughout the program period;
 - (iii) Investments (investments/GDP) in 2015 will grow by 5 percentage points from the level of 2002, reaching 24.3%. At the same time, national savings will increase at higher rates (6.6 percentage points of GDP increase compared to 2002) thus narrowing the investment/savings gap. Public investments will stabilize as a percent of GDP in the range of 4%, and government savings will show gradually growing trends;
 - (iv) Total revenues of the state budget, by 2015 will amount to about 20% of GDP, which is 2 percentage points higher than the level of 2004. At the same time, significant changes will take place in the structure of budget revenues due to a higher increase in tax revenues (an increase of 3.4 percentage points of GDP in the period). State budget expenditures will grow at lower rates leading to a lower budget deficit. The deficit-to-GDP ratio during 2005-2010 will stabilize at a level of 2% of GDP. For 2015, it is projected at 1.6% of GDP.
 - (v) The export of goods and services during 2004-2015 (in dollar terms) will grow at higher rates than imports (annual average of 9.2% and 7.4% respectively). This will serve as the main factor for the improvement of the current account. Starting in 2010, the current account deficit/GDP ratio will stabilize at the level of 4.5% of GDP, against 6.5% programmed for 2003.
136. Macroeconomic projections for the program period are presented in Table 6.1 below⁶⁰.

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

Table 6.1. PRSP macroeconomic framework: projections of main indicators

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

¹ Calculations are based on the de facto population.

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

- (v) trade and services sectors will have indicators of 86% and 4.9% respectively.
139. The economic growth in non-agricultural sectors in 1994-2001 was principally the result of a growth in labor productivity and declining employment, with the number of those employed in the agricultural sector remaining relatively stable. It is projected that economic growth will also lead to the creation of new jobs. Generally, it is projected that 248 000 new jobs will be created in 2003-2015, of which 231000 jobs will be in the non-agricultural sectors.
140. In 2003-2015, 73% of the GDP growth will be reached through a growth in labor productivity. This will account for 63% of the growth in non-agricultural sectors and 90% of the growth in the agricultural sector.

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

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

141. Maintaining such high growth rates in the long run will require a number of fundamental measures, including those of an economic policy that focuses on ensuring the growth of exports, introducing the

basic structures for the functioning of a knowledge-based economy and ensuring the above-mentioned improvements in economic efficiency and labor productivity. These issues will be discussed in detail in the strategy for sustainable economic development of Armenia for 2003-2015. In effect, this will be a supplement to the PRSP. Its target indicators and macroeconomic framework will be in line with those of the PRSP.

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

6.2. RURAL POVERTY REDUCTION ISSUES

6.2.1. SPECIFICS AND EXISTING PROBLEMS

143. As mentioned in Chapter 1 of the PRSP, the level of poverty in rural areas was lower than the national average in 1996-2001. In 2001, 48.7 % of the rural population was poor, which included the extremely poor population at 11.3 %. This compared with the national average of 50.9 % for the poor and 16 % for the extremely poor (see Table 2.2.). The main reason for this is the notably high level of self-sufficiency through subsistence farming among the rural population. Generally, the family consumes the produce and only the remainder, amounting to about 40 % of production, is marketed. A certain share of it is bartered for other products⁶¹. It must be noted that there is no correlation between the level of poverty and farm size (land area, number of animals). Here, the level of poverty is mainly the result of low productivity. In the uplands, unfavorable conditions are also a contributing factor, such as the non-existent, or very limited, irrigated land, the distance from markets, small production volumes, as well as limited possibilities for other types of employment. These factors are directly linked to the location of the settlement, as presented in Table 6.3.

Table 6.3. Rural poverty and location of rural settlements

Indicators	Level 1: up to 1300 m above sea level	Level 2: from 1301 to 1700 m above sea level	Level 3: 1701 m above sea level and higher	Total rural areas
Share of population, %	39.0	26.0	35.0	100.0
Poor, %	42.35	54.93	57.99	50.76
<i>including extremely poor, %</i>	<i>16.37</i>	<i>24.86</i>	<i>28.28</i>	<i>22.55</i>

Source: ISLC 1998/99.

144. On the other hand, the inequality is much higher in rural settlements compared to the national average. In rural settlements, the Gini coefficient for income inequality was 0.583 in 2001, compared to the national 0.535 and 0.466 for urban areas (see Table 2.2). The main reason is that the largest share of incomes is generated through farming (about 50 % of the total income) and the incomes received from the sale of produce are very unequally distributed⁶². The Gini coefficient for the concentration of incomes received from the sale of produce was 0.728 in 1999, and in 2001 it increased to 0.734.
145. One of the main characteristics of Armenian agriculture is the very large number of people employed in this sector. According to official statistics, there now are more than 334 000 farms in the country, where the total number of workers is 550 000 (43.5 % of the rural population) or 58.9 % of the rural population above 15 years of age (937 000 people). The workforce is severely underemployed, and its productivity is very low. The share of those working in the sector the whole year is 36.1 %. About

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

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

40% of the workforce is employed only 7 to 9 months in the year⁶³.

146. In 2002, those working in the agricultural sector made up 44.4 % of the total number of the employed. The share of agriculture in the GDP was 23 %: the productivity in agriculture was 1.9 times lower than the average and 3.1 times lower than the productivity in industry⁶⁴.
147. Farms are small; the average land size is 1.37 ha, varying from 0.61ha in Ararat Province to 3 ha in Syooneek Province. Non-cultivated lands amount to 15 % of the total land area. In 2001, an average of 1.68 people were employed on the typical farm, the latter had an average of 1.43 heads of cattle, 1.67 heads of sheep and goat, produced 0.91 t of grain, 1.29 t of vegetables, 0.95 t of potato, 142 kg of meat, 1.38 t of milk and 670 eggs. The average volume of the annual production for one farm was 1.015 million drams, including 614 000 drams of crop production, and 401 000 drams of livestock products⁶⁵. The sale of agricultural products has a seasonal nature. About 80 % of farms sell their agricultural products commercially⁶⁶. Yields are also very low. For example, the average yield of grain, which covers around 60 % of the total cultivated area, amounted to 1608 kg per hectare in 1997-2001. This can be compared to data from 1998-2000 on the average per hectare yield of grain: worldwide, it was 2067 kg, 2407 kg in European and Central Asian countries, 4000 kg in developed countries and 6067 kg in the EU⁶⁷. The average milk production per cow in 2001 amounted to 1000 L, which is 4 to 5 times less than in developed countries.
148. The use of credits is quite inadequate as well. As of January 1, 2002, the total credits provided to the agricultural sector amounted to only 7 billion drams or 2.25 % of the agricultural GDP in 2001. In 2001, the same indicator for industry was 13.2 % of the GDP, and 8.1 % for the entire economy⁶⁸.
149. Agricultural insurance systems against natural disasters and weather are practically non-existent, and this role, to some degree, is carried out by the state budget, which provides partial compensation for damages caused by natural disasters and unfavorable weather conditions. However, this system is ineffective and not flexible enough.

6.2.2. MAIN DIRECTIONS FOR THE ERADICATION OF RURAL POVERTY

150. In 2003-2015, the growth of agricultural production will continue to be the main factor for the reduction of rural poverty. According to macroeconomic projections of the PRSP, the average annual growth of value-added in the agricultural sector will be 2.2 %, or a total increase of 33.1 % throughout the period. The main indicators of agricultural development are presented in Table 6.4.
151. As presented in tables 6.2 and 6.4, the agricultural growth in the projected period will mainly result from the increase in labor productivity. A total increase in productivity of around 29 % is projected for 2003-2015 (an average of 2 % per year). At the same time, the number of employed⁶⁹ will not change significantly and will increase by about 0.22 % per year. In 2015, the volume of agricultural production will exceed the level of 1990 by about 40 %. The share of commercial agricultural production will increase notably from the present 40 % up to 70 % in 2015. This will provide for a substantial increase in the volume of financial resources available to agriculture and will allow a large number of farms to overcome their subsistence economy.

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

⁶⁴ Agricultural GDP per capita in 2002 was 45 600 drams per month. Considering the 40 % commercial factor of agricultural production, the net monthly output of one worker will amount to 18 000 drams, which can only support a minimal subsistence.

⁶⁵ Calculated using data from the Armenian Statistical Bulletin 2002, Yerevan 2002, p. 307.

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

⁶⁷ See 2001 World Development Indicators, p. 136.

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

⁶⁹ Here we refer to effective employment, which, according to some estimates, amounts to 70% - 80 % of those officially employed.

Table 6.4. Projections of the main indicators of agricultural development

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

¹ Data of 2001.

152. In order to ensure the described growth, it will be necessary to introduce significant changes in the financing mechanisms in agriculture: particularly by providing much more credits. According to the PRSP projections, it is planned to increase the volume of agricultural credits 10 times. This would amount to 11 % of the sector's GDP by 2015, compared to 2.3 % in 2001.
153. The Program envisages an average 3 % annual growth in price indices of agricultural products, which will be achieved by expanding the internal market for agricultural products, as well as through increased exports of produce and foods. The average annual growth here is projected to be 10 %.
154. In order to ensure stable agricultural growth and substantially reduce rural poverty and inequality, it is necessary to take a number of important measures, which will focus on:
- (i) A substantial increase in productivity and farm incomes, particularly by solving the problems of irrigation and water use, land use, yields, share of commercial production, and volumes of production;
 - (ii) The establishment and development of sales markets and institutions;
 - (iii) The development of financing and insurance institutions for agricultural production;
 - (iv) The provision of wider possibilities for non-farm activities.
155. One of the main reasons for the current inefficiency of farms, as already mentioned, is their limited resources and the small volumes of production. Land fragmentation⁷⁰ is also an issue. It makes the collective use of infrastructures particularly difficult. Thus, the enlargement of farms is one of the main preconditions for enhancing productivity. In this regard, in 2004-2005, all the conditions necessary to establish a land market will be created. In particular, mechanisms for determining the market value of land and the transfer of ownership will be in place. Land as collateral will be used widely: a necessary condition for a substantial increase in bank credits provided to agriculture. Since land resources are scarce, limits will be introduced for farm sizes, which will vary according to province. In order to include unused land areas in economic activities, an inventory of arable land and

⁷⁰ The average farm consists of 3 land plots, one of which is irrigated, and the other two are not (see Strategy for sustainable agricultural development in Armenia, Yerevan 2002, p. 23). Thus, agricultural activity presently takes place on about 1.2 million land plots, each with an average area of 0.45 ha.

perennial plots will be set up. Legal and other mechanisms will be put in place to prevent cases where land is not used or is used unproductively.

156. Irrigated farming accounts for more than 70 % of the gross crops production. Irrigation and water supply issues are discussed in detail in the "Infrastructure Development" section of the PRSP. However, here it must be noted that in 2004-2005, an inventory of the use of the country's water resources will be set up. Irrigation norms and volumes of water used for irrigation will be defined. The management structure of the system will be improved, including measures for increasing the effectiveness of the activities of water-users groups. The technical conditions of networks will be improved through public investment programs, and water losses in public networks will be substantially reduced. Mechanical irrigation systems will be gradually replaced by gravitational systems and modern irrigation technologies will be introduced.
157. One of the main causes of rural poverty and inequality is the insufficiency of incomes received from the sale of agricultural products. A large-scale road construction program will be implemented in order to ensure reliable and effective communications with the principal agricultural markets and to enhance the mobility of the rural population (see "Road Construction" section of the PRSP). Another issue is the promotion for the establishment and operation of institutions for sales and processing of agricultural products. The international experience shows that such institutions normally function in the form of farmers' cooperatives or associations. Thus, in 2003-2004, measures for promoting and financing the establishment and operations of such institutions will be developed and implemented.
158. The introduction of reliable financing mechanisms is of fundamental importance in increasing the share of commercial production in farms. In order to reach the financing volume levels projected in the PRSP, it is necessary to introduce effective mechanisms for the operations of the land market and land collateral. The link between the provision of credit and use of modern agro-technologies by farms must be ensured. For this purpose, a network of companies involved in agro-technologies will be established. Mechanisms for their cooperation with farms and credit institutions will be developed and introduced.
159. Subsidized consulting services for farms will continue in order to promote productivity and the share of commercial production in agriculture.
160. The establishment of an effective agricultural insurance system is a very urgent issue. The present mechanism of partial compensation from the state budget for damages caused by natural disasters will be replaced by an insurance mechanism by 2005. The necessary fund will be formed on a co-financing basis through contributions by the state and the farms involved. The specific action plan will be developed in 2003-2004. At the same time, the government will encourage the involvement of private insurance companies in agricultural insurance.
161. The issue of improving opportunities for non-farm employment will become more urgent with the projected slow changes in employment in the agricultural sector. For this purpose two main mechanisms will be used:
 - (i) micro-credit mechanisms, which will focus on the development of the services sector, as well as the establishment of non-farm micro-enterprises in rural areas;
 - (ii) targeted credit mechanisms, which will be used to process agricultural products and improve their packaging. These will be provided mainly to cooperatives or associations of farmers.
162. Donors or relevant specialized organizations will support financing of these schemes, especially the first one.
163. Projections for the public financing of agriculture for 2003-2015, are presented in the section on the PRSP budget framework (see "PRSP Implementation Financing: Budget Framework").

6.3. INSTITUTIONAL REFORMS AND THE IMPROVEMENT OF THE BUSINESS ENVIRONMENT

6.3.1. PUBLIC ADMINISTRATION AND JUDICIAL SYSTEM REFORMS

164. Transition difficulties and a variety of institutional issues have not allowed for the reforms undertaken

in public administration and the judicial system to achieve quick and tangible results. In contrast to other sectors, reforms here were launched relatively late and the influence of the former centralized governance system was very much implanted in the system.

165. The above had a negative impact on the efficiency of the public administration system in place. The degree of centralization in policy implementation and decision-making processes (absence of transparency, weak accountability, failure to ensure public participation) is still too high.
166. The efficiency, quality, and availability of public administration services still remain unsatisfactory, particularly for the poor. According to the results of a sociological survey⁷¹, the population views the addressing of social problems as a priority among public services rendered by the state. The accessibility assessment of public services directly depends on the poverty rate. These are more accessible for non-poor households, though completely inaccessible for the predominant share of the poor. The same applies to the judicial system in terms of its accessibility and quality. According to the households and business community, the judicial system is in the third place among the three most unavailable services⁷², especially for the poor.
167. The deficiency of the public administration and judicial systems, aggravated by a number of transition-inherent problems, gave rise to a blossoming shadow economy and corruption in Armenia. As a consequence of widespread corruption in the public administration, public services degenerated into payable ones. Essentially taking into consideration the structure of their expenditures, the poor have to pay more than the non-poor for these services. Given the illegal payments and protectionism widespread in the business sector, the poor – when embarking on business activities – encounter more complications and hardships than others. If ever the difficulties of the initial period are overcome, the poor are among the first to move to the shadow sector, because this approach is dictated by the prevalent rules. Their rejection leads to isolation and deprives them of much needed entrepreneurial income.

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

168. Recently, the government has adopted new structural reform strategies with the objective to enhance efficiency, quality, accessibility of public services; and the transparency, accountability, and oversight of the public administration system. The strategies are to be implemented along three main directions:
 - (i) Structural and functional reforms in public administration;
 - (ii) Introduction of civil service systems;
 - (iii) Reforms in financial management systems.
169. Currently, the statutory functions of the ministries are streamlined and the restructuring of administrative bodies is underway. Reforms resulted in lowering the number of ministries, governmental public administration agencies and committees, together with the number of their structural subdivisions. Staff is optimized to ensure its adequacy to the functions of the institutions.
170. Reforms in the civil service have been undertaken pursuant to the Laws on Civil Service, State and Non-State Institutions, Public Administration Bodies, and a number of other legislative acts. In accordance with legislative requirements, political, discretionary, and support positions were clearly separated and defined. Equality-based criteria for admission to and withdrawal from the civil service were established, as well as professional career opportunities guaranteed. Service stability, job descriptions, definitions of responsibilities of civil servants, remuneration and social security, as well as a system of declaring incomes and assets were also introduced.
171. The legislation regulating the civil service has been adopted, yet the issue of the number of civil servants is unresolved. Among others, this is the reason why the program estimation of the number of civil servants in public administration is unchanged for subsequent years (see Table 6.5). The number

⁷¹ *Armenian Democratic Forum, "Public Opinion on Public Services Provided to Households and Private Enterprises", Yerevan 2001.*

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

of employees in the public administration system will be finalized upon adjustment of the government structure, the number of ministries and governmental agencies, and their functions. It will not exceed the existing level. The process has already started to be supported by the relevant credit facility of the World Bank in 2004.

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

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

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

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

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

174. The main prerequisite for successful reforms in the public administration and judicial systems, as well as the most important factor to mitigate corruption in these sectors, is the increase of salaries for the sector employees. This is one of the important measures stipulated in the anti-corruption policy of the government. To this end, the PRSP public expenditures program envisages tangible resources for this, as well as other sectors (see Table 6.6). Allocations for salary (ratio to GDP) in the public administration and judicial systems during the program period (2003-2015) will grow more than three times, while total financing (ratio to GDP) will increase by 94%. Average monthly salaries in nominal terms will increase more than 12 times.
175. According to surveys of the population and businesses⁷³, the unpredictability of state policy is one of the main factors limiting economic activity and investments in Armenia; more than in any other transition country. According to some estimates⁷⁴, the unpredictability of policies is the second main factor constraining investments in Armenia after tax and customs regulations and administration (while among CIS countries, this factor was, on average, the fourth important one). Unpredictability is mainly manifested in frequent changes of legislation. At the same time, the population and businesses are normally not informed about the expected changes in the legislation⁷⁵, which renders

⁷³ See *Investment Climate Around The World, WB, 2003*.

⁷⁴ *Investment Climate Around The World, WB 2003, pp. 110, 128*.

⁷⁵ 68.55 % of companies in Armenia mentioned that frequent changes in legislation are a substantial constraint to investments, 83.87% mentioned that the level of unpredictability of legislative changes has risen in the past 3 years, 74.38 % mentioned that they

ineffective the process of an exchange of opinions between the government and a wide range of stakeholder groups.

176. Considering the importance of enhancing the predictability of state policies, Armenian authorities will take appropriate measures. In particular, using modern technologies (e-Governance), all legislative acts and programs will be electronically accessible starting 2003-2004. These documents, as well as explanatory notes and comments, will be available to the public on the Internet sites of the governmental agencies concerned. Drafts of legislative acts to be amended will be placed on the same sites in advance, and those who would like to comment on the draft will have the possibility to do so. These comments will be taken into account during the actual decision-making process.
177. In 2003-2004, a program ensuring a more efficient cooperation between the population and the central and local authorities, based on modern technologies (e-Government) will be developed and implemented. The program will transfer the issuance of permits for certain activities, and a number of other functions, to the Internet. This will reduce the immediate contacts between members of the public and civil servants, thereby significantly increasing the control over the activities of these employees. This program is also important in the context of measures in the anti-corruption strategy.
178. Currently, the participation of civil society organizations (particularly non-governmental specialized organizations and representatives of the private sector), in the decision-making processes is fairly limited and is not institutionalized. This constrains the development of a civil society and does not allow for a higher level of public trust in the authorities. Thus, in 2003-2004, an appropriate program will be developed and implemented. It will include:
 - (i) relevant legislative changes, particularly the adoption of a law on lobbying, which will allow specialized non-governmental organizations and private sector representatives to present and defend the interests of society and the private sector in various governmental agencies. Also, major amendments will be proposed in the law on Chambers of Trade and Industry. This will strengthen these institutions making them a central body that would ensure cooperation among private sector organizations;
 - (ii) relevant measures to regulate the participation of specialized non-governmental organizations in the decision-making process and enhancing the possibilities for their involvement. Furthermore, steps will be taken to transfer certain regulatory functions to representatives of the private sector (for example, issues related to the certification of qualifications).
179. In this context, the issues related to the participation of women in governance are also important. Armenia has joined the UN 1979 convention on Eliminating All Forms of Discrimination Against Women. Member countries have committed themselves to ensuring equality between women and men in the development and implementation of state policies, in senior governmental positions, as well as in carrying out public functions at all levels of government. The level of involvement of women in leadership and responsible positions – not only in government structures, but also in political parties and private enterprises, however, is not high at present⁷⁶. Thus, within the framework of governance, reforms measures will be taken to improve the situation and ensure the full participation of women in executive and legislative bodies, using, among others, a quota system.
180. In the PRSP process, a substantial role is attributed to enhancing the efficiency of budget management. At the present stage, this should be carried out along the following major directions:
 - (i) Relating the budget to the medium-term strategy. To this end, the incorporation of the MTEF in the budgetary process is an important step towards this objective.
 - (ii) Enhancing the publicity surrounding the entire budget process;
 - (iii) Expanding budget coverage, i.e. the budget should incorporate individual cash and non-cash flows of public finance, including extra-budgetary funds, and externally-financed operations

were not informed in advance of the expected changes, and 80.83% mentioned that their opinion was not taken into account by the authorities (see Investment Climate Around The World, WB, 2003, pp. 125-130).

⁷⁶ *In particular, in 1995, women constituted 6.3% of deputies in the parliament, in 1999, they were 3 % and in 2003, rose to 4.6%.*

- (iv) Strengthening the supervision of all the stages in executing the budget. The primary aspect of this is the higher responsibility of the ministries and agencies with respect to the management of allocations, budget implementation, and timely reporting. Enhancing the supervisory role and importance of the Chamber of Control of the National Assembly is crucial. This is also a tangible anti-corruption measure;
- (v) Enhancing the predictability of the budget. An important role here is attributed not only to the interactions with the MTEF, but also to the actual implementation of all the planned indicators;
- (vi) The budget must also be simple and understandable for all users/consumers. This would allow the public to monitor the budget.

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

181. Regional development reforms are primarily aimed at creating guarantees for the proper functioning of regional and local governance systems. The reforms also set the basis for regional development. However, shortcomings in the regional development policy and the absence of regional development strategies, principles, and approaches, resulted in a severe polarization of regional development and a deterioration of social and economic conditions. This fact had a direct and large negative impact on living standards, and contributed to the deepening of poverty across the nation – particularly in small and medium-sized towns.
182. The main directions for regional development in the country should be:
- (i) Optimizing the administrative-territorial division of the country based on comprehensively justified principles;
 - (ii) Developing cohesively, the country's territorial-administrative units, both socially and economically;
 - (iii) Rapidly developing those small and medium-sized towns that have high levels of poverty;
 - (iv) Improving the legal framework regulating the operations, rights, and responsibilities of central, regional and local governments.
183. In the context of poverty reduction, a primary role is given to communities that render public services. Communities in Armenia have certain specifics and are extremely heterogeneous in terms of their population, elevation, location, socio-economic development, and other characteristics. Poverty, therefore, is manifested in different ways depending on the community, its size, and specifics. Small communities are not in a position to make full use of their rights. Consequently, most of their own or their delegated powers are doomed to fail. That is why many communal, housing, educational, cultural, sports, health, and social problems of the community remain unresolved. This directly influences the problems of poverty and community development. In guaranteeing the rights of local governance systems, the legislation has not taken into consideration the capacity of the communities to enforce and exercise these rights. Without this capacity, such right have just a declarative value.
184. The powers of local governments, as a rule, are exercised through public services rendered to the population. These may be classified into two groups: free or fee-paying. Free services are funded from the community budget. An important issue is the fair distribution of budget resources, the solution of which depends on publicity, transparency, the active involvement of community councils in the budget process, and open discussions with the public at large.
185. With respect to fee-paying services, an important factor is the protection of the population by setting fair tariffs, fees, and local duties to ensure their affordability even for the poor. To the extent possible, they should be differentiated according to the level of need. In defining rates of duties, charges, and rents consideration should be given to the fact that the vast majority of expenditures incurred by local governments are not compensated because of the insolvency and poverty of the population. This is especially true of water utilities, heating, garbage removal, building maintenance, and other sectors. Consequently, the process of tariff determination should be open and transparent, involving the public at large and considering the interests of the population.
186. It is necessary to differentiate and streamline the rights vested in village, town, and district

communities. At the same time, the absence of legislatively defined procedures to exercise the rights of local governments is a serious impediment for a number of issues, including the creation of effective controls over performance, an adequate financial resource allocation, and the evaluation of additional financial needs, among etc. Subsequently, at the current stage, the legislative stipulation of procedures regulating the use of mandated rights by the local governments will enlarge the potential for development and implementation of comprehensive measures aimed at replenishing local budgets through an expansion of their income base.

187. The maintenance of living standards and poverty reduction in communities may not be efficient without the establishment and improvement of rational administrative systems. The improvement of community governance is largely dependent on establishing community councils, furthering the professionalism and abilities of local government staff so as to have the potential to take and implement high quality decisions with the available human resources. It is necessary to undertake serious measures to enhance the professionalism and management skills of more than 7500 employees of local governments to put them to serve the goal of efficiently managing the community. Existing legislation does not regulate human resources activity in local governments. This activity includes recruitment, career advancement, attestation, training, human resource databases, etc. Thus, the elaboration of the draft Law on Service in Local Governments and its proposal to the National Assembly for approval is imperative.
188. Within the framework of poverty reduction measures, importance is given to local governance and the consolidation of communities so as to reduce their number. The problems of small communities may be mitigated through the establishment of inter-community associations. In planning appropriations to local budgets to combat problems existing in the area of local self-governance, priorities should be assigned to inter-community associations and the development of their network.
189. In performing their functions, local self-governments should ensure the accessibility and quality of the public services rendered in their community. Thus, it is extremely important that the transfer of the authority to manage and administer local education, health, and social service functions to the local governments, be made after comprehensive preparatory measures have been completed.
190. The identification of the administrative and territorial specifics of communities plays a crucial role for a diversified approach to the communities when they elaborate relevant public policies. For instance, poverty is manifested differently in the earthquake area, border regions, high mountainous regions, and small communities. The state should legislatively stipulate and apply a targeted system of privileges, discounts, and allowances. In particular, there is a need to review the mechanisms of estimating and allocating state budget subsidies on the basis of a financial adjustment principle.

6.3.1.3. Judicial System and Poverty Reduction

191. In order to form an efficient and accessible judicial system, it is necessary to establish a system of guarantees, which are specifically attributed to officials involved in the exercise of justice and the improvement of legislation. In this regard, it is important to ensure appropriate legal and social guarantees, and a more effective application of laws. In particular, there should be adequate technical and human resource capacity and expertise in centers and with a better access to their services.
192. Legal guarantees include the independence of officials exercising justice in accordance with the constitutional and legislative requirements and a clear definition of their rights and responsibilities. In this respect, there is a need to make amendments to a number of provisions of the constitution relating to the Council of Justice and the Constitutional Court, by clearly establishing the powers of these institutions. One must also ensure the complete independence of these institutions and their staff from the authorities. More entities and individuals must be authorized to apply to the Constitutional Court and the jurisdiction of the latter must be widened. It is necessary to streamline the processes and principles of exercising justice and the activities of the police. The cases and issues relating to the responsibilities of judges and the Prosecutor's Office must be defined to provide the utmost transparency and public awareness concerning these issues. To this end, it is also important to establish requirements to publish court resolutions and decisions (web page, bulletins, and other means), which will enable society to form its opinion on the judicial system of the country.

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

6.3.2. ANTI-CORRUPTION POLICY

195. Poverty reduction is directly linked to the effectiveness of the efforts to limit corruption, as well as to prevent new and more dangerous variations. Priority should be given to preventive measures in the anti-corruption policy. Despite the fact that these measures are also reflected in various section of the PRSP, the government is currently developing a comprehensive anti-corruption strategy and an appropriate action plan, which should be approved by the end of 2003. The document will provide a definition of corruption, its causes, and the anti-corruption strategy in the following three main directions:
- (i) resolving economic problems and reducing the shadow economy;
 - (ii) combating political corruption;
 - (iii) eliminating corruption in government, the judicial system and city governments.
196. Economic problems and a reduction in the shadow economy include equal legal protection of all types of rights to ownership, as well as the promotion of economic activity and free competition. These are important matters. An important step to reduce the shadow economy would be to have a stronger control over incomes resulting from illegal economic activities (such as the adoption of a legal framework against money laundering), and limiting cash transactions.
197. Important measures to prevent tax and customs corruption are the elimination of tax privileges, publication of guidelines on the rights and obligations of taxpayers, and strengthening the tax and customs administration. It is necessary to establish a universal system for income declaration through the introduction of individual taxpayer identification numbers.
198. The administrative involvement in determining the customs value of goods should be reduced to a minimum, and possibilities for arbitrary interpretations should be ruled out from the customs code.
199. An important anti-corruption step in the economic sphere would be the establishment of specialized unions and associations.
200. In order to avoid “dual” accounting and reporting it is necessary to finalize the introduction of the audit system.
201. To prevent fake and intentional bankruptcies, it is necessary to improve the bankruptcy law in order to conduct bankruptcy processes with rapid and simplified procedures.
202. In order to promote a competitive environment, the government will take the necessary measures to improve the regulation of natural monopoly activities.

203. Preventive anti-corruption and associate measures in politics are an important part of the anti-corruption strategy. In this regard, it is important to fully apply the law on political parties, as well as to adopt a law on political lobbying. This would allow all actors in the political field to pursue their interests in accordance with legally defined functions.
204. The improvement of the electoral system has an important role in the eradication of political corruption. In order to bring elections up to international standards, it is necessary that voters' lists be checked and updated not just right before the elections, but periodically, at the community level. This will also strengthen the institution of observers.
205. The development and implementation of an anti-corruption strategy for the government, judicial system, and community governments is central to the anti-corruption activities. The key measures are presented in various sections of this document ("Reforms of Governance and the Judiciary System").
206. The success in implementing the anti-corruption strategy depends also on the efficiency of the implementation and monitoring of the strategy. Particular attention will be given to:
 - (i) analyzing the causes of corruption at all levels;
 - (ii) developing specific short and long term programs within the framework of the anti-corruption strategy;
 - (iii) cooperating actively with civil society in preventing corruption;
 - (iv) coordinating activities of individual ministries in developing and implementing anti-corruption programs, and coordinating the collaboration among law-enforcement authorities.

6.3.3. IMPROVEMENT OF THE BUSINESS AND INVESTMENT ENVIRONMENT

6.3.3.1. Current situation and development objectives for 2004-2015

207. The business and investment environment, the quality of which is a decisive factor in job creation and attracting investments, has improved significantly in recent years. A survey of 200 companies operating in Armenia conducted at the end of 2001 reveals that:⁷⁷
 - (i) the average time needed for the official registration of companies was reduced from 27.3 days in 2000 to 21.1 days in 2001;
 - (ii) the average cost of the official registration was reduced from the equivalent of USD 109 in 2000 to the equivalent of USD 92 in 2001;
 - (iii) the time needed to obtain an official license for operations was reduced from 23.5 days in 2000 to 18.5 days in 2001;
 - (iv) the average annual number of inspections of companies was reduced from 6.6 in 2000 to 6.4 in 2001;
 - (v) there was an increase in the overall confidence in the business environment, the economic policies of the state, and administrative conduct: from 2.57 in 2000 to 3.3 in 2001 (confidence is measured on a 6 point scale, where 1 corresponds to a total lack of confidence and 6 corresponds to full confidence);
 - (vi) the cost of transporting a standard-sized container from Yerevan to Poti (Georgia) was reduced by almost 25 % in 2001-2002 compared to 1999.
208. Nevertheless, the business and investment environment in Armenia needs substantial improvements, which is evident when compared to EU membership candidate countries in transition⁷⁸.

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

⁷⁸ See 2002 *Transition Report, EBRD, 2003*.

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

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

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

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

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

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

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

¹ Data for 2003.

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

Box 6.1. Economic Assessment Indicators System

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

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

Reforms of enterprises

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

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

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

Markets and trade

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

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

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

Financial organizations

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

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

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

Source: 2002 Transition Report, EBRD, 2003.

6.3.3.2. Business and investment environment development policy 2004-2015

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

productivity are noticeably higher in SMEs than in large enterprises⁷⁹. The transition experience of European countries shows that there is a direct link between economic growth and the number and production volumes of the newly formed (not privatized) SMEs⁸⁰. In Armenia, the growth in the number of newly formed enterprises (the majority of which are SMEs) lags substantially behind the economic growth rates. In 2001, the number of registered commercial organizations increased by 2,818 or 4.7 percent, in 2002 by 2,613 or 4.1 percent, while economic growth rates were 9.6 and 12.9 % respectively. As of January 1, 2003 there were 48 069 commercial organizations⁸¹ registered in Armenia (15.9 enterprises per 1000 people), which is far behind the levels of this indicator in developed countries⁸².

212. Since 1999, the pattern of private sector formation in Armenia has changed significantly. In 1994-1998, the non-agricultural private sector was formed mainly through wide-ranging privatization, while after the end of the voucher privatization stage, the development of the private sector – and generally the entire economy – was due to the increase in production volumes in existing SMEs and the establishment of new commercial entities.
213. Considering that the macroeconomic framework of the PRSP aims to create 248 000 additional non-agricultural jobs in 2003-2015, the development of the private sector becomes one of the main preconditions for reducing poverty and inequality and increasing the income from labor of the population. In order to ensure this development, the government intends to initiate wide-ranging measures to achieve the target indicators in Table 6.8.
214. These measures intend to:
 - (i) simplify procedures to register and license companies and reduce the time and money spent on such procedures;
 - (ii) promote the establishment of new companies, develop and introduce effective schemes for financing new businesses;
 - (iii) regulate labor relationships;
 - (iv) protect private ownership (including intellectual ownership) and introduce effective mechanisms to be answerable for economic violations;
 - (v) ensure significantly wider access to financial resources;
 - (vi) promote competition, in essence eliminate monopolies;
 - (vii) regulate inspections, substantially improve tax, customs, and other administrative regulation, as well as improve the quality of services provided by the state;
 - (viii) promote exports and innovation;
 - (ix) develop micro-entrepreneurship;
 - (x) reduce the shadow economy.
215. Although a certain reduction was achieved in the time and money necessary for official registration and licensing, these do not yet correspond to the requirements for a modern business environment and are substantial factors limiting the entry of new enterprises and new investments⁸³. Thus, in 2004-2006

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

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

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

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

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

the number of activities subject to licensing will be reduced, licensing procedures will be simplified, computerized official registration and licensing systems will be introduced (e-Government) and some specialization qualification functions will be transferred to corresponding private associations.

216. In order to promote the entry of new companies, especially in the manufacturing and high technology sectors, and in order to improve their access to financial resources, it is necessary to promote and:
- (i) Establish manufacturing zones and industrial parks using the territory and equipment of non-viable public and private enterprises, including state participation. For this purpose, the bankruptcy process for such enterprises will be made faster and simpler. Organizations specializing in restructuring will be established⁸⁴.
 - (ii) Establish venture-financing mechanisms for new products. The government will also support the formation of other organizations to finance new businesses. A legal framework to regulate their operations will be set up.
217. Currently, Armenia is characterized by a high level of shadow employment. According to a household survey conducted in 2001, the number of self-employed individuals was 3 times higher than the number of officially registered individual proprietors. The number of people employed in the trade and services sector is greatly underestimated⁸⁵. Undeclared salaries are also very common. In order to improve the registration of the labor force, the Government of Armenia has initiated a number of measures in 2003. These will continue in the future. The new Labor Code will be adopted by 2004 so as to adapt labor relationships to contemporary conditions and protect the interests of employees.
218. Mechanisms to protect property rights, execute contracts and ensure economic responsibility are the main preconditions for the development of the private sector. The current situation in this area is characterized by low financial discipline. As of October 2002, the total debt of Armenian organizations was 535 million drams, or 39.3 % of GDP, of which 359 million drams or 26.4 % of GDP was debt to suppliers and contractors. Arrears amounted to 98 million drams (7.2 % of GDP)⁸⁶. This situation is mainly the result of an ineffective application of bankruptcy legislation, as well as ineffective, protracted, and monopolized mechanisms for the liquidation of seized property. Thus, in 2004-2006, it is planned to simplify and clarify the law on bankruptcy, ensure its broad application, remove the monopoly power of judicial enforcement officers in the liquidation of seized property, substantially reduce the duration of proceedings for bankruptcy, seizure, and sale of property. In light of these issues, substantial improvements in the effectiveness of and access to the court system are fundamental and significant.
219. Better access to external financing for enterprises, particularly SMEs, is one of the most important factors contributing to the development of the private sector. Financing issues were classified as major constraints to development by 60.7 % of respondent enterprises in Armenia⁸⁷. As presented in Table 6.9, Armenia's enterprises finance their development mainly by their own investments or by funding from informal sources. The total of such funds amounts to 89 % of the total financing, which is the highest share among the countries presented in the table. Funding received through formal channels constitutes only 11.4 % of total resources, compared to 55.5 % in Estonia, 24.6 % in Georgia and 56 % in Poland. Financial and commercial markets provide only 6.5 % of resources; of which 3.2 % is provided by the banking system, compared to 54.6 % in Poland and 53.5 % in Estonia. This indicates that financial markets are underdeveloped, and levels of financial discipline and mutual trust in the business environment are fairly low. This can be a serious constraint to the development of the private sector in the near future.

⁸⁴ Currently two projects financed by WB credits are being implemented: establishment of an IT technological park and a reconstruction agency.

⁸⁵ *Growth Challenges and Government Policies in Armenia*, WB 2002, p. 40.

⁸⁶ *The Socio-economic situation in Armenia 2002 January-December*, Yerevan, 2003, p. 78.

⁸⁷ *Investment Climate around The World*, WB 2003, p. 110.

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

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

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

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

recent years, their quality still remains rather low. State regulation and public services were considered ineffective by 84 % of respondent companies in Armenia, compared to 43 % in Estonia and 48 % in Poland. Most (86 %) of the companies in Armenia mentioned that the judicial system is unfair. Customs services were rated as ineffective by 61 % of companies, and the tax administration was mentioned as a constraint to development by 74 % of companies⁸⁸. Measures for improving the quality and effectiveness of state regulation are presented in the PRSP sections on reforms of governance, the judiciary system, and tax policies.

223. In 2001-2002, for the first time in independent Armenia's history, increased exports were a main factor driving economic growth. Exports grew by more than 50 % in these two years. For 2003-2015, ensuring export growth will be one of the main priorities of economic policy (the PRSP macroeconomic framework projects an annual increase of 9.2 %). Ensuring a stable economic growth driven by exports will require the implementation of comprehensive measures for export promotion. These measures will be included in the Strategy for Sustainable Economic Development in Armenia, which should be approved by the government by the end of 2003.
224. Micro-enterprises (the self-employed and small family businesses) play a significant role in Armenia's economy⁸⁹. Micro-enterprises are labor-intensive businesses and are one of the most important sources for family income growth. According to the results of the household survey conducted in 2001, 174000 people had incomes from self-employment, amounting to 9.8 % of total incomes (10.7 % for the poorer segments of the population). Thus, the promotion and development of micro-enterprises have a direct impact on poverty reduction. International experience shows that micro-credit systems⁹⁰ are an effective tool in developing micro-enterprises. Credits of USD 500-1000 provide the opportunity to establish new micro-businesses – mostly in services, primary processing of agricultural products, and craftwork sectors. Under Armenia's conditions, micro-credits are especially important in rural areas and small towns to promote non-farming activities. This will also reduce regional differences in economic development. Thus, starting in 2004, comprehensive micro-credit systems for promoting non-farming employment will be introduced in Armenia. This will be accompanied by appropriate consulting services.
225. According to the most common definition of “shadow economy”, this involves activities and transactions of a commercial nature, which are not included in the official accounts of GDP. Tax authorities do not record generated incomes⁹¹. The shadow economy includes activities prohibited by law, as well as legal economic activities, which are either not officially registered or are totally or partially hidden from official statistics and tax authorities. There are a number of estimates of the shadow economy in Armenia, according to which it has reached 45% - 50% of the official economy. According to F. Schneider's estimate, the volumes of the shadow economy in 2000 were 46.3 % of GDP in Armenia, 67.3 % of GDP in Georgia, 60.6 % of GDP in Azerbaijan, and 46.1 % of GDP in Russia. This compares to an average of 38 % for transition countries and 18 % for developed countries⁹². According to the PRSP estimations, the shadow economy is almost equally divided into non-registered activities, which are prevalent in services sector, and incomplete declaration of incomes and volumes of activities by officially registered businesses. The share of illegal activities is quite small. The main illegal activity is widespread smuggling.
226. A cross-country analysis of the shadow economy shows that it is influenced by two main factors: the country's level of economic development and the effectiveness of the government. Improvements in both factors lead to a reduction of the shadow economy. Based on Armenia's specifics (high level of poverty and inequality, limited employment, importance of incomes from self-employment for poor families), the strategy to reduce the shadow economy within the framework of the PRSP in 2003-2015

⁸⁸ *Investment Climate Around The World, WB 2003.*

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

⁹⁰ *See The Microfinance Handbook, vv. 1-3, WB, 2001:*

⁹¹ *F. Schneider, Size and Measurement of the Informal Economy in 110 Countries around the World. 2002, p. 3.*

⁹² *F. Schneider. Size and Measurement of the Informal Economy in 110 Countries around the World. 2002, pp. 11, 13.*

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

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

6.3.3.3. Enhancing financial intervention

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

6.3.4. TAX POLICY

230. As mentioned in the chapter “PRSP Goals and Main Policy Directions”, increasing the financial capacities of the state is one of the major strategic priorities. Improvements in tax (customs) policies and administration will create the conditions to ensure tax revenue growth of 0.3% to 0.4% of GDP per annum. Thus, the potential for sustainable high economic growth would not be hampered, because improving the tax administration and simplifying the tax system will ensure the growth of tax revenues.
231. According to the World Bank⁹³, tax policies that are effective in reducing poverty should be guided through to establish a simple tax system with a wider tax base and low tax rates. In a transition country such as Armenia, it is difficult to create a tax system that would be efficient while redistributing the incomes of the population. Consequently, the selection of a tax policy in the coming years should be between (i) a tax system that is simplified and efficient, but with a low redistribution impact, or (ii) a tax system that is progressive and has a higher redistribution impact, but low efficiency – with complicated application and monitoring rules.
232. As a result of the reforms that have taken place in the past few years, a tax system has been established in Armenia with a wide tax base, minimal exemptions and, basically, with low rates. However, collection rates of the existing taxes are yet low. Thus, total tax and social contributions in 2002 constituted about 18% of GDP. Laws on some taxes still contain complicated, sometimes even contradictory, provisions for assessment and payment.
233. The need to enhance the financial capacity of the state to implement coordinated social and economic policies that target poverty reduction, means that the growth of tax revenues becomes the priority for the medium term. This should be implemented primarily by reducing the shadow economy. The simplification of tax laws should be continued, contradictions removed, and tax assessment and payment procedures and mechanisms made simple and understandable for the majority of taxpayers. Tax administration efficiency should be increased and lead to reduced taxpayer payments while meeting tax obligations (accounting and statements) and for the oversight of tax payments by tax authorities.
234. A wide tax base for value added tax has been established in Armenia with a unified 20% rate. This is not substantially higher than the rate established in the region. Existing exemptions are extremely limited (mainly financial services, charity, and local agricultural produce). The same procedures apply to the taxation of domestic or imported products. The only exception is the sales of local agricultural produce with specific privileges to be in force until 2009.

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

235. Excise tax is applied only to tobacco, alcoholic beverages, and petroleum products. The tax rate is predominantly presumptive. Excise tax is paid only when producing or importing. The same rates apply for domestic or imported goods. With the objective to enhance administration efficiency, excise stamps are applied to alcoholic beverages and tobacco.

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

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

⁹³ PRSP Sourcebook. Overview, WB, 2001.

investments within a limited time frame. The loss carry forward procedure is applicable for the five subsequent years.

Applying the profit tax should be simplified. Discrepancies between tax assessment and accounting systems should be removed to the extent possible. Approaches should be instituted and enforced to simplify the interrelations between tax authorities and taxpayers. Tax evasion should be minimized – if necessary by applying alternative methods of profit tax evaluation (including a minimum tax collection on the basis of estimating real profitability).

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

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

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

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

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

The targeting of simplified tax assessment mechanisms should be enhanced. It is necessary to preclude cases where the application of simplified or presumptive taxes would be a way for taxpayers to avoid their tax obligations. The tax assessment/accounting of people with restricted economic potential should be extremely simplified – thus reducing business risks based on the levied taxes.

240. In general, the tax base of Armenia has a huge unused potential in terms of increasing tax revenues through their inclusion in the tax framework – including the possibility to avoid raising tax rates or instituting new taxes. In the framework of a poverty-reduction strategy, the following issues in particular must be resolved:
- (i) Increase the share of taxes in the GDP;
 - (ii) Develop tax systems that promote investment activities, employment, and that maintain a maximum neutrality towards sustainable economic growth;
 - (iii) Refrain, to the utmost extent possible, from raising tax rates;

- (iv) Improve the tax administration, qualitatively improve the interrelations of tax and customs authorities and the taxpayer;
 - (v) Further simplify the tax system, consolidate existing tax laws into a tax code.
241. Taking into consideration these goals, the priorities of the state in tax policy in the medium term will be as follows:
- (i) Simplify tax (customs) legislation and develop effective mechanisms to supervise compliance with legislative requirements;
 - (ii) Improve the tax administration's efficiency and the tax oversight system;
 - (iii) Institute equity in tax payments;
 - (iv) The redistributive function of taxes will have a minimal application, until the principle of horizontally fair taxation is fully in place. The principle of vertically fair taxation can be used widely only after the horizontally fair taxation principle is fully established.
 - (v) Stabilize the principles stipulated by tax policies and continuity in improvement of tax payment mechanisms.

CHAPTER 7. HUMAN DEVELOPMENT

7.1. SOCIAL PROTECTION SYSTEM

7.1.1. DESCRIPTION OF THE SOCIAL PROTECTION SYSTEM AND THE MAIN DIRECTION OF POLICIES

242. The social protection policy is aimed at practicing and protecting the economic, social and legal guarantees of human rights and liberties. The essence of the social protection policy is the management of social risks by the state so as to reduce them. The concept of social risk management derives from the notion that the living conditions of individuals, families and communities are exposed to a number of risks from various sources, both natural (earthquake, flood, diseases, etc.) and human (unemployment, deterioration of environment, wars, etc.)⁹⁴. The poor who lack adequate resources to confront social risks are far more vulnerable than the non-poor. This factor motivates people to elaborate and apply self-protection mechanisms, such as resource accumulation in a "rainy day fund", diversification of income sources, reduction of expenditures, creation of informal networks of family and/or community assistance, and so on. Often, and especially in case of the poor, these mechanisms are not efficient, their capacity is very low and they do not enable sustainable insurance against risks. These realities represent the fundamentals for state involvement in social risk management.
243. State policies in social risk management should target risk prevention, reduction, and regulation. To this end, the three major spheres of social risk management by the state are⁹⁵:
- (i) Social assistance, which enables the state to minimize the social risks of income reduction or persisting low levels of income among vulnerable groups of the population, as well as to ensure minimum living standards for them;
 - (ii) Pensions and other social insurance, which provides protection against certain social risks (as risks related to old age or disease), through the allocation of adequate resources throughout the working period of individuals;
 - (iii) Employment and remuneration regulations, which govern social risks related to employment and salary.
244. The social protection system of Armenia currently includes:
- (i) State social assistance programs, such as family benefits, disability, age, and other social

⁹⁴ *Social Protection Sector Strategy. From Safety Net to Springboard, WB, 2001.*

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

- pensions, one-off childbirth allowances, and a child allowance (up to the age of two);
- (ii) Social assistance programs for the handicapped, veterans, and children, in particular, medical and social rehabilitation programs, in-house social services for the elderly and disabled, homes, orphanages and boarding schools;
 - (iii) State social insurance programs, consisting of age and disability pensions, as well as allowances for temporary disabilities and pregnancy;
 - (iv) Employment programs, including unemployment benefits, retraining the unemployed, and public (or similar) works;
 - (v) A system of privileges for certain target groups of the population that, in 1999, lived through significant distressing conditions. It currently includes a few privileges, primarily for veterans of World War 2 (and similar groups) established in the framework of CIS (international) agreements. Service providers mostly fund these privileges. No new privileges are planned in the 2003-2015 period.
245. These programs are currently funded from the state budget (family and other benefits, pensions of military servicemen, social assistance programs and public works and, starting in 2003, social pensions, too) and the State Social Insurance Fund (state pensions, unemployment benefits, and temporary disability and pregnancy allowances). Donors' involvement is substantial in a number of social programs, particularly in public works and social security programs. Nevertheless, it is extremely complicated to evaluate and forecast the financial aspect of this involvement.
246. Given the importance of economic growth, in the framework of the PRSP, the social protection policy:
- (i) Should not hamper high rates of economic growth and stability, in other words, the objectives of the social protection policies and the volume of the relevant state resources should be derived from the priorities of ensuring high rates of economic growth and investment;
 - (ii) Should ensure the efficient utilization of the limited state and public resources: they should be precisely targeted and address the prevention, reduction, and regulation of the social risks of clearly defined categories of the population. In other words, this utilization cannot try to ensure social protection, employment, and income guarantees for the entire population, from birth to death, as in Soviet times.
247. Considering the above, the priorities of the social protection policies by spheres are:
- (i) **Social assistance:** use of the family benefit system to reduce poverty among the most vulnerable through a substantial enhancement of the targeting of the extremely poor and ensuring that their consumption level is not below the food poverty threshold. In later periods, provided there is an increase of allocations to family benefits and poverty reduction generally, the aim should be to raise the consumption level of the poorest population above the food poverty threshold;
 - (ii) Another important priority of social assistance is rendering high quality, targeted services to those in need of special protection, such as the handicapped, orphans, refugees and displaced people, with a view to substantially meeting the demands for such services;
 - (iii) **Social insurance:** a reduction of the number of poor pensioners and an increase of pensions to bring them above the general poverty threshold, indexing pensions according to pension contributions and the period of employment;
 - (iv) Comprehensive reform of the mandatory social insurance system, including enhancing its efficiency, substantial review of the principles of allocating pensions and ensuring the financial stability and sustainability of the system;
 - (v) **Employment policies:** replacement of the currently existing inefficient policies of unemployment insurance and a transition to proactive employment policies;
 - (vi) **Income policies:** ensuring an accelerated increase of salary rates in budget and social infrastructures so as to ensure a level at least twice that of the general poverty threshold. Furthermore, the legally defined minimum salary should equal the general poverty threshold.

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

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

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

Source: National Statistical Service, PRSP projections.

7.1.2. SOCIAL ASSISTANCE SYSTEM

7.1.2.1. Family Benefits

249. The basis for state allowances was established back in Soviet times by introducing a law on the “Allowances for Children from Less Secure Families”. The system of allowances has undergone many modifications, including monthly allowances paid to children under 17, privileges related compensations to certain categories, etc. All these, and others, were replaced in 1999 by the system of family benefits.

250. According to the 2002 Integrated Household Survey, social transfers (mainly pensions and family benefits) constituted the largest source of income of poor families, i.e. 57.8% for the poorest 10% of families; 45.5% for the next 10%; and 52.9% for the third decile.

251. Family benefits and pensions are an efficient tool for poverty and inequality reduction. Some 45% of the reduction in the share of very poor households from 22.9% to 16% was preconditioned by the increase of social transfers.

252. On the other hand, family benefits represent the most efficient tool to eradicate income inequality. To this end, according to 2001 data, a 1 % increase in family benefits at the national level, reduced the income inequality (Gini coefficient of income concentration) by 0.67 percentage points: 0.4 percentage points in rural areas, 0.25 percentage points in Yerevan, and 1.14 percentage points in other cities.

253. The volumes of family benefits and the number of eligible households (see Table 7.2) envisaged in the framework of the PRSP reflect the imperative of reducing the number of very poor households. This is the main reason to introduce the system of family benefits. On the other hand, a reduction in the number of very poor families leads to a reduction of beneficiaries, which, in turn allows for a significant increase in the average benefit rate.

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

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

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

254. Despite the fact that the introduction of the family benefit system has substantially improved (doubled) the targeting of social protection measures towards the most needy segments, nevertheless in 1999-2001, the targeting efficiency of family benefits has diminished (see Table 2.3). Tightening the eligibility criteria in 2000-2002 (additional provisions were introduced in the formula, such as

benchmarks for electricity consumption and telephone bills, import and export customs declarations, acquisition of real estate leading to improvement of housing conditions, etc) has led to a substantial reduction of budget allocations and beneficiaries. To improve the targeting of benefits, starting January 2002, another change in the formula of family benefit calculation was introduced: additional benefits were earmarked only for children up to 18, in eligible families. The reasoning was that families with many children are among the most vulnerable groups. However, these changes did not allow for improvements in targeting, as compared to 1999.

255. Taking into consideration the fact that family benefits are an efficient tool to increase the well-being of very poor families (who have extremely restricted sources of permanent income, besides social transfers), while improvements in living standards of poor families⁹⁶ should mostly result from policies that promote their “primary” incomes (wages, pensions, income from self-employment), the 2003-2015 state policies in family benefits envisages:

- (i) The number of beneficiary households should be periodically revised to coincide with the actual number of very poor households. The ratio of the number of beneficiary households to the number of very poor households is to be used for this purpose. In projections, starting 2006, this ratio is maintained at the level of 1.15⁹⁷. Taking into account the dynamics of the number of poor people assumed under the PRSP, the number of beneficiary families is also decreasing. It should reach 108 500 in 2010 and 42 300 in 2015 (against 139 000 in 2003).
- (ii) Effective 2004, one-off allowances will be completely removed and the savings will go to family benefits. The reasoning behind the removal of one-off allowances is that these are not a permanent source of income (the payment period is up to three months and the amount is 4000 drams, which is equal to the base allowance).
- (iii) This regular reduction of the number of beneficiaries⁹⁸ should be based on a substantial enhancement of targeting in the system. The program envisages increasing targeting efficiency from 55.3%⁹⁹ in 2001, to 80%, and for the poorest 10% to 40%¹⁰⁰ by 2007, and maintaining this level up to 2015.
- (iv) In order to enhance the targeting of family benefits, effective 2005, the transition from the currently existing indirect system of household evaluation (scoring) will move towards the direct one (whereby the criterion for evaluating a household’s standing will be based only on the incomes¹⁰¹ of the household members). It would be appropriate to pilot this in one of the territorial social assistance services in Gyoomree¹⁰². If the integrated surveys show a higher degree of targeting reached under the regression analysis on the basis of income evaluation, then in 2005-2007, this will replace the current scoring system nationwide.
- (v) A matter of concern is the low degree of inclusion of very poor families in the family benefit system. This is partially due to an insufficient awareness of the scheme among the poorest

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

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

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

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

¹⁰⁰ Strengthening of targeting is envisaged along these lines: 20% and 60% in 2003; 25% and 65% in 2004; 30% and 70% in 2005; and 35% and 75% in 2006.

¹⁰¹ Regression analysis of the formula based on the evaluation of household incomes was successfully tested in 2001 in Aragatsotn province for a sample of 2000 households that displayed a higher degree of targeting.

¹⁰² Gyoomree has been selected in view of the highest share of poor and very poor households and because according to the data of the Ministry of Social Security, the distribution of households in the regional social assistance centers is the most disproportionate in the nation in terms of scoring. The numbers of households that scored 36-37 are, respectively 9% and 16.5% more than those who scored 35-36. Currently, 36 is the minimum benchmark allowed to be eligible for the family benefit.

population. This requires that regional social centers themselves identify the poorest rather than merely making a selection among applications filed by households.

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

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

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

Source: National Statistical Service, PRSP projections.

256. Per capita family benefits will reach the poverty food threshold in 2013, and exceed it thereafter. A comparison of family benefits with the minimum salary rate and average salaries shows that a substantial increase in the benefit rates in 2004-2015 may not affect the labor force participation negatively, since the benefit does not exceed 15% of the average salary and does not exceed 65%¹⁰³ of the minimum salary. As of 2004, the minimum salary will equal the general poverty threshold.
257. The following measures are envisaged under the family benefit policy:
- (i) Adopt the Law on State Benefits aimed at improving the public benefits system. This will regulate all issues related to public benefits currently administered by various government decrees.
 - (ii) Improve access to information, create a national information network on social services;
 - (iii) Reform the appeals system: creating a simplified, understandable, transparent, and fair system;
 - (iv) Elaborate effective mechanisms to monitor the family benefit selection and payment system, prevent corruption and potential arbitrariness.

¹⁰³ Drastic growth of family benefits will be recorded in 2014-2015 because of a proportionate reduction in the number of very poor families – projected at only 4.11% by 2015.

7.1.2.2. Other Social Assistance Programs

7.1.2.2.1. Maternity Allowances

258. Currently, there are three types of allowances in Armenia that deal with childbirth. The first is the one-off maternity allowance¹⁰⁴. The objective is partial compensation of costs related childbirth and is currently paid by the State Social Insurance Fund. Next, is the monthly payment to people who take care of the child (until aged 2) and are on partially paid leave. These are paid from the state budget¹⁰⁵. In addition, the existing legislation provides for one year unpaid leave, following two years of partially paid maternity leave. After this three-year period, the employer must ensure the same or an equivalent job to the person returning from such leave. The third is pregnancy and delivery allowance (maternity benefits) payable to employed women for a period of 70 days preceding the delivery and 70 days thereafter. This allowance is equal to the average salary received during the three months preceding the leave (on a daily basis¹⁰⁶).
259. The above allowances are extremely important to encourage a higher birth rate, for material support to families, and for family planning purposes. Taking into account that poverty risks for families with 0-7 year-old children, and families with many children are higher than that of average families (see Tables 2.10 and 2.12), these allowances may serve the goal of poverty and inequality reduction as well. However, while carrying the legacy of the social security system that operated in the Soviet Union, neither the rates nor the eligibility criteria comply with current realities and requirements.
260. To encourage a higher birth rate and enhance the efficiency of allowances related to childbirth, it is envisaged to:
- (i) Substantially increase the rate of the one-off allowance so as to cover a larger share of relevant expenses and, as of 2005, to pay those from the state budget¹⁰⁷;
 - (ii) Cut the duration of the partially paid leave (to take care of children) to one year¹⁰⁸ effective 2004.
 - (iii) Maternity benefits (pregnancy and delivery benefits) are common almost worldwide. However, the duration of this allowance in Armenia, given the current realities, is long¹⁰⁹. Effective 2004, the duration will be curtailed to 112 days (126 days for complicated deliveries and 156 days in cases of multiple births). Effective 2005, maternity benefits will be financed from the state budget, because they are not of an insurance nature.

7.1.2.2.2. Other Allowances

261. **Temporary incapacity benefit:** Hired employees making mandatory social contributions are entitled to temporary incapacity benefit in cases of incapacity or professional disease and industrial injuries. The allowance depends on the period of employment and varies from 80% to 100% of the salary. Unlike many other countries where temporary incapacity allowance is partially paid by the employer (as a rule, during the first two weeks of the disease), in Armenia it is entirely paid by the State Social Insurance Fund. A partial payment by the employer would allow for a higher efficiency in monitoring these allowances. Bearing this in mind, effective 2004, the first two weeks of temporary incapacity benefits will be paid by employers. Relevant legislative amendments will be made in 2003.
262. **Recreational treatment** is paid out of the resources of the State Social Insurance Fund based on a number of legislative acts, in particular, the “Law on Social Protection of Disabled People in Armenia”. Around 150 000 citizens are entitled to free recreational treatment in sanatoria, including

¹⁰⁴ In 2001, this allowance was 5900 drams.

¹⁰⁵ The average monthly rate of this allowance in 200,2 was some 5400 drams. In 2002, around 5400 people received this allowance.

¹⁰⁶ Around 6000 women received maternity benefits in 2001; the total allocation was 435.2 million drams.

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

¹⁰⁸ The duration of this allowance in Armenia is much longer than in other CIS countries (average 18 months).

¹⁰⁹ In the Soviet Union, maternity benefits were paid for 56 days prior to delivery and another 56 days after childbirth.

110 000 handicapped. In 2002 480 million drams were spent for this purpose (1.2% of the State Social Insurance Fund revenues, or 14% of resources spent for employment pensions of the handicapped). For this purpose, 550 million drams will be spent in 2003. These expenditures, in essence, contradict the priority of “primary” income policies in social protection, particularly, the strategy to increase pensions. Thus, the provision of free recreational treatment in sanatoria will be discontinued from 2004. Appropriate amendments in the legislation will be introduced in 2003.

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

Table 7.4. Childbirth and other allowances, 2002-2015 (in current prices)

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

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

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

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

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

Source: Ministry of Social Security, PRSP projections.

7.1.2.2.3. Social Security Programs

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

- (i) The provision of free prosthesis and orthopedic accessories to the handicapped and repairs to these devices. Considering that the number of beneficiaries of this program is relatively stable, budget financing of this item in 2003-2015 will stay at the level of 395.5 million drams (at 2002 volumes and prices);
- (ii) A program to maintain homes and in-house social services to the handicapped who may be single and the elderly. In-house social services to these two groups are carried out by the “National Center for in-house Social Services to the Handicapped who are single and the Elderly”. It renders services to 1200 pensioners in Yerevan only. Currently around 900 pensioners live in six public and non-public homes, of which 450 are in two homes under the authority of the Ministry of Social Security. Financing of the program in 2003-2015 will amount to 762 million drams per annum (2002 prices), maintaining the level of financing of 2002.

265. Donors make substantial investments in social programs for the handicapped and the elderly. Taking into account the lack of financing and the large needs in this sector (e.g. there are 600 people registered in the Ministry of Social Security to get wheel-chairs, including 100 children, while around

2000 people are registered to get otoscopes, including around 150 children), the government will take appropriate measures to coordinate the activities of the state and the donors, starting in 2003.

266. **Social assistance to children:** There are 8 orphanages under the jurisdiction of the Ministry of Social Security (with around 900 children), including two for children with restricted abilities (300 children). In addition, there are also three non-public orphanages, currently serving 150 children. Currently there are 55 000 households headed by women in Armenia. The number of children in such families is more than 63 700. These households are classified as socially vulnerable: 23 800 of these children (37.4%) have single mothers, 11 100 (17.4%) have divorced parents, and 28 800 (45.2%) children have lost the male heads of their families. Thus, the predominant majority of the children in orphanages come from single-parent families. In recent years, however, orphanages have been receiving more and more children from complete, but socially vulnerable families. Per child expenditures in the orphanages are 50 000 drams per month. Effective 2004, on adopting the Family Code and the relevant legislative framework, children will move from orphanages to foster families and will receive (annually) 600 000 drams as financial aid from the state. In addition to the positive moral aspects of being in these families, which is evident from international experience, this will also be economically efficient and will also address the problem of housing for the children after leaving their orphanage. Total allocations to maintain orphanages in 2003-2015, are projected at 366 million drams, maintaining the level of 2002 (2002 prices). Except for a few special boarding schools (for children with mental and physical disabilities, juvenile delinquents, and special occupational institutions), the other children at boarding schools are the ones from very poor families. It is necessary to place these children in general schools, providing them with the necessary financial resources for food, clothes and school accessories. The issues of the social protection of those who leave orphanages and their integration in society are also important. Since 2003, the government has been implementing the program “State Assistance to those leaving Orphanages”. It aims to solve these issues.
267. **Programs of social assistance to refugees:** Refugees, as a socially vulnerable category, have the following specifics: most of them reside in temporary shelters, they have insufficient or no furniture or other necessities, and the level of poverty or extreme poverty is much higher than average. Conditions for women refugees are especially harsh. They have insufficient (or no) representation in national, regional, or community bodies. In rural areas, they do not own domestic animals or land, and they face difficulties with regard to social and cultural integration, to name a few problems.
268. Taking this into account, the social protection policies for refugees should aim to create equal opportunities for refugees and local residents and mitigate the evident differences between them. To this end, the problem of housing is the most painful impediment to refugee integration into society. The program to provide housing to refugees from Azerbaijan in 1988-1992, approved by the government on December 14, 2000, pursues the resolution of this problem. In particular, it targets the completion of construction works on incomplete multi-apartment residential buildings and individual residential units located on residential land, renovation of the hostels inhabited by refugees to convert them to residential buildings, acquisition of apartments for refugees residing in emergency buildings, and the construction of residential units (boarding houses for seniors) for single senior refugees. As a result, 11 000 families will be provided with flats and more than 1500 seniors will be placed in boarding houses. In 2003-2004, the government will undertake measures to improve housing conditions for refugees residing in temporary shelters. An alternative approach in this respect is the implementation of a housing certificate program with the involvement of donor organizations.
269. The next priority is to provide opportunities to extremely poor rural refugees to get involved in animal husbandry and crop growing. This program seeks to create equal opportunities for refugees and extremely poor local people. Taking into consideration the fact that a substantial portion of rural refugees used to be urban residents, the program should provide for a relevant training component as well.
270. **Program of social assistance to internally displaced people:** Along the regions adjacent to the national borders, the harshest conditions exist in the ones that suffered from military activity: or the so-called “post-conflict” areas. Out of a total of 170, 132 near-border settlements are ruined, residences, roads, drinking water, communications, and sewage systems are destroyed. Health,

education, and household services are in extremely poor condition. Some 72 000 people were forced to leave their homes. About 40% returned later; the rest are the so-called internally displaced. A substantial part of agricultural lands is mined. In order to carry out post-conflict rehabilitation, promote the return of the population and improve their living standards, the government has elaborated three programs;

- (i) The program of “Post-conflict Rehabilitation in Near-border Regions of Armenia”, which exclusively targets internally displaced people;
- (ii) “Preliminary program to improve residential conditions for residents of near-border regions damaged by bombing”;
- (iii) “Comprehensive development program in near-border regions” provided by the Law of Armenia on the Adoption of the Comprehensive development program in near-border regions.

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

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

7.1.3. PENSION SYSTEM

7.1.3.1. Existing Pension System

273. The pension system of the Republic of Armenia consists of state pension insurance and state pension security systems.
274. The state pension insurance system includes:
- (i) Old-age pensions (392 000 people received pensions in 2001: or 71% of all pensioners). The Law on State Pensions enacted on April 10, 2003, set a common retirement age for men and women at 63, and required a minimum of 5 years employment. Meanwhile, the schedule of a gradual increase in the retirement age for women, as defined in the previous law, has been maintained. Thus, the retirement age for women will increase by six months per year reaching 63 by 2011¹¹⁰. Currently, the retirement age for men is 63 years, and for women, it is 59¹¹¹.
 - (ii) Protracted service pensions (total of 19 100 beneficiaries, or 3.4% of all pensioners in 2001): Currently, the Law on State Pensions regulates the eligibility criteria for protracted service pensions¹¹².
 - (iii) Disability insurance pensions: (the number of beneficiaries in 2001 was 66 700, or 12% of all pensioners). The requirements on the minimum number of years worked, for different age groups to be qualified for this pension are defined in the Law on State Pensions. In particular, for the age group 30 and above, it is set at 5 years.

¹¹⁰ The previous law regulating pensions was enacted on January 1, 1996. It allowed for a gradual increase in the retirement age for both men and women from 60 to 65 and from 55 to 63, respectively.

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

¹¹² According to the Law on State Pensions, only employees in the civil aviation sector are eligible for protracted service pensions. Some groups employed in the educational and cultural sectors are eligible for partial pensions.

- (iv) Insurance pensions to families who have lost the head of the household. In 2001, their number was 14 400, or 2.6% of all pensioners.

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

275. The state pension security system includes social pensions, as well as pensions paid to public servants in the departments of defense, national security, the interior and emergency situations management. Pensions to military personnel are set at 70% of their financial remuneration and include a number of supplements. Pensions to veterans of World War II and equivalent persons, as well as pensions paid to military personnel wounded in service, and to families of military personnel killed in action, are also paid from the state pension security scheme. The number of beneficiaries in this category was 22 300 in 2001. At that time, 47 000 people received social pensions.
276. The social pension system includes:
- (i) Old-age social pensions (these are provided to people who are not eligible for old-age pension insurance starting at age 65);
 - (ii) Social pensions for disability (these are provided to handicapped people non-eligible for disability insurance pensions, as well as to disabled children);
 - (iii) Pensions paid to families who lost the head of the household with an insufficient employment record.
277. The current pension system is mainly financed from mandatory social contributions. Pensions of personnel serving in the military, national security, interior and emergency situations management departments are financed from the state budget. In 2000, these pensions were on average 6 times higher than the old-age pension rate. In 2002, more than 7.9 billion drams were allocated from the state budget for this purpose. Starting in 2003, allocations for social pensions are also made from the state budget (2 billion drams for 2003).
278. Mandatory social contributions are the source of financing for a number of other social programs as well (state employment programs, including unemployment benefits, partial compensation of funeral costs to pensioners, disease and maternity benefits). Since 2001, the progressive-regressive three-layer scheme is in place, according to which employers pay 5000 drams +15% (for salaries between 20 000 drams and 100 000 drams) or + 5% (for salaries higher than 100 000 drams), while employees pay 3% of the salary. Mandatory social contributions paid by individual entrepreneurs and landowners, in 2000, totaled 429.2 million drams, or 1.4% of social payments. In 2001, the amount was 537.6 million drams, or 1.5% of social payments.
279. In the last decade, both the branch structure of the economy and the ratio of its formal and informal segments have undergone tangible changes. As a result, both the number of payers of mandatory social contributions and the volumes of payments have substantially decreased. The latter is due to a substantial underreporting of actual salaries, among other factors. Thus, while in Soviet times, 1.6 million people employed in various branches of the economy were all payers of mandatory social contributions, out of 1.37 million employees in 1997, only 570 000 paid their dues (in 2000 these figures were 1.27 million and 490 000 respectively).
280. This factor, together with the substantial payments of allowances not related to social insurance from the budget of the State Social Insurance Fund¹¹³, became the main reason why the development of the Armenian pension system in 1999-2002, lagged behind the GDP and average salary increases. While the GDP in 1999-2001 grew by 18.8% (in current prices) and average salaries by 18.7%, the average pension rate grew by only 3.4%, and the average retirement pensions by 2.9%.
281. Pensions in Armenia are very low: currently, the lowest in the CIS countries. If other sources of income are absent, all pensioners in the country may have been considered poor in 1999-2001, with 94% being very poor. This is because the average pension rate had not guaranteed even the minimum food basket.

¹¹³ In 2001, the State Social Insurance Fund spent 63.8% of its revenues to pay for retirement pensions.

282. An important feature of the existing pension system of Armenia is the annual reduction of old-age pensioners. In 1999-2001, the number of pensioners declined by 16 400, or 2.9%, and the number of age pensioners by 21 700, or 5.2%. The reduction in the number of old-age pensioners, which will continue in 2003-2015, is attributed to:

- (i) A gradual increase of the retirement age, 6 months per year, with its impact felt up to 2011, when women reach the new retirement age of 63. The stress will dissipate a bit in 2003, however, when men reach their retirement age of 63;
- (ii) The fact that those entitled to old-age pensions now and in the near future were born in 1941-1945, when the growth of the population was extremely low because of the War;
- (iii) Migration: according to estimates based on official and sampled data¹¹⁴, a 25% reduction in the number of pensioners is a consequence of emigration from 1991 to 2001.

These factors also affect other types of pensions, such as pensions related to military service. The number of occupational disability and social pensions is relatively stable and dependent on the number of the handicapped. In 1996-2001, they made up 3.2% of the population in Armenia.

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

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

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

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

* Note: The Table does not contain pensions paid to military, national security, interior and emergency situations management

¹¹⁴ Armenian Statistical Yearbook (1997, 1998), p 37, Yerevan, 2001; Armenian Statistical Yearbook (1999, 2000), p 39, Yerevan, 2001; Armenian Statistical Yearbook (2002), pp 43-47, Yerevan, 2002, pp 43-47.

department personnel. These are paid entirely from the state budget. The number of beneficiaries is not reported here.

**** Note:** Projections of the number of population in Armenia are based on the preliminary data of the 2001 Census and do not take emigration into consideration.

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

284. The reduction in the number of pensioners will help maintain the financial stability of the pension system up until 2015. This will happen provided the existing rates of social contributions continue and the contributors to the State Social Insurance Fund do not decrease from the level (490 000) of 2000.
285. At the same time, current and future reduction trends in the number of pensioners and the related financial stability of the system provide a unique opportunity to implement fundamental reforms in the pension system of Armenia in 2003-2005. These reforms target:
- (i) An increase of pensions so that average employment pensions in 2005-2006 exceed the per capita poverty food threshold, and the per capita general poverty threshold by 2008;
 - (ii) In 2003-2005, social and other pensions not based on mandatory social contributions are to be financially separate from employment pensions;
 - (iii) The streamlining of a collection mechanism regarding mandatory social contributions;
 - (iv) A radical increase in the differentiation between old-age pensions on the basis of length of employment;
 - (v) A certain tightening of eligibility criteria for pensions;
 - (vi) The development of legislative and organizational measures to start the transition to a three-layer pension system in 2006 (mandatory social insurance, social pensions, and a voluntary pension insurance system).
286. Table 7.5 shows that in 2003-2015, a substantial improvement of the living conditions of pensioners will take place. Effective 2005, old-age pensions will be above the poverty food threshold, while disability pensions will approach it. The poverty threshold will be surpassed in 2008. Social pensions will exceed the poverty food threshold in 2013. Such developments will materialize given the financial stability of the pension system, which is, in turn, preconditioned by economic growth and an unprecedented reduction in pensioners, especially old-age pensioners, up until 2015. The proportion of the average pension to the average salary will also improve, reaching 37% in 2014-2015 – up from 19.4% in 2002.
287. Despite the annual contraction of the financial basis of the existing pension system (in 1997 each employee financed 1.03 pensioners, or 0.92 employment pensioner, or 0.75 old-age pensioner. In 2000, these proportions were 1.14, 1.02 and 0.81 respectively. In 2002, they were 1.15, 1.01 and 0.82 respectively. In 2003-2015, the financial basis will significantly expand given the reduction of the share of pensioners and the tangible increase in the number of population of working age. These are preconditions for the financial stability of the pension system.
288. In addition to demographic developments favorable for the financial stability of the pension system, there are three possible types of policies to strengthen financial stability, including (i) increasing the number of payers of mandatory social contributions; (ii) increasing the rates of contributions; and (iii) checking and adjusting the number of beneficiaries receiving pensions from the State Social Insurance Fund. The combination of the first policy with the third policy has been identified as the key policy direction for 2003-2015. It will aim at limiting the coverage of pensions paid from the State Social Insurance Fund to employment (insurance) pensions only. It will also transfer the burden of financing the other pensions to the state budget, while tightening the eligibility criteria to be qualified for insurance pensions. In particular, as a result of transferring the payments of social pensions to the state budget in 2003, each employee finances 1.03 pensions. As a result of transferring the payment of pensions for military service to the budget in 2005, each employee will finance 0.96 pensions.
289. An increase in the rate of mandatory social contributions may not be considered efficient for a number of reasons. Firstly, while being the lowest in the CIS, mandatory social contributions are actually quite high (for example, in the US, these payments constituted 12.4% of the average salary rate in 1997). On

the other hand, an increase in the rate of these contributions will significantly complicate the introduction of a voluntary pension insurance scheme, as well as other insurance schemes (for example, medical insurance). Nor will it contribute to the reduction of a shadow economy. Nevertheless, it is envisaged to simplify the existing payment mechanisms and shift to a unified assessment scale.

290. An increase in the number of contributors and their share is one of the priorities of the pension system development. Being long-term in nature, however, its PRSP-related impact would be felt only in 2012-2015.
291. The long-term essence of the issue lies with the currently existing pension system characterized by a very weak differentiation of pensions, as well as weak eligibility criteria. Just five years of employment is sufficient to be eligible for an old-age pension. On the other hand, there is essentially no linkage between a salary (and related social contributions) and the eligible pension rates in later years. This state of affairs is far from promoting an engagement in the mandatory pension insurance system. Rather, it induces shadow activities. The existing pension system is constructed on internal "cross" subsidies. People having a longer employment subsidize those with shorter employments. People with high salaries subsidize those with low salaries. This, in addition to the high levels of the shadow economy, explains the fact that less than 40% of the officially registered employees make social contribution payments (for example, this indicator in Slovenia in 1997 was 84%, and in United States it was 91%).
292. Thus, addressing the issue of increasing the number of contributors lies with the transition to individualized pension schemes, whereby the pension rate will depend on the actual salary and social contributions made. With a view to enact this approach in 2006, the following measures are to be undertaken in 2003-2005:
 - (i) A new Labor Code should be enacted to lay the ground to regulate labor relations appropriate to a market economy;
 - (ii) An individual registration system will be introduced. It will enable the proper accounting of contributors' payments and obligations (salary rate of each employee, social contributions by employers and employees, period of insurance payments, etc). It will also allow for the allocation of the pension on the basis of data contained in individual accounts and in accordance with pension legislation;
 - (iii) On introducing this system, the minimum benchmark for pension eligibility will be raised in 2005, to 10 years (from the current 5);
 - (iv) In 2003, mechanisms and relevant measures to introduce a personal registration system will be designed. Measures toward improving the legislative basis to introduce voluntary pension schemes will be taken;
 - (v) In 2004, the Law on Pension Funds will be adopted to create the legislative framework to introduce voluntary pension schemes and the regulation of their activities;
 - (vi) A minimum salary rate will be defined to correspond to the general poverty threshold. This issue is to be solved in 2004. It will minimize shadow salaries, while increasing the volume of collectible indirect taxes. It will also eradicate remuneration inequalities and contribute to poverty reduction.
293. Effective January 2003, employees of farms are exempt from mandatory social contributions. The financial implications (losses) of this measure are small: in 1999, contributions by farms totaled 289 million drams or 0.8% of revenues of the State Social Insurance Fund (excluding budget transfers). In 2001, these were 207 million drams or 0.5%, respectively. Thus, effective 2003, the accrued employment period for employees of farms will not be recorded. The positive impact of this measure on the pension system will materialize in the long run. On the other hand, regulations for the voluntary participation of farm employees in the state (mandatory) pension scheme will be considered to introduce a voluntary social insurance scheme on a contractual basis.

294. Effective 2004, the procedure to evaluate disability pensions will be modified:
- (i) The current approach, with three degrees of handicap, will be replaced by the functional disability approach and establish two relevant groups: functionally incapable and limited ability;
 - (ii) From 2004, no new pensions to the third degree of handicap will be provided;
 - (iii) In order to ensure financial sustainability of the disability insurance, an amendment to the Law on State Pensions will be made to set the share of financial resources to be allocated for disability pensions at around 10% of all contributions;
 - (iv) In order to supply legislative bases for these challenges, a new Law on the Social Protection of the Handicapped will be adopted in 2003.

These measures will bring about a 25% decrease in the newly set disability pensions and expand the pensions for the first and second categories as early as in 2005. They should exceed the general poverty threshold by 2010.

295. Prior to introducing an individual registration system, a differentiation of employment pensions will be implemented mainly at the expense of incremental funds paid for the employment period. This provides for a tangible improvement of pension differentiation on the basis of employment period.

7.1.4. EMPLOYMENT PROGRAMS

296. Employment programs include unemployment benefits, support in looking for and finding jobs, retraining of and financial assistance to the unemployed. These, as well as public works programs, are implemented by Regional Unemployment Centers. Their maintenance costs are funded from the state budget. The implemented programs (except public works funded from the state budget) are funded from the State Social Insurance Fund.
297. Currently, those who are entitled to unemployment benefits would have paid mandatory social contributions for at least 12 months. The period of entitlement depends on the employment period of the applicant and may last from 5 to 12 months. The amount of benefit also depends on the employment period but may not exceed 3900 drams per month. The benefits are paid out of social contributions and other resources, which employers must transfer to the State Social Insurance Fund once an employee is dismissed. On completion of the period of entitlement to unemployment benefits, the unemployed person has the right to receive a monetary assistance of 1300 drams per month.
298. By the end of 2002, there were 133 700 unemployed (9.58% of the economically active population)¹¹⁵ registered with the National Unemployment Center. It collects data on the status of the unemployed. The number receiving unemployment benefits was 6000 people as of December 2002. The average rate of unemployment payouts was 3214 drams. In December 2001, there were 5800 beneficiaries with an average benefit of 3187 drams.
299. Taking into account the widespread unemployment (according to official data the registered unemployed made up 32% of people paying social contributions, but it is closer to 70%-80% if the real unemployment rate is taken into account), the unemployment insurance system is not in a position to insure unemployment risks in an efficient manner.
300. An unemployed person registered with the Unemployment Center is entitled to participate in free training courses held by such Centers and funded from the resources of the State Social Insurance Fund. According to 2001 data, only 989 unemployed participated in training courses and 855 acquired new professions. In 2002, 8500 people found jobs. These data demonstrate the extremely inefficient system of training and addressing unemployment issues. The existing scarce financing of training and retraining does not ensure the proper quality of trainees with the labor market requirements.
301. Bearing this in mind, the following measures are to be undertaken in the area of employment

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

programs, effective 2004:

- (i) Unemployment insurance will be discontinued together with the payments that employers have to pay to the State Social Insurance Fund on dismissing an employee. The legislative basis for this will be enforced through relevant amendments in the legislation;
- (ii) The share of mandatory social contributions used for unemployment insurance (2% of total payments) will be earmarked for disability insurance.
- (iii) Effective 2005, the financing of employment programs will be done through the state budget;
- (iv) State training programs will be suspended. The training of the unemployed will be undertaken by labor services on the basis of tendered state orders for certain groups of unemployed to get retrained in specialties that are in high demand on the labor market. These groups will contain refugees, the handicapped and people with limited capacities, and people who are uncompetitive on the labor market. This will also contribute to the development of training institutions;
- (v) Unemployment benefits will be replaced by a larger monetary unemployment support, but with a shorter entitlement period. This will be provided under stricter eligibility criteria than the existing benefits. The rate and eligibility criteria will be determined by the government in 2004;
- (vi) Effective 2004, financial assistance to the unemployed to become involved in business activities and job creation will be discontinued. The freed resources will be earmarked for professional training and retraining of the unemployed.

302. **Public works:** The state budget of Armenia has been financing “benefit for work” programs since 2001 (500 million drams in 2001 and 2002). The goal of this program to provide temporary employment to families enrolled in family poverty benefits, and to help the unemployed search for a job. Programs are in the domain of social infrastructures, area improvement, tidying monuments and architectural structures, sanitary cleaning, etc. Since the beginning of 2001, around 9051 people took part in public works. In 2002, the number increased to 11 700 and each was paid 800 drams per day. In order to expand this program:

- (i) The enrollment procedure will be simplified in 2004. There will be no limitations for people of working age. Resources of the Armenian Social Investment Fund will also be used to finance unskilled labor to be performed by local residents registered for public work with regional unemployment centers;
- (ii) A large volume of public work is currently funded from international, donor, and non-governmental organizations (“food for work”, etc). The format of cooperation with such organizations will be developed by 2004 - especially the process of involving applicants in public works.

7.2. INVESTMENT IN HUMAN CAPITAL

7.2.1. HEALTH

7.2.1.1. General Overview

303. The PRSP pursues the objective of turning back the negative trends observed in the development of the health sector recently. It seeks to enforce the constitutional right of the people to maintain health through a substantial increase in accessibility and quality of health care services guaranteed by the state. The priority is for the poor. Measures suggested for implementation in the health sector are particularly intended to meet target indicators for infant and mother mortality as declared by the UN within the Millennium Developments Goals framework.

304. As a result of socio-economic transformations in recent years, the indicators describing the health of the population showed negative trends. Furthermore, the consumption of health care resources by the population substantially contracted. Analyses show that the affordability of services for certain groups of the population widely differs depending on the type of service. The Table 7.6 reflects the structure of public expenditures in the health sector in 1990, by types of services and consumer groups.

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

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

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

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

305. Expenditures channeled from the state budget to the health sector are rather low (see Table 7.7). In 1998-2002, the highest indicator was 1.4% of GDP (for comparison, in countries with an average income level, this indicator is 3%). The severity of the situation would not be eased; even if the significant role of humanitarian aid received to finance the health sector recently is taken into consideration. The difference becomes more striking if the basis for comparison were selected to be the per capita public expenditures in the sector. In Europe and Central Asia in 1997, the per capita expenditures were USD 123, while in Armenia they were only USD 7. Concurrently, a major part of budget allocations were channeled to hospital services instead of redistributing them to primary health care, which is more accessible for the poor.

Table 7.7. Public expenditures in the health sector

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

Source: Ministry of Finance and Economy, NSS.

7.2.1.2. Priorities and Targets

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

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

309. Increase in public funds allocated to the health sector is one of the priorities in improving the situation. Throughout the duration of the program, public expenditures will display growth (2004-2015, with an average of 14% per annum). In the period between 2004 and 2006, growth rates will be higher (average 19% per annum) with a further stabilization in the range of 11% in 2010-2015.
310. The main sources of such growth in public expenditures in the sector will be in the collection of revenues from domestic sources and project financing from foreign sources. Within the context of

important international cooperation projects (such as vaccinations, etc), the government intends to take on the main financial burden. Donor (specialized) organizations, however, will mostly concentrate on the technical support side of cooperation projects.

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

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

311. Throughout the program period,, the growth rate of public expenditures in the health sector will exceed growth rates of total public expenditures. This will lead to an increase in the share of health expenditures in the state budget. It is envisaged to increase the share of health expenditures in the state budget to 9% in 2006, 10% in 2008, and 11% in 2012, with the end-period indicator as high as 12%. The behavior of the health sector share in GDP is programmed to be consistent with the dynamics of nominal indicators as above. In 2015 (compared to 2003), public expenditures in the health sector-to-GDP ratio will increase by 1.1 percentage points to reach the program target indicator of 2.5% of GDP in 2015. According to the program, the planned changes will be ensured mainly during the first five program years (0.6 percentage points increase in 2008 from 2003), thus reaching the target indicator of public expenditures in the health sector-to-GDP ratio of 2% in 2007.
312. Increase in budget allocations are mainly targeted to increase the wages of doctors and other medical personnel, to supply medicines and medical materials, to improve buildings, and to supply modern equipment. Both in terms of wages and capital expenditures, the improvement of conditions in primary health care institutions is prioritized (especially in rural areas). So as to meet these targets, the state will control salaries for primary health care system employees and allocations for capital spending, while other funds will be assigned on a per capita normative basis.
313. Should the required levels of funding be impossible to reach, the authorities will be ready to undertake even more substantial inter-sectoral redistributions than envisaged here, in view of the priority they attach to the health sector.
314. The intra-sectoral redistribution of public expenditures will be carried out with the following priorities:
- (i) Taking into consideration the higher rate of accessibility of primary health care (out-patient and polyclinic) and its physical proximity to the population, the share of state budget financing of primary health care will increase by reallocating funds from appropriations to hospital care;
 - (ii) Both hospital and primary health care systems (including family doctors) will have as priorities the health of mothers and children, and the mitigation of special, socially significant diseases.

7.2.1.4. Program Priorities in the Health Sector

7.2.1.4.1. Primary Health Care (out-patient and polyclinic)

315. It is programmed to increase the share of primary health care in total health expenditures to 40% in 2006, 45% in 2008, and channel 50% of the sector expenditures in 2015.
316. The introduction and coverage of a family doctor system should continue and expand throughout the entire country. Family doctor and primary health care systems should gradually receive independent status based on per patient (properly registered) financing, independent resource management and decision-making systems. In the context of primary health care for the poor, it is necessary to ensure the accessibility of diagnostic services. To this end, the targeted use of diagnostic equipment procured under the World Bank project to regional polyclinics and the placing of orders with off-hospital

diagnostic centers for expensive diagnostic examinations should be prioritized. In addition, strengthening the ambulance service is important. It may be implemented through the creation of a fleet of reanimation vehicles with special equipment.

317. In the context of poverty and inequality reduction, the authorities will attach a special importance to the accessibility of primary health care services, including family doctors for the rural population.

7.2.1.4.2. *Mother and Child Health Care*

318. Attaching an appropriate importance to women's and children's health, including reproductive health, is of primary significance in terms of ensuring healthy generations and, subsequently, the improvement of the health conditions of the population and poverty reduction. It is necessary to reiterate the priority of women's and children's health at the national level by ensuring continued improvement of health conditions of pregnant and nursing women and the nutrition of children up to the age of 5. Furthermore, breastfeeding should be encouraged, as well as the provision of prenatal and postnatal quality medical service.
319. A special importance is attached to fulfilling these issues, and the millennium goals announced by the United Nations in respect of infant and mother mortality. This is to be brought about through the improvement of the quality of obstetrician and gynecological medical aid and improving the equipment of obstetrician hospitals (see Box 7.1).
320. In terms of medical aid to children, special attention is given to quality improvement and disease prevention measures, including vaccinations and programs on the healthy growth and development of children. The introduction of the WHO's strategy of integrated management of childhood diseases is also important.

Box 7.1. Financing of Obstetrician Medical Aid

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

7.2.1.4.3. *Contagious Diseases and HIV/AIDS Prevention*

321. Poverty is closely related to such contagious diseases as tuberculosis, sexually transmitted diseases and AIDS. Given the drastic increase of these diseases in the recent decade (twice for tuberculosis, triple for syphilis, etc), it is necessary to strengthen preventive measures, carry out early diagnosis and identification, and carry out thorough treatment programs. Redistribution of budget resources, in particular, will contribute to the implementation of the above measures.

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

322. Currently, there is a substantial gap between the demand and supply of health sector services. Despite the fact that in recent years some reduction of the doctor/per 1000 people indicator (10% reduction from 1997 to 3.8 in 2001), as well as hospital beds per 1000 people (-36% and 5.4, respectively) have been recorded, international comparisons prove that Armenia is close to (in many cases, above) countries having medium and high income levels. As a result, insufficient budget resources are allocated to the health sector, often channeled to maintain a substantially exaggerated network of medical institutions exceeding the demands of the population. This led to an undue duplication of

health services in the context of scarce budget allocations.

- 323. Priority directions in enhancing efficiency are optimization and management reforms. As a result of sector optimization, services should shift towards a more accessible and relatively cheap primary health care network and away from relatively expensive hospital care.
- 324. One of the main directions to enhance the effectiveness of hospital healthcare would be to concentrate the limited public resources as much as possible in the fewest healthcare facilities. Among the measures to be implemented, the consolidation and merger of healthcare facilities in Yerevan is very important.
- 325. Special measures should be taken to enhance the efficiency of the planning, budgeting, and oversight functions of medical institutions.
- 326. Within the authority of the legislation, it is necessary to strengthen the regulatory and supervisory functions of the state in the health care system. In particular, it is necessary to launch the process of the elaboration and introduction of quality control standards and review sanitary norms and regulations.

7.2.2. EDUCATION

7.2.2.1. General Overview

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

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

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

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

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

- 329. An analysis of enrollment indicators at various levels of education gives the following picture (gender specifics of enrolment at the different levels of education are presented separately in Box 7.2):
 - (i) Despite the declines observed in recent years, enrollment in basic general education is quite high and, essentially, is not a basis for serious concern. Such a conclusion is a result of the analysis of both gross and net indicators of enrollment. In particular, results of the 2001 integrated household survey show that although enrollment of 7-year-old pupils is low (around 47%, which may be interpreted as resulting from children attending schools at a later age: 8, for example), but net enrollment in the group of 8-15-year-olds (which may be accepted as the closest

approximation of the general education period) constitutes 98.7% (see Figure 7.1).

- (ii) Enrollment in senior school (including preliminary professional (vocational) education) has not substantially changed and, in recent years, has fluctuated between 70% and 75%. The same stability is evident in professional education as well. In 1997-2001, around 22% of 17-24-year-old children were covered in professional education programs. It should be emphasized that in the program period, the authorities will undertake measures to promote enrollment both in the senior school and professional educational programs, with particular attention to equality issues.
330. The efficiency of the education system is far from satisfactory. This refers both to the labor force and the utilization of physical resources. Efficiency issues, however, are especially acute in terms of their utilization. In particular, pupil/teacher and pupil/non-teacher ratios in the secondary education system in 2002 were 11 and 18, respectively. For comparison, in 2000, the average indicator of pupil/teacher ratios in OECD countries was 14.3. Even this is considered inefficient. The workload of teachers is also below OECD indicators. A matter of concern is the low remuneration of teachers. The average salary of a teacher/GDP per capita ratio in 2002 was 0.41 (0.96-1.45 in 2002 in OECD countries depending on experience).

Box 7.2. Enrolment in Educational Institutions by Gender

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

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

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

For example, in the 2001-2002 academic year, girls were about 54 % of 9th graders and 56 % of 10th graders (see table). Analyzing the same data by provinces, we can conclude that deviations from the national average are not substantial (the prevalence of girls in senior grades is more underlined in Syooneek and Tavooosh provinces). Such manifestations are due to a number of factors, including tradition. The poverty factor also has a role. Boys, for example, leave school earlier so that they can participate in income generation for the family. Nevertheless, the share of this factor, most probably, is not predominant.

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

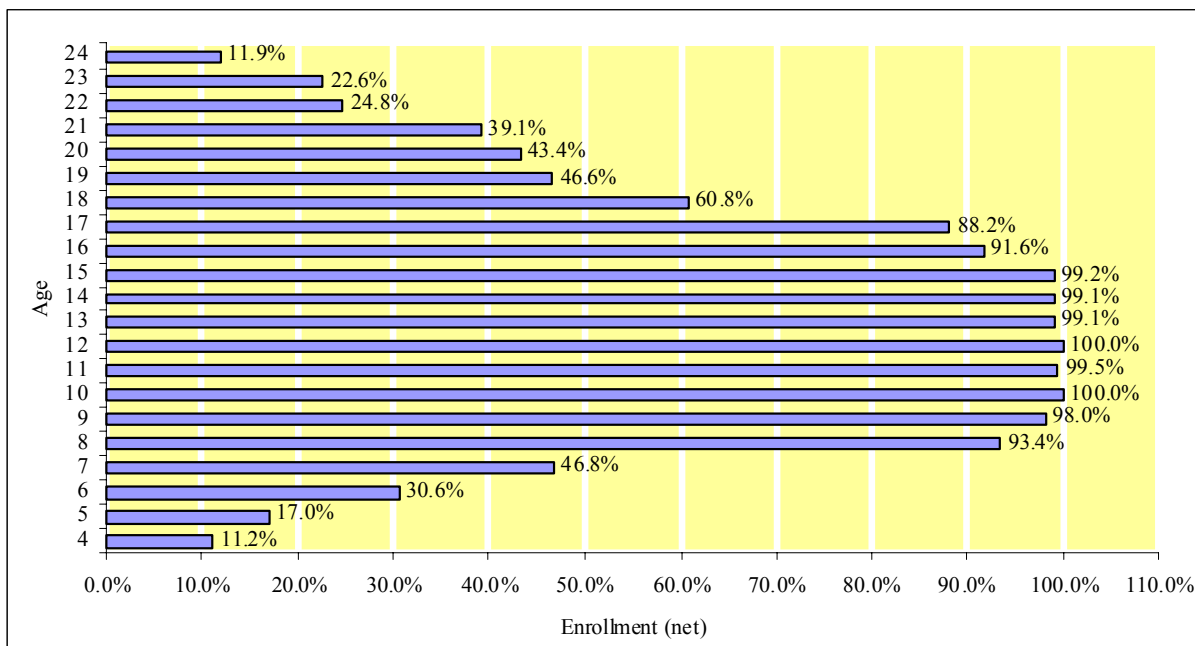
Table B 7.1. Enrolment structure in various levels of education by gender, 2001-2002 academic year

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

¹ Pre-doctorate, doctorate, post-doctorate.

Source: National statistical service

Figure 7.1. Enrolment by age



Source: 2001 Integrated Household Survey.

7.2.2.2. Priorities and Targeting

- 331. Within the framework of the program, a priority is the further development of the general education system to improve the quality and efficiency of services. An equally accessible, and high quality general education system is an important precondition (i) to educate society and improve literacy; (ii) to ensure the fundamental knowledge necessary for the labor market; and (iii) to further education.
- 332. By enhancing the quality of general education, the state will thus create good conditions to increase enrollment in senior schools and the professional education system, particularly for children from vulnerable families.
- 333. Within the framework of this program, secondary vocational as well as higher education sectors are viewed as the second level of its objectives. Nevertheless, primary policy objectives in this area include: (i) parallels with the rules of a market economy; (ii) enhanced quality and compliance with international standards; and (iii) improved accessibility and equality.
- 334. In the area of higher education, the government will pay special attention to equality and targeting issues by creating the necessary conditions to increase the enrolment of all gifted young people willing to receive a higher education. One of the alternative approaches to resolving this problem is the development and introduction of a student loan system, where loans will be granted based on success in studies and the level of well being. Although the possibilities for intra-sectoral redistributions to the benefit of higher education in the first years of the program period are fairly limited, nevertheless resources can be allocated for the operation of the loan system by appropriate redistribution within sectors. For example the stipendium system in its current form may be dropped. It is inefficient and, in fact, not well targeted.
- 335. The state will pay special attention to educational and training programs with the objective to smooth the gap between job opportunities (supply) and the requirements of the labor market.
- 336. The objectives inherent to the program will be reached by increasing allocations to the education sector and enhancing the efficiency of the system.

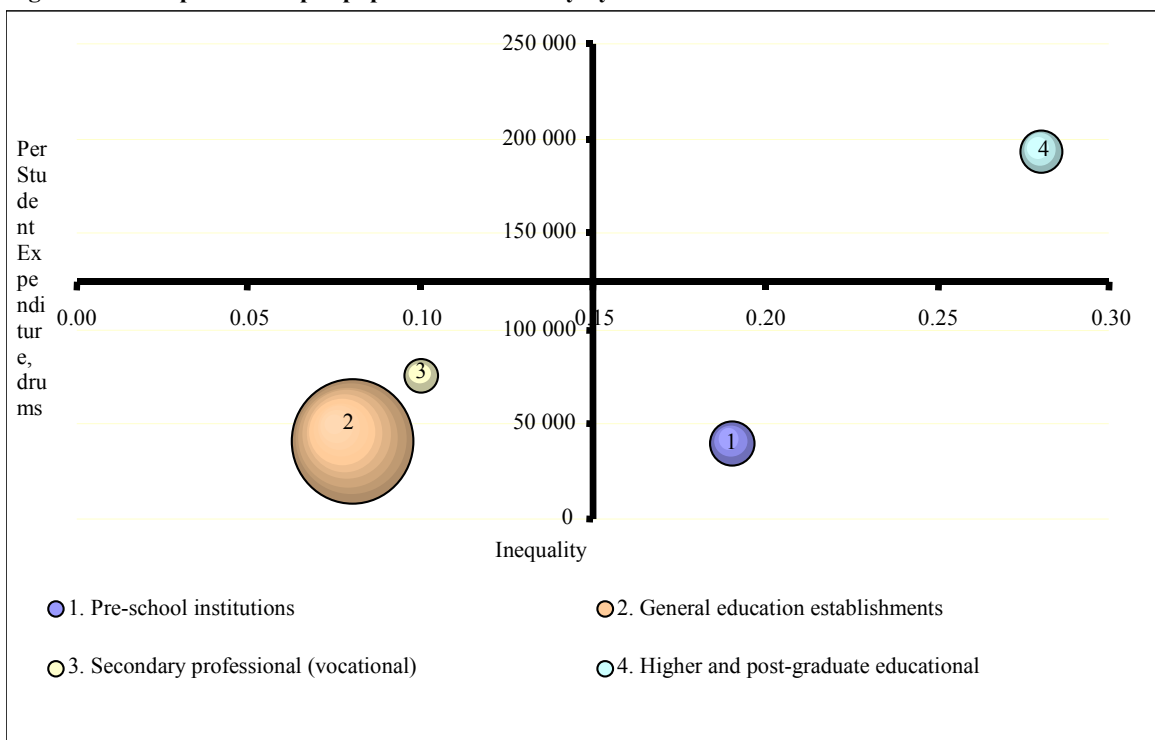
Box 7.3. Priority Determination

Determination of priorities is conditioned, in particular, by the following factors (see Figure B 7.1):

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

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

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



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

7.2.2.3. Public Expenditures in the Education Sector

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

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

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

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

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

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

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

341. The programmed increase of public spending in the education sector will result in a substantial growth of per pupil expenditures. Within this scenario, per pupil expenditures in 2006 (compared to the 2003 indicator) will be doubled, and more than quadrupled in 2008 (See Table 7.12). However, it is necessary to mention that such a behavior of per pupil expenditures is partially preconditioned by predicted changes in the demographic structure of the population. Despite the improvement of enrollment indicators, the number of pupils enrolled in the general education system will decrease in

2015 by some 25% (from the 2003 indicator).

Table 7.12. Per pupil expenditures in the general education system

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

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

7.2.2.4. Priorities of Public Spending

343. Priorities in the general educational system are the increase of salaries and training. Measures undertaken to this end are considered a precondition to increase the quality of educational services. The state will continue its implementation of salary increases. It is envisaged to increase the average salaries of the teachers to the equivalent of 80 US Dollars a month in 2005, and ensure an average 12% increase per annum in each of the subsequent program years (see details in Box 7.4). Although calculations in this particular case are justified through the logic of a payback of expenditures incurred on higher education, however, setting such a rate of remuneration is also acceptable from the point of view of the ratio to per capita GDP. In particular, in the framework of the suggested scenario, the average salary of a teacher in 2005 will become equal to the per capita GDP, and exceed that indicator by 43% in 2015. In the medium term, it is proposed to introduce effective mechanisms of salary differentiation based on experience. Such approaches to remuneration will become an effective stimulus for working teachers, as well as promote the replenishment of high quality pedagogical staff in general education schools in the future. This will lead to a rejuvenation of staff, as well as softening the existing gender disproportions in the staff structure¹¹⁶. Issues relating to the replenishment of high quality staff in schools are especially crucial for schools in rural and border-area communities, which will be the cynosure of the authorities.

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

345. Although during the first years of the program period (2004-2006), funds to be channeled to increase salaries will be 80% to 85% of current expenditures, they will stabilize in the range of 70% to 75% of current expenditures enabling the authorities to meet the other needs of current expenditures¹¹⁷.

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

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

348. With respect to improving quality at the general education level, the government will pay special attention to improve assets and teaching and learning materials. In particular, issues related to the content of education, curriculum, teaching, and learning materials modernization, school library

¹¹⁶ In the 2001-2002 academic year, the average age of teachers employed in public and private general education schools was near 55 (6.2% of teachers were of retirement age) Women made up 84% of the total teaching staff.

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

resource upgrading, as well as ensuring the availability of modern information technologies in schools are of high importance. External project assistance will play a significant role to resolve these issues.

349. Despite the fact that the predominant portion of educational expenditures will be allocated to general educational establishments, in view of the structural changes in progress in the economy, enhancing the quality of vocational and training programs, and their compliance with socio-economic development goals of the country, will be given a high priority. Thus, reforms in vocational and additional training in the program period are prioritized, which will enable training that meets the requirements of the labor market by envisaging special mechanisms to involve people with protracted unemployment status and their re-training.

Box 7.4. Remuneration of Teachers

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

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

The following assumptions underlie the calculations:

- (i) Expenses related to preparation to entry exams to higher educational establishments and further studies are considered investments and constitute 600 US Dollars and dram 80 000 (with a 3% increment every year);
- (ii) In all the years of study in higher educational establishments, the annual rate of tuition is unchanged and equals the tuition of 2002-2003;
- (iii) A person with secondary education may have been involved in other work besides studying in a higher educational establishment and receive remuneration for such work. This is viewed as an amount "lost" by the graduates of these establishments or investments made;
- (iv) Initial monthly pay of a graduate from secondary school is dram 23 000 with a growth of 10% per annum;
- (v) A graduate from a higher educational establishment, on graduation, will be employed and start working immediately;
- (vi) Wages will increase by 10% per annum.

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

7.2.2.5. Enhancing the Efficiency of the Education System

350. An important aspect of educational sector reforms is the enhancement of efficiency. The authorities will continue and increase rationalization measures in education. The need for rationalization is particularly evident here when projected demographic changes are considered. The measures target enhancing the efficient use of human and physical resources in education and management.
351. The following measures addressing efficiency issues are to be implemented in education:
- (i) Increasing the pupil/teacher ratio to reach 16 in 2008;
 - (ii) Increasing the workload of teachers to 22 hours per week in 2005 (according to some estimates, this indicator may be increased to 27 hours per week)
 - (iii) Increasing pupil/non-teacher ratio to 24 in 2005;
 - (iv) Increasing the compactness of classes;

- (v) Defining the optimal number of pupils in schools, and merging schools, if necessary.

7.2.3. POVERTY REDUCTION: CULTURAL CONCEPT

352. In this paper, culture is perceived as a complex of social groups and structures, a world vision, behaviors, skills, and a cultural heritage, certain aspects of which may either impede or help reducing poverty.
353. One of the specific manifestations of culture in Armenia's poverty is the prominent identity of Armenian culture, a totality that includes traditional, national, and Soviet perceptions. There is a widespread perception, for example, that the new era which Armenia entered after regaining its independence is a system founded on exploitation, the trampling of human dignity and values: a society for the rich and mired in social injustice. Kindness, fairness, and flexibility are values that are in no demand whatsoever. Such a generalized perception of the new system reinforces the notion of the inevitability of poverty and the conviction that there is nothing to hope for. This is one of the major impediments for social progress and poverty reduction.
354. The tough attitude towards the poor in society leads to their isolation and self-isolation. Covering up poverty is perceived as the decent, dignified thing to do. An individual strategy of self-esteem orients people towards the family, community, and neighborhood system of values. At the national level, it translates into citizenship. Society lives in a system of family and relatives. This network has mechanisms and means of existence within it. While in individual cases family affiliations have a decisive role in assisting the poor, at the national level, a further implantation of this system severely restricts the potential to create a civil society. To a large extent, community life is built on family and friendship groups. The embryos of civil society, such as NGOs, associations, and unions, are very weakly manifested – even non-existent at the community level. Transferring the Soviet era's clubs and culture houses to the jurisdiction of local governments practically put an end to their existence. This led to the dissolution of the general socio-cultural domain, which might otherwise have served as the place where the poor would have participated in general discussions and debates, the elaboration of community opinions, and the preparation of decisions, as well as public hearings of the poor.
355. Armenians have a very special attitude to history. Armenia has an ancient civilization and, throughout the centuries, this has been viewed as an inseparable part of the nation's image. The last 3-4 decades of the Soviet Union allowed for extensive archeological digs. Research and the restoration of historic and cultural monuments reinforced national pride and patriotism in the population. People want to feel they are part of global civilization. Maintenance of the image of Armenia as the cradle of civilization is necessary – especially for its own people. In a number of areas, people themselves initiate the maintenance and repair of historical monuments located in their communities.
356. The poor in Armenia, having isolated themselves, do not turn to the Armenian Church, but join various “sects” – seduced not by worship and ideologies lavished in propaganda sessions, but rather by the ideas of sympathy, sincerity, fairness, justice, and mutual assistance. The concept of “poverty is not a vice” has a certain level of stable manifestation in some of the newly imported religious communities, rather than within the Armenian Church. The perception of poverty as a vice, however, is more widespread. Its rehabilitation and proliferation is an indication of the progress of Armenian society in a direction opposite the “social” one.
357. **Poverty Reduction within a Cultural Development Concept**
- (i) In order to prevent the self-isolation of the poor, one must promote their participation in community life, increase their access to information (of a general and cultural nature), **create or recreate cultural units in communities** with special attention to areas populated by refugees of a mixed community of locals and refugees. In particular, culture clubs and libraries should be repaired and equipped. Measures should be undertaken to enhance access to information in these communities.
- (ii) **Promoting savings, initiative, entrepreneurship, and tolerance as national values** will help proliferate the notion in people that these values have been, and will remain, the cornerstones of any fair and prosperous society. Radio and television programs, lectures, training, and assistance to create appropriate centers will be among the measures taken to reach these objectives.

- (iii) **Participating in excavations, restorations, and exhibits of historical and cultural monuments of great value** will have a significant role in enhancing national identity. The image of Armenia as a civilized country will be advanced, an interest in ones surroundings (particularly, for the poor) will be encouraged, with a greater awareness of the fallout in the potentially immense area of cultural tourism.
- (iv) **Organizing and carrying out national celebrations** and festivals will have a significant importance in the establishment of social equality. It would also enhance civic participation and social activity: factors that are difficult to overestimate. To this end, plans include the creation and implementation of scenarios to hold national festivals and celebrations in accordance with the official calendar, presentation of special events (national, local and other). These could include fairs, folk contests, and festivals of folk-tale narrators, etc.

7.2.4. ENVIRONMENTAL PROTECTION

358. Environmental issues are manifested differently from the point of view of their impact on the poverty amongst the rural or urban populations. The impact on the rural population is largely conditioned by the fact that they are essentially dependent on natural resources. Thus, land and forest degradation has a direct impact on the levels of incomes of the rural population. At the same time, air pollution, as well as the non-regulated construction in parks, and the destruction of green areas, have an indirect negative impact on the living standards of the urban population. The urban poor, as a rule, live mainly in environmentally unfavorable areas of the city, adjacent to industrial enterprises and industrial zones.
359. In the period of transition to a market economy, the ways of consuming natural resources was disrupted radically. This threatens to become an environmental and social disaster. On the one hand, natural resources are overexploited in the absence of regulations. This will inevitably engender a frittering away of natural riches and a disruption of the ecological balance. On the other hand, this threatens economic productivity and the means for future generations to use Armenia's natural resources.
360. From the viewpoint of poverty reduction, environmental issues can be classified into the following groups:
- (i) manage forest resources efficiently;
 - (ii) prevent land degradation, reduce anthropogenic factors leading to desertification;
 - (iii) manage and use water resources efficiently, improve the ecobalance of Lake Sevan;
 - (iv) deal with the issues of municipal and hazardous industrial waste.
361. **Degradation of forest resources.** The volumes of legal and illegal tree cuttings for heating and industrial purposes have increased significantly. Nevertheless, there are no realistic estimates as to the present volumes of forest resources (as of 1989, forests covered 11.2 % of the country's territory). This is the result of the poor forest inventory and monitoring system. Forest degradation is also caused by the use of forest areas as grazing land in some settlements, disrupting the natural reproduction process of the forest. The impact of shrinking forest areas on water resources, ecosystems and livelihoods can be presented by the following negative phenomena:
- (i) shortage of irrigation and drinking water, which has a direct negative impact on farming and life in general;
 - (ii) more frequent floods, salinization and low fertility reduce the quality of lands;
 - (iii) difficulties for the poor to use forest resources such as fruits and medicinal herbs;
 - (iv) “distancing” of forests from settlements, which entails other serious problems: women and old men have greater difficulty to heat their houses through a rationally sound cutting of trees and are forced to buy expensive firewood, or not to heat their homes in winter.
362. **Land degradation** In many villages, the poor do not use a significant part of their arable land, because of the lack of investments, as well as machinery, fertilizers, and other supplies. As a result, arable lands gradually turn into pastures, become eroded and gradually lose their quality. Inappropriate

agricultural practices also have an impact on the degradation of arable lands. According to data from 2000, the total area of such lands in Gegharqooneeq province exceeded 1000 ha. In Armenia, with its limited land areas, this is gradually becoming a serious threat. Remedies will need much larger investments in the future.

363. In the summer, the majority of the poor in rural areas can use only proximate pastures. This causes overgrazing in both the existing pastures and the arable lands used as pastures. The poor overexploit their arable lands because of their poverty, and the reduced fertility of overexploited arable lands, in its turn, deepens their poverty.
364. **Lake Sevan problems.** The problems of Lake Sevan have a strategic significance for Armenia. This is due to the following three main factors:
- (i) Lake Sevan is the largest water resource reservoir in Armenia. It provides a significant part of the drinking water, as well as water for industrial use (irrigation, hydro-power);
 - (ii) Lake Sevan is one of the most important income resources (fisheries) for the population living in surrounding settlements; and
 - (iii) Lake Sevan is one of the main recreational areas in Armenia with a huge significance for tourism development.
365. **Issues of hazardous industrial waste.** Although no serious studies to assess the volumes and impact of hazardous industrial waste were conducted in recent years, it is nevertheless obvious that it can have serious health, social, and economic consequences for the population. The inadequacy of the legal leverage necessary to protect the population from pollution is a potential threat to health. Lands surrounding the mining industries in the north of Armenia are polluted with cyanide and heavy metals. These pollutants may end up in the drinking water system.
366. From the viewpoint of a poverty reduction strategy, the environmental policy will:
- (i) develop the mineral resource base;
 - (ii) contribute to scientific research, protect natural resources and develop new methods and technologies for the rational exploitation, promotion, and development of economical energy. Furthermore projects should be implemented for secondary raw materials processing;
 - (iii) improve the legal framework for environmental protection and nature use, develop concepts for the development of the sector, improve mechanisms to control the implementation of laws and decisions;
 - (iv) ensure proper payments for the use of natural resources and channel these funds to the protection of nature;
 - (v) create an environmental standards and norms system, develop an environmental impact assessment system and improve its control mechanisms;
 - (vi) rehabilitate Lake Sevan's ecosystem, protect it, and use it rationally;
 - (vii) strengthen the forest resources management system, attach special importance to the introduction of modern inventory and control mechanisms;
 - (viii) improve the inventory system for hazardous industrial waste, apply administrative and financial sanctions, improve economic instruments to protect the environment;
 - (ix) conduct research on the volumes and potential hazards of industrial wastes, especially in areas with mines and chemical industries;
 - (x) introduce municipal waste collection and processing technologies.

7.3. INFRASTRUCTURE DEVELOPMENT

7.3.1. WATER UTILITIES

367. The quality, accessibility, and availability of basic public utilities, including drinking and irrigation

- water are key factors affecting living standards. The results of studies carried out in recent years show that the deterioration of water quality primarily affects the poor. The same is true with regard to the irrigation network, where a reduction of irrigated areas had a direct impact on poverty.
368. The currently existing centralized system of water supply covers all urban areas and 36.5% of rural areas. A centralized water supply is available to 71% of households, including 87% in urban, and 45% in rural areas. In 2001, the irrigation network covered 161000 hectares of land (58.8% of irrigated plots).
 369. Investments made in a public investment program basically address the restoration and maintenance of the network's physical condition. Despite this, system losses remain very high. Losses in the drinking water network in 2001 were as high as 65%, and those in irrigation network were 30%.
 370. Subsidies to sector enterprises were streamlined to cover financial gaps in their current operations. Those gaps left out of the subsidy schemes were financed through the accumulation of payables (especially for electricity). However, these were essentially funded from the state budget as well, since budget credits were allocated to the sector companies to cover electricity arrears. In essence, therefore, the entire shortfall was financed from the state budget. For the companies supplying drinking water, budget financing was around 6 billion drams in 1999-2001. For irrigation companies, it totaled 5.5-6.5 billion drams.
 371. The targeting of subsidies allocated to cover the deficits of the sector companies was quite unsatisfactory. Calculations for the 1999-2001 data, show that only 56% of budget funds allocated to cover these budgetary deficits for the drinking water companies reached the poor. In other words, these funds were almost equally distributed among the poor and the non-poor.
 372. The irrigation water subsidies were even less focused. Only 45% of funds reached the poor. In reality, these indicators were even lower, since the volume of both drinking and irrigation water supplied to the poor had been evidently lower than supplies to the non-poor. The evaluation of the targeting was based on the assumption that equal volumes of water were supplied to the poor and the non-poor.
 373. Taking into account the above, the following issues are prioritized in the public service sector:
 - (i) increase the accessibility, availability, and quality of the services;
 - (ii) improve subsidy targeting;
 - (iii) enhance the management efficiency in the sector companies; and
 - (iv) improve the recording system.
 374. From the perspective of a poverty reduction strategy, the primary objective of the policies in public utilities will be to **provide accessible, affordable, and high quality services to the population**.
 375. According to the Human Development Goals declared by the UN, the number of those who do not have access to secure drinking water should be halved by 2015. In Armenia's case, it means that by 2015, the centralized water supply network should cover at least 86% of the population. This implies a secure water supply for an additional 120 000 - 130 000 households. The latter will require USD 200-220 million in investments or 55-60% of total investments expected to be done for the network.
 376. In order to ensure an accessible and good quality water supply, the state will continue investing in the public services sector. This investment policy should target the physical maintenance and rehabilitation of the engineering systems, the replacement of high-energy consumption equipment, and the improved accountability of the sector and its modernization.
 377. As mentioned earlier, the centralized water supply system covers around 71% of households. This is not a bad statistic. However, the reliability of the existing network is not high. The average daily duration of the water supply in urban areas is 8 hours and 14 hours in rural areas. To this end, investments in the sector should address both the expansion of the centralized water supply network and the improvement of its reliability.
 378. The sources of investments will be mostly foreign. Currently, in the framework of international loan projects and co-financing by the government, a number of loan projects are already underway. These

include Municipal Development, Water Supply and Sewage to Communities, Irrigation Network Development, Dam Safety, projects of the World Bank, KfW loan project implemented in Armavir province to rehabilitate the regional water supply and removal network, etc).

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

	2004	2005	2006	2009	2012	2015	2004-2015
Current expenditures (subsidies)	4.4	4.0	2.6	0.0	0.0	0.0	11.8
<i>of which: Irrigation</i>	3.6	3.4	2.6	0.0	0.0	0.0	10.5
<i>Drinking water</i>	0.8	0.6	0.0	0.0	0.0	0.0	1.3
Investments¹¹⁸	17.2	22.8	28.7	37.3	47.2	59.6	468.6
<i>of which: Irrigation</i>	10.2	12.3	15.3	19.9	25.1	31.8	251.1
<i>Drinking water</i>	7.0	10.5	13.4	17.4	22.0	27.8	217.5
Total	21.6	26.8	31.3	37.3	47.2	59.6	480.4
Investments/GDP, %	1.1	1.3	1.5	1.5	1.5	1.5	1.5
<i>of which: Irrigation</i>	0.6	0.7	0.8	0.8	0.8	0.8	0.8
<i>Drinking water</i>	0.4	0.6	0.7	0.7	0.7	0.7	0.7
Investments/capital expenditures of the state budget, %	19.8	29.1	34.3	35.2	36.2	37.2	34.6
<i>of which: Irrigation</i>	11.7	15.7	18.3	18.8	19.3	19.9	18.5
<i>Drinking water</i>	8.1	13.4	16.0	16.4	16.9	17.4	16.1

379. In order to enhance the cost-recovery of tariffs and increase collection rates, it is necessary to gradually abstain from subsidizing drinking and irrigation water companies. This policy implicitly contains two types of subsidies, including a general tariff subsidy and “arrear accumulation” subsidies.
380. The tariff policy should define the indemnification by the consumers of current operational costs incurred by sector companies. In respect of capital expenditures, these will remain the responsibility of the state and implemented through public investment programs, although in the long term the issue of their compensation through tariff setting will be placed for consideration.
381. In the irrigation sector, it is necessary to define zoning tariff-setting policies on the basis of current operation costs incurred in individual zones. The need to determine zoned tariff structures is based on the notion that irrigation water is a means of production affecting pricing. Thus, the application of a unified tariff structure that does not reflect the real costs in specific zones impedes the formation of realistic prices for agricultural produce and does not promote an efficient use of resources.
382. If tariffs are set according to zones, there will be a need for alleviating its potential social impact in certain regions. Thus, the government may channel to these regions any budget savings accumulated after the suspension of subsidies. This may be done under the financial adjustment policies, or other methods, with the final choice to be made after further investigations.
383. Budget savings generated on the suspension of subsidies may be channeled to implement social programs, while ensuring the maximal targeting possible.
384. Management reform in sector companies should be one of the important components of the implemented policies. The policies, especially those regarding irrigation and drinking water companies, should target their financial viability through an enhanced efficiency of operation costs and an increase in the collection rate of tariffs charged for services. In general, improving collection rates and enhancing operational cost efficiency are the major sources for the financial rehabilitation of sector companies. In recent years, the emergence of financial deficits has taken place mainly as a consequence of subjective factors such as inefficient management and weak administration. Thus, it is necessary to carry out strict company management policies and shift to contractual arrangements in company management. Management contracts should clearly define and require mechanisms aimed to stimulate good practices and responsible management. The main indicators for the evaluation of managers’ activities are the collection rates and operational levels, especially in terms of electricity

¹¹⁸ Including investment programs currently underway.

consumption.

385. Water metering systems are very important to improve the management of drinking water companies. Deficient water metering systems do not allow for a clear understanding of the water supplied to consumers, which in turn hampers the fee collection process. As mentioned earlier, one of the policy directions in the sector is the improvement and modernization of water metering systems. This implies, at least, that individual water consumption metering equipment should be installed for consumers. The installation of meters for the poor will be the responsibility of the government. Installing such metering equipment will enable cutting down on the inefficient use of water and will contribute to extend the daily duration of the water supply to consumers.

7.3.2. ROAD CONSTRUCTION

386. As mentioned earlier (see Chapter 1), poverty in this program is defined as the impossibility to meet minimum biological, social, and cultural needs. Another factor having a direct impact on the capacity to meet these three needs is the physical isolation of these people: an important factor.
387. This is evidenced in the results of the Survey¹¹⁹ of the Most Vulnerable Populations in Armenia, undertaken by the UNDP in 2002. In particular, according to this Survey, the more remote the communities from regional centers and the capital, the more these communities, and their populations, are exposed to poverty (Table 7.14).

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

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

Source: UNDP 2002 Survey of the Most Vulnerable Populations in Armenia.

388. The physical isolation of communities is a consequence not so much of their remoteness from regional centers and/or the capital, but rather of the extremely poor condition of the roads between locations, or, in some cases, the complete absence of roads. To this end, there is a direct correlation between poverty and the condition of the road network. Without a proper road network, it is not feasible to provide for reliable and accessible transportation services.
389. The impact of the road network on poverty is evident in these factors:
- (i) **As a factor of economic growth:** The quality of the road network affects economic growth in various ways. Good roads have a direct impact on transport expenses¹²⁰. They promote the specialization of various sectors of the economy and areas, which results in reducing the prices of local producers, promoting local commerce, market integration and a stronger competition.
 - (ii) **As a factor of income distribution:** The quality of the road network has an impact also on income distribution, especially in agriculture. As mentioned in the section on the Evolution of Poverty and Factors Preconditioning Poverty, income inequality in rural areas is much higher than in cities. The main reason is the extremely unequal distribution of the gains from the sales of agricultural produce: the major source of income for rural households. Improving the road network, and particularly community roads, will increase the opportunities to sell agricultural produce by rural households and may lead to a substantial alleviation of income inequality. Taking this factor into account, and the one mentioned below, the rehabilitation of the community road network is a priority in poverty reduction.
 - (iii) **As a factor of the accessibility of social services:** Good roads promote the accessibility of the

¹¹⁹ Social Trends in Armenia, Information and Analytical Study, December 2002

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

principal social services. This problem is particularly urgent in rural areas and small towns, where access to education, health, and other social services is very restricted.

390. From the perspective of poverty reduction, state policies in the road construction sector should target the rehabilitation and maintenance of the existing road network¹²¹.
391. According to the results of the Road Financing Survey undertaken in 2002, the total demand to finance the maintenance and rehabilitation of the entire road network is estimated at 22.2 billion¹²² drams per annum (USD 38.6 million, or 1.6% of GDP - see Table 7.15).

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

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

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

Table 7.16. Budget expenditures in the road construction sector

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

393. The policy in this sector should provide for an appropriate level of financing through a gradual increase in financial allocations (Table 7.17).
394. The burden of financing, particularly that for routine maintenance, should be primarily placed on the consumers (by evaluating poverty and social impact analysis of changes within the sector). Fees paid by users will be enforced directly (annual fees for using the road network and transit fees), and indirectly (taxes and charges for fuel).
395. According to the amendments to the Law on the Introduction of Amendments and Additions in the Law of Armenia on the Budgetary System, 10% of the previous year's fuel (petrol, diesel, and liquid gas) tax revenues should be earmarked for the maintenance and operation of national roads. Calculations for 2004-2015 show that expenditures for the routine maintenance of roads will be, on average, 20%¹²³ of budget revenues expected from fuel taxation. Total expenditures envisaged for the maintenance and rehabilitation of the road network will be around 80% (including capital expenditures).
396. Thus, the entire volume of expenditures envisaged for maintenance and rehabilitation of roads will almost be equal to the total fuel tax revenues of the state budget. The maintenance and the rehabilitation of roads, however, are not the only beneficiaries of fuel tax revenues. Fuel taxation is a tool for income redistribution. To this end, up to 20% of budget revenues generated from fuel taxes will be the allowable benchmark (based on domestic sources) within which the road construction sector may be funded for the routine maintenance of the road network.
397. The financing of capital repairs is expected to be funded from external sources, equally distributed

¹²¹ Total length of roads in Armenia is around 10 405 kilometers: main roads are 3360 km, local roads 4341 km, and city roads 2704 km.

¹²² In 2002 prices.

¹²³ The selection of the indicator of budget revenues from fuel taxation as the comparative indicator for road construction financing is conditioned by the fact that this indicator reflects the predominant share (90%) of budget revenues related to road construction.

between grants (including the Lincy Foundation) and loan projects. Capital repairs of the roads in 2004-2015 are projected at 0.9% of GDP per annum, which is an ambitious and optimistic benchmark. Should external financing be lower than programmed, it would be necessary to repair community roads as a priority, taking into consideration their particular impact on poverty.

Table 7.17. Financing of road construction in 2004-2015

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

7.3.3. ENERGY SECTOR

398. The impact of the energy sector on poverty runs along the following main directions:

- (i) Energy services, including electricity supply, heating, etc, are considered to be means of meeting basic human needs (cooking, heating of residential units, meeting other household needs, access to information, and so on) and have a substantial impact on living standards;
- (ii) The energy sector is viewed as one of the most important infrastructures for economic development. In this respect, the impact of the energy sector on poverty is manifested through general economic development patterns.

399. The accessibility of electricity services in Armenia is close to 100%, with almost all households connected to the electricity supply network. With respect to heating services, the accessibility is extremely low. Recently, central heating has become accessible for some districts in Yerevan, Gyoomree, Hrazdan, Tsharentsavan, and Jermook.

400. Investment policies in the central heating area should target greater access to services with an emphasis on the installation of local heating systems. Not only does the availability of heating have a substantial impact on household expenses, but it also addresses environmental issues. In many populated areas, households see stove wood as the only means of heating. As a rule, such wood is obtained from neighboring forests thereby significantly degrading the environmental situation in the community.

401. The main emphasis with respect to investments in the supply of electricity should be:

- (i) Rehabilitation and development of the electricity transmission and regulation network (ArmEnergo high-voltage networks). The electricity distribution system is already privatized, and the privatization of electricity generation companies is in progress. Thus, the electricity transmission and regulation system is a component of the energy sector, which will still remain state owned.
- (ii) Financial assistance to the energy sector. In recent years, a huge volume of payables has been generated in the system (110 billion drams as of the beginning of 2003). This is a serious impediment to normal operations.
- (iii) Maintaining and strengthening energy independence by developing indigenous and alternative energy sources and promoting energy efficiency. Regarding the development of indigenous

resources, priority should be given to developing renewable energy production. In addition to energy independence, renewable energy will produce significant local and global environmental benefits, and will facilitate the development of the private sector.

402. From the perspective of tariff policies, it is necessary to insist that all operational and maintenance expenses incurred in electricity supply and heating supply systems, must be reimbursed by consumers.
403. The introduction of an effective management system in multi-story residential buildings will hugely contribute to enhance the accessibility and effectiveness of water supply services and all other municipal services. Some steps have already been taken in this direction. In particular, the law on the Management of Multi-Story Residential Buildings was adopted in 2002. The law sets the main principles to manage multi-story residential buildings.
404. The main objective of this policy is to strengthen the multi-story residential building management bodies (condominiums and owners associations) in market conditions, with support from the state. The policy will focus on providing both technical and financial support to multi-story residential building management bodies.
405. The main directions for technical assistance would be: supporting the establishment of management bodies, training the staff of management bodies, supporting the provision of services by management bodies to residents (organizing bids, developing effective mechanisms to collect fees, etc.). The methods for financial assistance are: renovating common property, providing opportunities to use credit and grant resources, heat insulation in buildings, etc.

CHAPTER 8. EMPLOYMENT ISSUES IN THE CONTEXT OF POVERTY REDUCTION

8.1. EMPLOYMENT: TRENDS AND SITUATION

406. Increasing employment is undoubtedly the most socially acceptable and economically efficient means of poverty reduction. In the transition, the most significant reason for population impoverishment and deepening inequality was the drastic, disproportionate, and accelerated decline of employment rates and incomes. As a consequence of shrinking employment and incomes, the household income structure reflected only 29% of revenues generated from formal employment in 2001 (2.5 times lower than from the beginning of the transition period), and only 38% from self-employment incomes. The same is observed in terms of inequality. The employment income concentration ratio (Gini coefficient), reached 0.44 in 2001, a two-fold increase in the same period.
407. According to the official statistical data, the number of the economically active population in 2002 was 1 416 000 people, including 90.6% (1 282 000 people) in the main sector. About 9.4% (134 000 people) were officially registered as unemployed. In reality, the official integrated survey statistics overestimate both the economically active strata and the employment rates in quantitative terms (see Box 8.1), while underestimating the unemployment rate for the entire past period.
408. Changes in the rates and the structure of employment in the transition period have shown distinct trends. These have impacted directly and indirectly on the reduction of incomes and on the increase of income inequality:
- (i) The general employment rate in the non-agricultural sector was halved, reflecting the shrinkage of economic activity;
 - (ii) Changes in employment rates during the transition period had a weak (if at all), correlation with economic activity in terms of timing;
 - (iii) Within the conditions of a general unemployment reduction, formal employment was lowered at even higher rates;
 - (iv) According to official statistics, employment in the agricultural sector softened the general drop in employment rates;
 - (v) In general, the sectoral structure of the economy underwent significant changes, primarily affecting branches with an inherently high productivity and remuneration, such as industry and construction.
409. Having been officially recognized in 1992, unemployment displayed increasing trends up until 1996 reaching the level of 9.3% of the economically active population. It has fluctuated over the subsequent years, with no particular observable trends¹²⁴.
410. In the transition period (since 1991), the employment rate had consistently decreased. It was only in 2002 that the employed increased by 1.3% over the previous year. Thus, between 1994 and 2001, economic growth had been accompanied by declining unemployment (exceeding even the estimated GDP growth by 74%¹²⁵). A comparison of the employment and economic activity rates for the 1990-2002 period is presented in Figure 8.1.

¹²⁴ According to official statistics, the registered unemployed in 2002 constituted 9.4% of the economically active population. At the same time, according to integrated surveys, the real unemployment rate as early as 1996, was and persists substantially over and above the registered figure. According to the integrated surveys, the unemployment rate in 2002 was 38.1% of the economically active population. Like in the case of the number of the employed, such a difference is mainly due to the definition of unemployment and the method of its assessment.

¹²⁵ As early as in 2002, the GDP index of 84 (1990 =100) was over and above the employment index estimated on the same basis, i.e. 79.

Box 8.1. Estimating the Economically Active Population and the Employment Level in Armenia

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

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

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

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

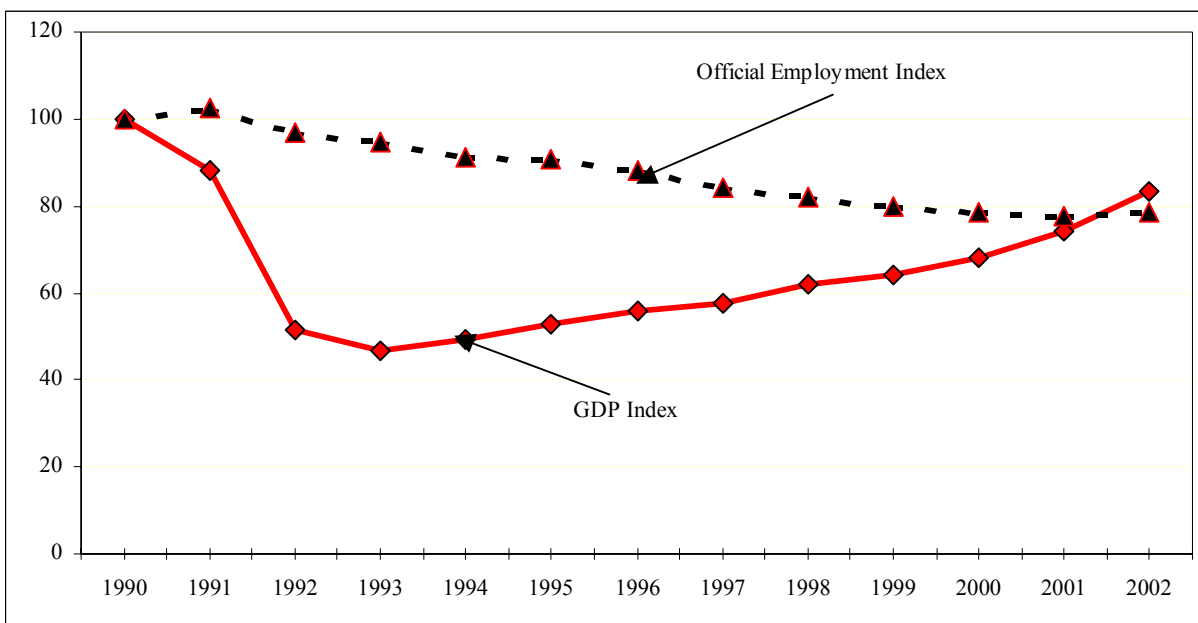
In view of the unrecorded huge migration and irregular LFSs in Armenia, a reconciliation of the two sets of data throughout the transition period is a complicated, if not impossible, undertaking. Nevertheless, the preliminary results of the 2001 census used for expert evaluation show that the number of 16-year olds and above is 2.2 million. This figure is substantially different from the 2002 indicator arrived at on the basis of the above two methods. Thus, according to official statistical data, the economically active population in 2002 was 1 415 000, including 90.6% employed. On the other hand, according the NSS (LFS Q2 2002), the employed were 61.9% of the total population: or 28.7 percentage points less. Taking into consideration that according to the same survey, the economically active population constituted 56.1% of the population of those aged 16 and above, the estimated number of the employed (according to the LFS) will be 710 000 people: or only 55% of the official employment data. It should also be mentioned that similar values are generated if estimates are made for all the years when labor force or household surveys were conducted.

With respect to the assessments of the economically active population, greater faith should be put in LFS data. This group constituted around 60% of the working age population (in contrast to official data showing about 70%). To this end, international experience shows that the number of the economically active population in a vast majority of countries fluctuates between 50 and 65%. Finally, this indicator is heavily dependent on the degree of economic development of the country. Activeness is higher in developed countries primarily as a result of the higher activity of women.

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

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

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

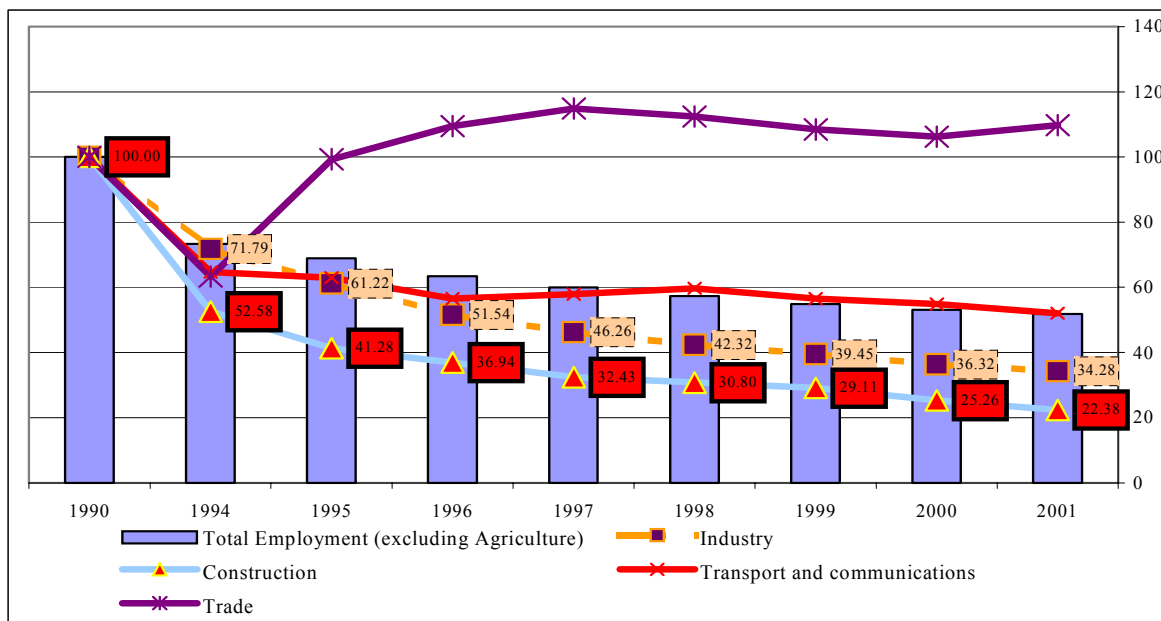


411. Echoing the contraction of economic activity and the increase of productivity, the general rate of employment has diminished except in agriculture and commerce. Reduction of the employment rate in industry and construction dropped in 2001 to 34% and 22%, respectively, from the 1990 level. Around 60% of the reductions in industry were a consequence of diminishing volumes of output. The other 40% was due to an increase in productivity.
412. In the first years of the transition, employment drops lagged substantially behind the decrease in production volumes. The low levels of productivity, a legacy from former times, further diminished in the majority of sectors. It should be mentioned that such a trend was specific to almost all the former republics of the USSR, and in contrast to East European countries where the employment rate has reacted to the economic decline at higher rates of decrease. The policy to contain the reduction of the employment rate resulted from administrative leaves¹²⁶ and the shrinkage of salary rates¹²⁷. It gave rise to a situation whereby economic growth between 1994-2001 actually coincided to the persisting reduction trends in the employment rate.
413. In the recent decade, informal employment (self-employment and unregistered employment) stabilized, then expanded in Armenia and many other transition economies. According to various estimates, the rate of informal employment in urban areas fluctuated between 30% and 38% of total employment. Being one of the major reasons for declining formal incomes, the concurrent increase of informal employment caused the proliferation of income inequality based on a higher concentration.

¹²⁶ The concept of administrative leave was widespread in 1994 when 16% of employees in industry were on such administrative leaves. Increasing over the years, this indicator, as early as 1996, constituted 40%. Then it showed decreasing trends to reach 17.6% in 2001 (almost the level of 1994). It is symptomatic that taking the factor of administrative leave into account, the number of employees in industry increased by 11 000 between 1998 and 2001, which contradicts the substantial decrease of around 40% recorded in official statistics.

¹²⁷ As a result, the remuneration in these years underwent an unprecedented decline (more than 15 times) according to some estimates. Thus, the average monthly pay in industry in 1994 was below 10 US Dollars, 5 US Dollars in agriculture, and 3 US Dollars in education.

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



414. In contrast to other sectors, agriculture has been the main one to display sectoral employment trends that differ along two major lines from other sectors. First, it refers to the employment rate. Agriculture has been the only sector where a substantial increase has been recorded in the transition period. The number of employees in agriculture in 1995 doubled from 1990 and has remained unchanged since. Thus, having increased by 260 000, the number of employees in agriculture “statistically” mitigated the 300 000 jobs lost in industry and construction. Second, in view of the specifics inherent to employment statistics, employment trends in agriculture correlate poorly with other indicators of this sector’s development. In particular, changes in gross agricultural output during the last 7-8 years have practically not had any impact on the employment rate in the sector.
415. The existing employment structure includes sectors of predominantly low productivity and efficiency: agriculture, education, health, culture, science and industrial infrastructures. These will become major impediments to increase employment in the future. Despite increasing trends in recent years, salary rates in these sectors remain below the general poverty threshold, or close to it.
416. Employees in these sectors, constituting 68% (around 856 000 people and their families) of total employment, definitely replenish the category of the poor if they have no other source of income. When adding the trade sector, where the level of declared salaries is also very low, the employment for 75% of the population is inadequate for living properly. The expansion of employment in these sectors, or its containment by virtue of the low salaries, is not promising from the viewpoint of poverty and inequality reduction, or any development within these sectors.
417. Recent surveys come to show that the employed and the self-employed have better chances of avoiding poverty. This correlation shows increasing trends in recent years. At the same time, employment-generated income inequality is also reduced. Such trends are primarily conditioned by a significant increase in salaries. Thus, the average nominal salary in 2002 was twice as high as in 1997. This increase was partially a consequence of formalizing salaries. This is at least reflected in the indicators of economic growth and inflation (1997 = 100) for the period: 144 and 113 respectively.
418. Nevertheless, the average monthly salary, which according to official statistics was 26 444 drams, remains very low by any measure. Thus, a family of four whose income is based on only one member’s salary (equivalent to the monthly average salary) will plunge into the category of the extremely poor. Should two members have such salaries, the family would be part of the poor. On the other hand, the current official salary level is significantly lower than resources channeled to

remuneration that are indirectly estimated in the system of national accounts. For 2000, the difference between these two indicators was about 35%.

419. Among the factors affecting employment, the most important one is its structure according to the size of economic agents. For very small and small enterprises, as well as the self-employed, the usually very extensively deployed available resources are considered to be the main sources of the strength of the work. Because of low productivity, employment elasticity in this sector is at a relatively higher level than economic activity. Hence, in countries having large shares of employment in small enterprises, economic growth leads to a higher employment rate. On the other hand, the expansion of the small enterprise sector (with its inherently relatively smaller inequality in income distribution between employers and employees) has a positive impact in terms of generally reducing inequality. Finally, ensuring favorable conditions for small enterprises and self-employment is important also from the point of view of promoting equal business opportunities.
420. Thus, Armenian realities are difficult to evaluate, taking into account the number of employed in agriculture and the informal economy. However, according to expert assessments, no less than 70% of total employment is located in small enterprises, agricultural work, or self-employment. As in other countries, high employment rate indicators are recorded in agriculture (95%), trade (90%), construction (60%), and the lowest are in industry (26%)¹²⁸.
421. In the transition period, the demand for a labor force and sector structure has drastically decreased, together with qualitative changes in the requirements of the labor force. As a result, discrepancies in supply and demand in the labor force resulted in the creation and the deepening of structural unemployment. This is characteristic for all countries in transition. In 2002, the share of the unemployed for over one year was 62.4% in Slovakia, 58.2% in Bulgaria, 56% in Latvia, 48.3% in the Czech Republic, and 44%¹²⁹ in Hungary. This indicator, for the officially registered unemployed in Armenia, was 78%¹³⁰ in 2002. Such protracted structural unemployment, in addition to its direct impact on material poverty, is an impediment to employment expansion, as international experience indicates¹³¹.
422. In developed market economies, labor market regulation issues are, as a rule, priority issues in employment sector analyses. The level and methods of labor market regulation may undoubtedly have an influence on the employment rate in a country. Nevertheless, the influence of these factors on employment in Armenia's transition period was insignificant compared to the others. In the future, however, the labor market regulation system may have a significant impact on the economic activity of the population, i.e. employment and unemployment.

8.2. EMPLOYMENT PERSPECTIVES

423. In the years to come, increasing employment rates will depend on economic growth rates, in the first instance. However, according to the analysis, the factor of labor productivity and structure of economic growth will have a significant impact on employment. At the same time, in the context of poverty and inequality, an equal – if not greater – importance will be assigned for employment expansion to increasing wages, formalization of incomes, and a reduction of unemployment, particularly structural unemployment.
424. The projections for the next 10 years envisage an average 1% of economic growth that will result in a 0.21% increase in employment. In the first years of this period, this indicator will be lower: 0.17%, then an increase to reach the level of 0.27%. Such conservative projections are based on a forecast of productivity in the main sectors of the economy, agriculture in particular, as well as on government programs to enhance the efficiency of social and industrial infrastructures. The general index of labor

¹²⁸ *The share of employees in very small and small industrial enterprises is estimated without self-employment and the informal sector (See Socio-economic Situation in Armenia 2002 January-December).*

¹²⁹ *See Labor, Employment and Social Policies in the EU Enlargement Process, The World Bank, 2002.*

¹³⁰ *The same indicator for 2001, projected on the basis of a labor force integrated survey, is 73%.*

¹³¹ *See Economic Survey of Europe, Economic Commission for Europe, 1999 No1, Geneva, 1999.*

productivity in 2015 will be 165% of the year 2002, while the employment index for the same period will be 120% (see Figure 8.3).

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

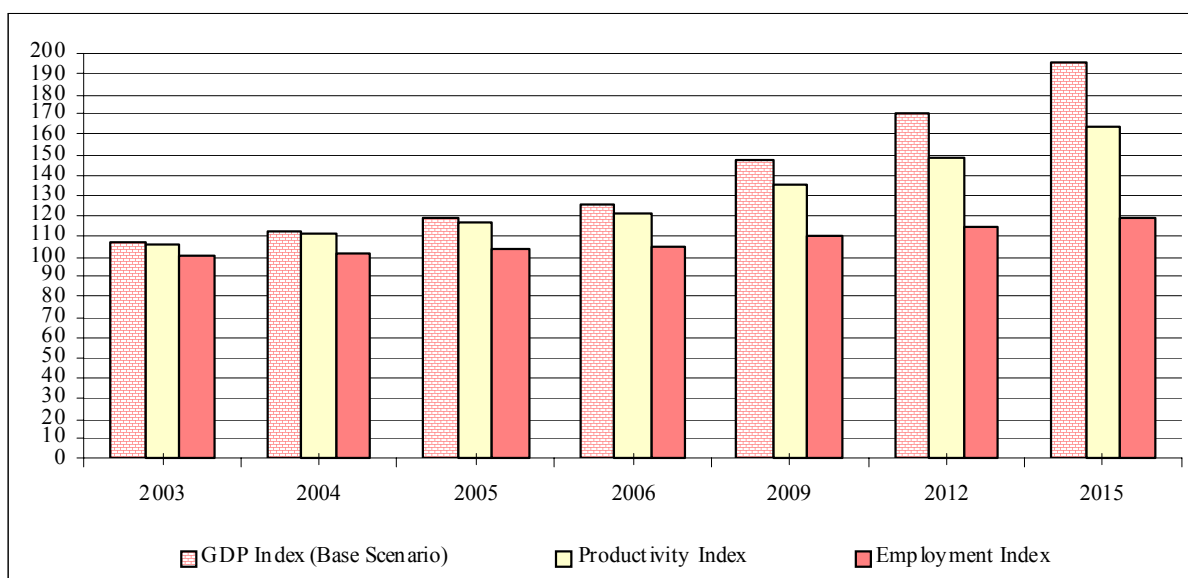


Table 8.1. Projections of changes in employment incomes as a share in total monetary incomes of the population in 2003-2015 (in % of per capita monetary income)

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

425. Taking into account the sector trends of economic growth and labor productivity, the sectoral structure of employment will undergo certain modifications. Generally, changes in the sectoral structure of employment will be contingent on a contraction of the social and agricultural sectors in favor of an expansion of construction, trade, and business services. Quantitative projections of sectoral structures of employment may be speculative in view of the significant discrepancies in estimates currently made on the basis of different sources of employment assessment. However, it should be mentioned that according to projections, the predominant share of the 248 000 new jobs expected in 2003-2015 would be in the non-agricultural sector.

426. From the perspective of poverty and inequality reduction, priority will be given to changes in incomes generated from employment and self-employment. Taking into consideration the potential for

employment expansion, these changes will be dependent on changes in remuneration. Existing salaries and trends recorded in previous years may lead one to think that the officially registered rates of remuneration will be growing faster than the increase of salaries based on a growth of labor productivity. Should the trends of the previous years be maintained, one might expect a significant increase of the share of employment and self-employment incomes in total incomes in 2015. This would represent 61% of the monetary income of the population, up from 29% in 1999 and 39% in 2001.

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

SECTION 4. PRSP IMPLEMENTATION FINANCING: BUDGET FRAMEWORK

CHAPTER 9. TRENDS IN THE CONSOLIDATED BUDGET AND POVERTY REDUCTION

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

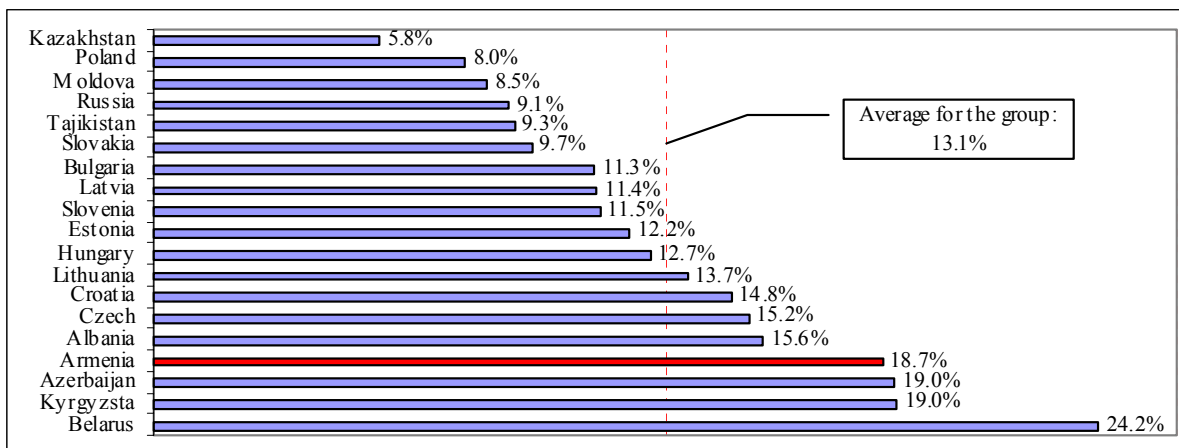
Table 9.1. Consolidated budget: main indicators by economic classification (% of GDP), 2002-2015

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

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

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

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



* 2002 data for Armenia. For other countries, the data is from 1999.

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

433. The need for capital expenditures will be more pronounced in the coming years. On average, capital expenditures will stay at the level of around 4% of GDP in 2004-2015. Public capital expenditures will complement, rather than substitute, private investments in terms of their targets or structure. These expenditures will be mainly directed towards the rehabilitation and reconstruction of social and productive infrastructures.
434. As in the past, budget formulation and execution in the coming years will have expenditures exceeding revenues. The deficit will be financed both from domestic and foreign sources. This deficit will gradually decrease from 2.6% of GDP projected for 2004, to 1.6% of GDP in 2015.

9.1. PUBLIC EXPENDITURES AND POVERTY REDUCTION STRATEGIES

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

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

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

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

436. Directly or indirectly, a substantial portion of the consolidated budget expenditures will be channeled to poverty reduction through the financing of PRSP measures in economic activity that aims to raise living standards. Expenditures having an immediate impact on living standards relate to social sectors. With respect to a part of them (education, health), the state will finance basic social services that are directly related to improving living standards and to reducing human poverty. Other social sectors (social security and insurance) cover state assistance that is directly provided to vulnerable groups and/or the disabled.
437. The Table 9.3 shows that social expenditures for the coming years are characterized by higher growth rates compared to other major budget expenditures.

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

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

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

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

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

Table 9.4. 2003-2015 budget developments

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

441. The table shows that a consistent growth of budget resources is projected for 2003-2015. As a result, revenues in 2015 will be triple the level of 2002, both in nominal terms and as % of GDP. In addition, expenditures in some of the sectors will decline, thus giving rise to incremental resources to be distributed among other sectors.
442. A substantial portion of incremental budget resources projected for the period under consideration will be channeled to implement programs in the social sector, general public service, and infrastructure development. In the program period, the average annual increase of incremental budget funds is projected at 8.6%. The total amount of incremental revenues expected in 2002-2015 compared to the 2002 level will be 777 billion drams. The predominant share of this increased revenue, i.e. 51%, will be allocated to social and cultural sectors; 13% to military, national security and public order expenditures; 17% to economic sectors; 13% to state administration, and 6% to other sectors.
443. Thus, expenditures channeled to poverty reduction in 2015 will be 760 billion drams, or 75% of total expenditures (60% in 2003), including 471 billion drams to finance direct measures of poverty reduction (or 47% of total expenditures). This is 4.3 times more than in 2002.
444. In particular, significant additional allocations (395 billion drams, or 63% of the incremental resources channeled to poverty reduction) will be made in the social sector. About 32% (127 billion drams), is projected to finance educational programs.
445. The additional budget allocations for the health, social security, and insurance sectors will be substantial. For the health sector these will be 22% (85 billion drams) of the total social sector allocations. Emphasis will be on primary health care development and capacity building in the sector.
446. Additional resources allocated to develop the social security and insurance sector will equal 156

billion drams (or 40% of the increased resources earmarked for the social sector). The lion's share of these additional resources will be for pensions (111 billion drams or 73% of the total incremental funds earmarked for social protection and insurance). Additional allocations will also be earmarked for poverty family benefits, and other allowances for the protection of orphans, employment programs, and for strengthening and developing social services for specific segments of the population.

- 447. An additional 238 billion drams will be allocated to finance measures having an indirect impact on poverty reduction (30% of incremental resources channeled to poverty reduction). In particular, additional investments in the areas of culture and sports (17 billion drams) will support the activities of cultural and sports organizations.
- 448. Additional allocations of around 113 billion drams will be earmarked for road building, housing, water utilities, environment protection and agriculture. Specifically, additional resources (22 billion drams) will be earmarked for the maintenance and renovation of roads, and 91 billion drams for housing, environment protection, water utilities, and agriculture.
- 449. Financing of public expenditures in 2004-2015 will depend on the level of state revenue collection, the level of the budget deficit, and the availability of sources for deficit financing¹³².

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

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

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

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

Source: TransMONEE 2002 Database, UNICEF IRC, Florence.

- 451. Future budget development and implementation will take place in an environment of expenditures prevailing over revenues, with the involvement of both domestic and foreign sources of budget deficit financing. The principal share of budget deficit financing will be through loans. A large portion of funds borrowed from external sources will be targeted and channeled to finance investment programs in the social sector and in public infrastructure. The deficit will gradually decline from 3.2% of GDP in 2003, to 1.56% in 2015 (see Table 9.6).

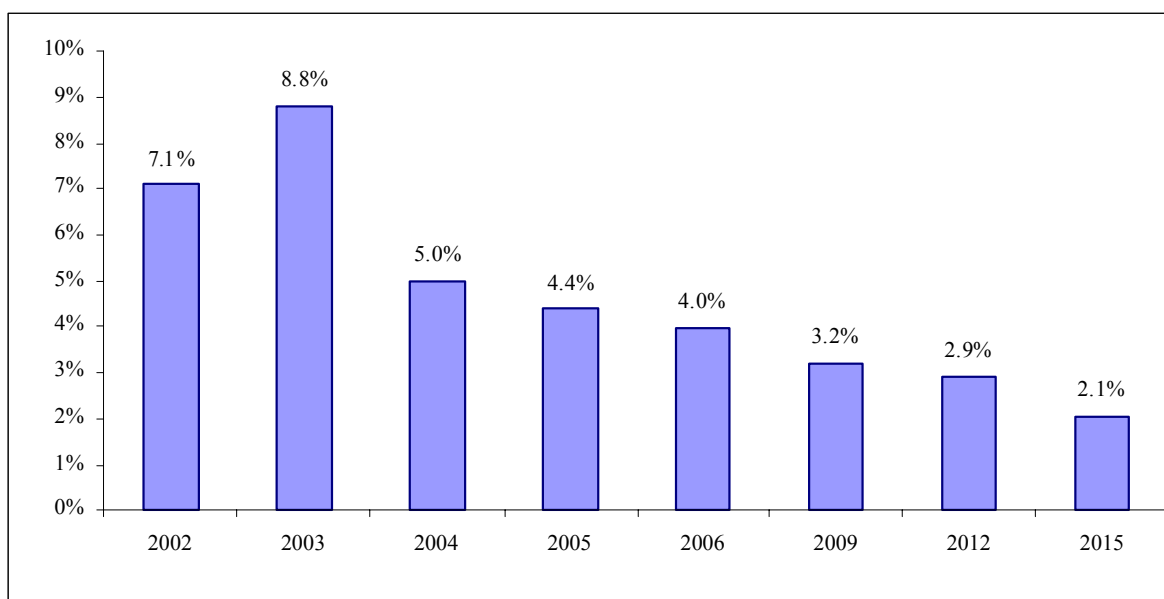
¹³² Possible deviations from the projected scenario and their consequences are summarized in the box below.

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

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

452. Within the period under consideration, the share of domestic sources of deficit financing will gradually increase from 0.1% of total deficit financing in 2003, to 0.7% in 2015 (mostly based on issues of treasury bills).
453. As in most CIS and East European countries in transition, public finances in Armenia have a certain dependency on the flow of external funds (foreign loans and official transfers). Despite the fact that such dependency will persist, it is envisaged that it will sharply decline (Figure 9.2). Since the budget deficit is mainly financed through loans, its level and structure are closely related to the indicators describing the domestic and foreign debt of the country.

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



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

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

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

However, it is also possible that GDP growth rates will be higher than the corresponding projections. The resulting additional budget revenues will be entirely allocated to human capital development (the health and education sectors) that comprehensively incorporates the main PRSP priorities.

The proper planning and timely receipt of grants needs to be emphasized among the purely tax/budgetary risks to the implementation of the consolidated budget. In this regard, the inclusion of all types of grants in the consolidated budget is very important, since it will allow for better control over their receipt and use, a better coordination of activities with donors, and a timely completion of the relevant conditions to receive grants. Since grants are mainly allocated to the financing of specific programs, delays or discontinuation of their provision will directly reduce the possibilities to implement those programs. Thus, discontinuing grants from the American Lincy Foundation will immediately reduce the corresponding capital expenditures (mainly in public infrastructures), which will have a negative impact on the implementation of the PRSP program.

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

CHAPTER 10. PUBLIC DEBT OF THE REPUBLIC OF ARMENIA

454. The public debt of Armenia started at zero in 1992-93, when the first foreign loans were received (European Union, Russia). In 1993, the first issue of state bonds and, in 1995, the issue of treasury bills laid the ground to establish a domestic securities market. The level of public debt increased at an accelerated pace and by 1999, it was already more than USD 900 million. The increase of the public debt gave rise to rather serious problems towards the end of the 90s – both in terms of management and servicing. In particular, with respect to the external debt, these problems were related to the servicing of non-concessional loans received in 1992-96.

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

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

455. **Domestic Debt:** The problems inherent to the early stages of the formation and establishment of a public securities market were linked to the limited number of market participants. This made it possible for them to influence fluctuations on yields. There were also shortcomings in the procedures for the issue, circulation, and repayment of short-term securities, as well as in the deficient structures of the investors.

456. In 1999, new rules for issuing securities were enforced. A new procedure to allocate, circulate and repay them was adopted. The Treasury Direct system was established. In 2000, mid-term maturity treasury bills were issued and allocated in the public securities market. This allowed for the expansion of the government domestic debt without jeopardizing its solvency, since the ratio of the average daily domestic debt to the average daily tax income was reduced from 36% - 37% to 20% - 21%.
457. The substantial fall of the domestic debt burden is reflected in the drastic decline in interest payments resulting from the decline in public securities yields. This is more evident, given the growth of GDP and tax revenues. A possible trend of the domestic debt management is towards cheaper domestic debt and longer maturities, particularly through a better publicity of the securities market and better predictability.
458. **External Debt:** In 1999-2002, the government successfully negotiated a restructuring of its non-concessional loan obligations. This made it possible to repay them under more favorable conditions for Armenia, without jeopardizing the country's solvency. The maturity date of the Turkmen loan of about USD 11 million was extended, with an opportunity of partial in-kind repayment, while the Russian loans of USD 93.76 million has been repaid under equity-exchange arrangements.
459. Around 80% of the foreign debt in 2002 reflected loans received from international financial institutions with concessional terms (see Table 10.2). These were mainly earmarked to support structural reforms of the government, as well as financing public investment programs in certain sectors (energy, housing and utilities, agriculture, transport, etc).

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

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

** The high indicators of debt service in 2003 reflect the repayment of the debt to Russia*

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

revenues will grow. Given the relatively stable level of resources earmarked for servicing and repaying the external debt, a sustainable growth in exports will bring a substantial improvement of the external debt interest payment-to-export and external debt service-to-export ratios. These positive trends are also a result of prudent government policies: credits with a grant element lower than 35% are not acceptable¹³³.

463. In the coming years, the fiscal policy in Armenia should be aimed at a maximal expansion of non-interest expenditures – consistent with a constant burden of public debt. This means that the growth of the public debt in present value terms may not exceed the economic growth. Moreover, any increase in the public debt should be accompanied by a faster growth of tax revenues.
464. In 2003-2008, it will be possible to finance the budget deficit exclusively from external concessional sources. An increase in concessional lending within the loan portfolio is expected in 2003-2008. Later, there will be a parallel shrinking of the potential to borrow from external concessional sources and a reduction of interest rates in the domestic market. This will favor domestic sources of financing as well. Relatively stable indicators that evaluate the external debt burden should accompany the growth of the external debt. At a minimum, the growth of the external debt burden should be accompanied by a reduction of the domestic debt.
465. Regarding the external debt burden, it is important to investigate debt sensitivity. It is necessary to consider the risk of changes in the debt burden resulting from deviations of the macroeconomic scenario for 2003-2015. To this end, the debt burden may be evaluated in a pessimistic macroeconomic scenario, whereby economic growth will be 3% per annum rather than the planned 6%, and the export growth rate will be 5% instead of the planned 9% - 10%. The impact of inflation deviations from the program indicator may be ignored here, because a net inflow of borrowings from foreign sources is expected during the coming years. Under these circumstances, the indicators describing the debt burden will be as follows:

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

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

466. Following an analysis of the data in Table 10.2 and Table 10.3, the debt burden increases substantially. In 2015, the share of debt service in GDP will increase by 28% - 36%, while the debt service/export ratio will grow by 50% - 65%. Given the rather low values of these indicators, however, such a growth will not affect the fiscal stability and solvency of the country, while the external debt of the

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

government will be within the range of acceptable indicators describing light debt burdens.

467. This analysis supports the conclusion that under favorable macroeconomic circumstances and the availability of concessional foreign loans, the government will be in a position to expand the budget deficit by some 30% without facing serious problems with respect to debt servicing. This will allow it to fully implement public investment programs, particularly in social sectors and public infrastructures.

CHAPTER 11. THE PRSP AND MEDIUM TERM EXPENDITURE PROGRAMMING

468. The feasibility of the PRSP and the efficiency of its implementation largely depend on the extent to which it is incorporated in the public policy processes and is consistent with the social and economic policies of the government, particularly the medium term expenditure framework and the state budget.
469. The main principles of the interim PRSP are reflected in the 2002 programs of the government. Some important measures envisaged in the full PRSP (and agreed within the 2003-2005 medium term expenditure framework) are reflected in the 2003 State Budget. In particular, the state budget for 2003 incorporates the following major measures envisaged in the PRSP:
- (i) As an important implementation aspect of civil service reform and the anti-corruption program, the salaries of civil servants (tax, and customs service staff) will be increased by 78% in 2003;
 - (ii) In education sector reforms, the increase of the pupil-teacher ratio will be accompanied by a 34% salary increase for teachers and administrative staff in the schools;
 - (iii) Priority in the health sector is given to medical services to vulnerable groups of the population and the primary health care system. In general, health sector financing increased by around 31% as compared to the previous year, with 73.5% of the increase allocated to these two priorities.
 - (iv) In accordance with the reforms in the pension system, social pensions will now be paid from the state budget.
470. The majority of PRSP measures refer to the volume and structure of public finances. To this end, the most important medium term strategic document of the government is the medium term expenditure framework, which reflects macroeconomic, monetary, fiscal and public investment priorities. Consequently, incorporating PRSP policies and measures in the medium term expenditure framework will make implementation of the PRSP more realistic. Assessment of the PRSP process by international financial institutions¹³⁴ emphasizes this necessity. Moreover, these programs should be prepared and discussed in parallel in order to avoid possible disproportions and discrepancies¹³⁵. Today, we are confident that the public expenditure program envisaged in the full PRSP and budget framework under the 2004-2006 MTEF are quite consistent. On the other hand, in order to safeguard the continuity and sustainability of this process, it is necessary to consistently include the MTEF in the budget process.
471. Effective 2003, the MTEF of Armenia is officially incorporated in the general budget process. This means that before the start of budget formulation activities for the subsequent year (end of Q1 for the current year), the government has to get the approval of the MTEF for the next three years. In particular, prior to the 2004 budget formulation, the 2004-2006 MTEF should be approved by the Government of Armenia (by July 1). This provision has been stipulated in the legislation, namely in the Law on the Introduction of Amendments and Additions in the Law on the Budgetary System, adopted by the National Assembly on April 11, 2003.

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

¹³⁵ *In prioritizing this task, the PRSP coordinating council issued a decision to include the experts elaborating the MTEF in the PRSP preliminary discussions so as to harmonize these two programs.*

SECTION 5. PRSP IMPLEMENTATION, MANAGEMENT, MONITORING AND REGULATION

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

CHAPTER 12. THE PRSP IMPLEMENTATION MANAGEMENT STRUCTURE

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

objective of the Participatory Steering Committee will be to ensure the participation of all stakeholders in the PRSP implementation, any further elaboration and revisions, and a discussion of current approaches. It will also formulate relevant recommendations for the Government.

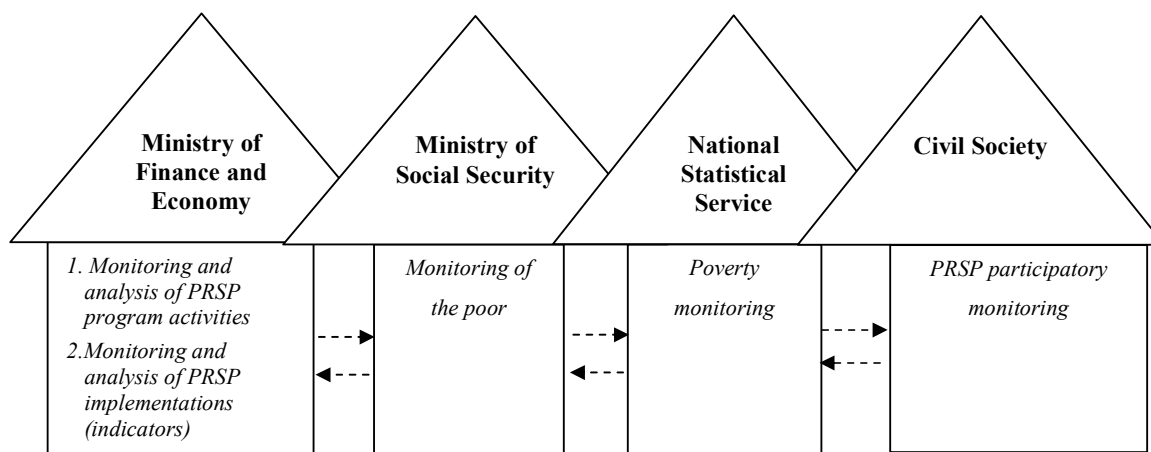
477. The PRSP Working Group (WG) will implement the day-to-day activities within the functions of the PRSP Participatory Steering Committee. Its membership and statutes will be proposed by the Participatory Steering Committee and approved by the Government of Armenia. The main objectives of the WG will be to: (i) monitor the objectives, intermediate and target indicators, and implementation of program activities; (ii) assess the impacts of PRSP policies; (iii) prepare and publish an annual report; (iv) revise and finalize the PRSP; and (v) ensure international cooperation throughout the implementation of the PRSP. Until the end of the interim phase (in the next 6 to 12 months), the WG will maintain its current membership.
478. The PRSP Secretariat, formed by the Government of Armenia with support from UNDP, WB, GTZ and DFID, will organize the implementation of activities. This should be conducted within the framework of the functions of the PRSP Participatory Steering Committee and the Working Group. The Secretariat will conduct PRSP monitoring and policy impact assessment, prepare and publish annual PRSP implementation reports, update and revise the PRSP – all in close cooperation with structures involved in implementing the PRSP, including the PRSP Coordination and Monitoring Unit in the Ministry of Finance and Economy, and, as required, experts and specialized structures. It may also commission separate studies.
479. The Ministry of Finance and Economy, in accordance with its statute, will coordinate and monitor the PRSP implementation. On the one hand, it implies: (i) monitoring of the PRSP implementation action plan¹³⁶; (ii) adapting programs outlined in the PRSP to the Medium Term Expenditure Framework (MTEF) and the annual state budget; and on the other hand (iii) coordinating the PRSP implementation and monitoring information flows, their analysis, and evaluation. The unit especially established for that purpose in the Ministry of Finance and Economy would conduct these activities.

CHAPTER 13. THE PRSP MONITORING, EVALUATION SYSTEM AND REVISION

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

¹³⁶ The Government of Armenia will approve the PRSP Plan of Actions within two months after the approval of the PRSP.

- (iii) Ministries involved in the implementation of the PRSP, provide monitoring and evaluation of indicators relevant to their spheres. A number of ministries already have some experience in this regard. Others, however, need the necessary technical and expert assistance.
- (iv) Provincial Governor's Offices will conduct the monitoring and evaluation of the PRSP program activities, target, and intermediate indicators at the provincial level, and the UNDP is currently



supporting them through capacity building and technical assistance activities.

483. The Government of Armenia should pay special attention to the monitoring and evaluation of programs implemented by development partners, as well as those stemming from the PRSP. The participation of civil society in the monitoring and evaluation processes, which will be assured through the establishment of a comprehensive participatory body at the PSC level, should also be a matter of concern. The civil society evaluation of the PRSP implementation process should be examined annually and the results should be included in the annual report of the PRSP's implementation.
484. The Government, with the support of the donor community, will develop and approve a PRSP management and monitoring strategy. Thus, it will organize and regulate the monitoring and impact assessment of the PRSP implementation, which will define:
- (i) the set of PRSP monitoring indicators;
 - (ii) the methodology for monitoring indicators;
 - (iii) the methods and time-frames for collecting data on indicators and the methodologies for summarizing, processing, and analyzing them;
 - (iv) the training and capacity building measures for the PRSP monitoring and evaluation staff. Furthermore, the mechanisms for the participation of civil society in implementing the PRSP and monitoring the processes and informing the public of the results.
485. Target and intermediate indicators, policies and priorities are not meant to be unalterable. They are, however, the basis to implement long-term objectives and provide the means for the necessary assessment of the process of the PRSP implementation and, consequently, the necessary adjustments

Box 13.1. Civil Society Participation in the PRSP's Implementation

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

Measures contributing to participation at the local government level are:

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

Measures contributing to participation at the national government level are:

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

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

and changes to PRSP target indicators and priority policies. The PRSP will be reviewed once every two years, taking into account the recommendations presented by all stakeholders and the results of the monitoring. Summary reports on progress will be prepared annually.

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Annex 1. Poverty Reduction Strategy: Summary Indicators

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Prog.</i>	<i>Projections</i>					
(i) POVERTY AND INEQUALITY								
Number of Poor, % of total population	50.9 ¹	46.2	43.7	41.0	37.9	30.8	26.3	19.7
<i>of which: Very Poor, % of total population</i>	16.0 ¹	15.2	14.7	14.2	13.5	11.4	8.6	4.1
Gini Coefficient of Income Inequality	0.535 ¹	0.510	0.498	0.491	0.483	0.469	0.458	0.446
Incomes of the poorest population as a % of incomes of the richest	5.9 ¹	6.9	7.4	7.9	8.4	8.7	8.8	9.1
(ii) HUMAN POVERTY								
School-Life Expectancy, years ²	...	11.6	...	...	11.8	12.0	12.1	12.3
General secondary school completion rate, %	63	67	...	...	69	77	80	85
Child Mortality Rate, per 1000 live births ³	15.9	15.6	...	...	14.4	13.0	11.5	10.0
Mother Mortality Rate, per 100000 live births ^{3,4}	34.4	27.0	...	...	22.0	15.5	13.0	10.0
Access to Drinking Water, %								
Urban Population	87 ¹	90	...	...	93	95	98	98
Rural Population	45 ¹	47	...	...	49	51	70	70
(iii) LIVING STANDARDS AND SOCIAL PROTECTION								
GDP per Capita, thousand drams	451	489	533	580	631	808	1 006	1 244
GDP per Capita, USD	786	834	904	980	1 061	1 338	1 640	1 999
Average Monthly Wage, drams	26 488	29 462	32 078	35 048	38 235	48 927	59 609	71 607
Minimum Monthly Wage, drams	5 000	5 000	12 767	13 053	13 387	14 414	15 446	16 588
Average Monthly Family Benefit per Capita, drams	1 893	2 140	2 702	3 393	4 396	6 188	8 849	10 661
Average Monthly Pension, drams	5 148	6 365	7 407	8 939	10 138	15 755	20 994	26 714
Monthly Extreme Poverty Line, drams	7 576	7 632	7 827	8 002	8 207	8 836	9 469	10 169
Monthly Poverty Line, drams	12 358	12 450	12 767	13 053	13 387	14 414	15 446	16 588
(iv) MACROECONOMIC INDICATORS								
Nominal GDP, drams bn	1 357	1 474	1 609	1 757	1 918	2 485	3 143	3 976
Real GDP, year-on-year % change	12.9	7.0	6.0	6.0	6.0	5.5	5.0	5.0
Investments, % of GDP	19.5	22.6	20.6	20.4	20.8	21.9	22.7	24.3
National Savings, % of GDP	13.4	16.1	14.8	14.9	15.5	17.3	18.5	20.0
Period Average CPI, year-on-year % change	1.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Period Average Exchange Rate, drams/USD	573.9	586.3	589.3	592.2	595.2	604.2	613.3	622.5
Exports of Goods and Services, USD million	699	768	840	920	1 007	1 313	1 704	2 210
Imports of Goods and Services, USD million	-1 082	-1 170	-1 256	-1 354	-1 460	-1 814	-2 216	-2 751
Current Account Balance, % of GDP	-6.2	-6.5	-5.8	-5.5	-5.2	-4.6	-4.3	-4.3
(v) FISCAL SECTOR⁵								
Total Revenues and Grants, % of GDP	22.6	23.1	21.5	21.8	22.0	22.8	23.5	23.9
<i>of which: Tax Revenues, % of GDP</i>	17.9	18.3	18.8	19.3	19.8	21.2	22.0	22.6
Total Expenditure and Net Lending, % of GDP	23.4	25.5	24.1	24.0	24.1	24.8	25.4	25.5
<i>of which: Capital Expenditure, % of GDP</i>	4.8	6.8	5.4	4.5	4.4	4.3	4.1	4.0
Overall Balance, % of GDP	-0.8	-2.5	-2.6	-2.2	-2.0	-2.0	-1.9	-1.6
(vi) PUBLIC EXPENDITURE ON BASIC SERVICES AND INFRASTRUCTURE								
General Public Services, % GDP	1.7	1.9	2.2	2.4	2.3	2.6	3.0	3.1
Social Expenditures, % of GDP	7.8	8.7	9.3	10.1	10.5	11.4	11.6	12.0
<i>of which: Education, % of GDP</i>	2.2	2.4	2.7	3.0	3.1	3.6	3.8	4.0
<i> Health, % of GDP</i>	1.2	1.4	1.5	1.8	1.9	2.1	2.3	2.5
<i> Social Protection, % of GDP</i>	4.4	4.8	5.1	5.4	5.6	5.7	5.5	5.4
Drinking Water and Irrigation, % of GDP	1.5	1.7	1.3	1.5	1.6	1.5	1.5	1.5
Road Construction, % of GDP	0.5	2.3	1.1	1.2	1.2	1.3	1.2	1.1
Memorandum Item								
<i>De facto population, thousands</i>	3 008.6	3 013.8	3 020.5	3 028.4	3 038.1	3 074.2	3 125.7	3 196.0

¹ 2001 data. ² At the age of 6-2. ³ Projections based on official data of the National Statistical Service.

⁴ Three-year average. ⁵ Consolidated budget operations.

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

Annex 2. Breakdown of Gross Domestic Product by Main Sector

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

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

Annex 3. Use of Gross Domestic Product

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

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

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

	2002	2003	2004	2005	2006	2009	2012	2015
	<i>Actual</i>	<i>Budget</i>	<i>Projections</i>					
	<i>in billions of drams</i>							
Total Revenue and Grants	307.1	339.9	346.2	383.0	422.9	566.8	737.9	950.5
Total Revenue	259.8	279.0	312.9	349.6	390.7	541.1	711.8	924.0
Tax Revenue	242.4	269.4	302.2	338.8	379.8	526.2	690.8	899.1
Non-Tax Revenue	14.8	7.6	9.8	10.1	10.3	14.7	20.8	24.7
Capital Revenue	2.6	1.9	0.9	0.8	0.6	0.2	0.2	0.2
Grants	47.3	61.0	33.3	33.4	32.2	25.7	26.1	26.5
Current	17.0	14.1	9.7	9.0	8.5	10.3	10.5	10.6
Capital	30.3	46.9	23.7	24.4	23.7	15.4	15.6	15.9
Total Expenditure and Net Lending	317.4	376.5	388.1	422.2	461.5	617.2	799.0	1 012.2
Current Expenditure	239.2	279.0	294.0	335.6	366.7	498.4	655.8	838.9
<i>of which: Interest Payments</i>	<i>15.9</i>	<i>13.9</i>	<i>12.6</i>	<i>12.5</i>	<i>12.6</i>	<i>13.8</i>	<i>18.7</i>	<i>27.2</i>
Capital Expenditure	64.5	101.0	86.9	78.5	83.7	105.9	130.2	160.2
<i>of which: Capital Grant Financed</i>	<i>30.3</i>	<i>46.9</i>	<i>23.7</i>	<i>24.4</i>	<i>23.7</i>	<i>15.4</i>	<i>15.6</i>	<i>15.9</i>
Net Lending	13.6	-3.5	7.2	8.2	11.1	13.0	13.0	13.0
Overall Balance	-10.2	-36.5	-41.9	-39.2	-38.6	-50.4	-61.1	-61.7
Financing	10.2	36.5	41.9	39.2	38.6	50.4	61.1	61.7
Identified	10.2	36.5	41.9	39.2	30.0	-0.3	-4.1	6.1
Domestic Sources	-26.8	46.4	2.7	3.6	4.3	7.9	10.7	25.8
External Sources	37.0	-9.9	39.2	35.6	25.7	-8.2	-14.8	-19.6
Non-Identified ¹	0.0	0.0	0.0	0.0	8.6	50.7	65.2	55.6
	<i>in % of GDP</i>							
Total Revenue and Grants	22.6	23.1	21.5	21.8	22.0	22.8	23.5	23.9
Total Revenue	19.1	18.9	19.4	19.9	20.4	21.8	22.6	23.2
Tax Revenue	17.9	18.3	18.8	19.3	19.8	21.2	22.0	22.6
Non-Tax Revenue	1.1	0.5	0.6	0.6	0.5	0.6	0.7	0.6
Capital Revenue	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Grants	3.5	4.1	2.1	1.9	1.7	1.0	0.8	0.7
Current	1.3	1.0	0.6	0.5	0.4	0.4	0.3	0.3
Capital	2.2	3.2	1.5	1.4	1.2	0.6	0.5	0.4
Total Expenditure and Net Lending	23.4	25.5	24.1	24.0	24.1	24.8	25.4	25.5
Current Expenditure	17.6	18.9	18.3	19.1	19.1	20.1	20.9	21.1
<i>of which: Interest Payments</i>	<i>1.2</i>	<i>0.9</i>	<i>0.8</i>	<i>0.7</i>	<i>0.7</i>	<i>0.6</i>	<i>0.6</i>	<i>0.7</i>
Capital Expenditure	4.8	6.8	5.4	4.5	4.4	4.3	4.1	4.0
<i>of which: Capital Grant Financed</i>	<i>2.2</i>	<i>3.2</i>	<i>1.5</i>	<i>1.4</i>	<i>1.2</i>	<i>0.6</i>	<i>0.5</i>	<i>0.4</i>
Net Lending	1.0	-0.2	0.4	0.5	0.6	0.5	0.4	0.3
Overall Balance	-0.8	-2.5	-2.6	-2.2	-2.0	-2.0	-1.9	-1.6
Financing	0.8	2.5	2.6	2.2	2.0	2.0	1.9	1.6
Identified	0.8	2.5	2.6	2.2	1.6	0.0	-0.1	0.2
Domestic Sources	-2.0	3.2	0.2	0.2	0.2	0.3	0.3	0.6
External Sources	2.7	-0.7	2.4	2.0	1.3	-0.3	-0.5	-0.5
Non-Identified ¹	0.0	0.0	0.0	0.0	0.4	2.0	2.1	1.4
Memorandum Items								
<i>Social Expenditure², % of GDP</i>	<i>7.8</i>	<i>8.7</i>	<i>9.3</i>	<i>10.1</i>	<i>10.5</i>	<i>11.4</i>	<i>11.6</i>	<i>12.0</i>
<i>Primary Balance³, % of GDP</i>	<i>0.4</i>	<i>-1.5</i>	<i>-1.8</i>	<i>-1.5</i>	<i>-1.4</i>	<i>-1.5</i>	<i>-1.3</i>	<i>-0.9</i>

¹ It is projected that concessional external financing will cover the shortfall.

² Includes expenditures on education, health care, social security and social insurance.

³ Defined as overall balance excluding interest payments.

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

Annex 5. Consolidated Budget Operations: External Financing Requirements

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

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

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

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

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

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

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

¹ Excluding expenditure on the system maintenance and development.

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

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

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

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

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

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

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

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

	Policy	Objective	Responsible Agency	Timing
48.	Consistent social and economic development of the administrative regional units of the country	Increase the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures Ministry of Finance and Economy	2004-2006
49.	Accelerate the development of the small and medium sized cities with high levels of poverty	Increase the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006
50.	Improve the legal framework regulate the activities of central community governance bodies	Increase the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
51.	Increase the transparency and public awareness on the community budget formulation process	Increase the efficiency of local governance	Local Self-governance Bodies Ministry of Finance and Economy	2004-2006
52.	Increase the affordability of tariffs and duties charged for the services provided to the population by community governments	Increase the efficiency of local governance	Ministry of Finance and Economy Community governments	2004
53.	Streamline the roles and responsibilities of rural, municipal and territorial administrations	Increase the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2005
54.	Legally define the rules of implementation of mandatory responsibilities by local governments	Increase the efficiency of local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
55.	Enhance management skills and professional knowledge in the local governance system	Improve the community governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006
56.	Develop a draft law on the service in the self-governance bodies	Create a legal framework for regulating the flows of human resources in local governance	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004
57.	Give financial support to the development of inter-community unions and networks of their infrastructures	Increase the efficiency of local governance	Ministry of Finance and Economy	2004-2006
58.	Gradually transfer the functions of local significance in the supervision of the secondary education, health, social services systems to local governance bodies	Increase the accessibility and improve the quality of public services	Ministry of Education and Science Ministry of Health Ministry of Social Security	2004-2006
59.	Develop a targeted g system of privileges, discounts and allowances in the earthquake zone, near-border, mountainous and high mountainous regions and small communities	Implement a state policy differentiated according to communities	Ministry for Regional Government and Coordinating the Operation of Infrastructures	2004-2006

	Policy	Objective	Responsible Agency	Timing
60.	Provide sufficient material, technical and human resources to investigation centers and ensure the accessibility of their services to the public	Establishment of an efficient and accessible judicial system, increase the efficiency of legal practice	Ministry of Justice	2004-2005
61.	Revise the Constitutional provisions, regarding the Justice Council and the Constitutional court	Streamline the jurisdiction of these bodies and guarantee the highest possible level of independence of officials	Ministry of Justice	2004-2006
62.	Streamline the principles of justice practice.	Increase the effectiveness of justice	Ministry of Justice	2004
63.	Set requirements for the publication of decisions and verdicts on trial cases	Give the public an opportunity to assess the practice of justice	Ministry of Justice	2005
64.	Increase the salaries of employees in the judicial field'	Increase the effectiveness of Justice	Ministry of Justice	2004-2006
65.	Revise the rates of legal duties, development of mechanisms for deferral of payment.	Increase the availability of judicial services for vulnerable groups.	Ministry of Finance and Economy Ministry of Justice	2005
66.	Support permanent independent investigation processes (independent from governmental bodies)	Streamline legislative and sub-legislative regulations	Ministry of Justice	2005
67.	Adopt an anti-corruption strategy and relevant measures	Prevent Corruption	Ministry of Cabinet Chief of Staff	2003
68.	Detect and prevent profits from illegal economic activities	Prevent Corruption	State Tax Service under the Government State Customs Service under the Government	2003 To be continued
69.	Limit tax exemptions and strengthen tax and customs administration	Prevent tax and customs corruption	Ministry of Finance and Economy State Tax Service under the Government State Customs Service under the Government	2003 To be continued
70.	Streamline and simplify customs legislation	Prevent tax and customs corruption	State Customs Service under the Government Ministry of Finance and Economy Ministry of Trade and Economic Development	2003 To be continued
71.	Streamline and improve bankruptcy legislation	Accelerate and simplify bankruptcy processes	Ministry of Justice	2004
72.	Regulate monopoly behavior	Support competition	Ministry of Trade and Economic Development	2005
73.	Legally regulate political lobbying	Legally regulate the rights of all participants of the political field	Ministry of Justice	2005
74.	Improve the elections system	Prevent political corruption	Ministry of Justice	2004 To be continued
75.	Actively cooperate with civil society in corruption prevention	Ensure effectiveness of the anti corruption strategy implementation and monitoring	Ministry of Cabinet Chief of Staff Other ministries and departments	2003 To be continued
76.	Reduce the number of activities subject to licensing	Improve businesses environment	Ministry of Justice	2004
77.	Simplify the licensing procedure	Improve businesses environment	Licensing Agencies	2004

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

	Policy	Objective	Responsible Agency	Timing
96.	Reduce the differences in accounting and tax calculation related to taxation and accounting of profit tax	Simplify taxation mechanisms	Ministry of Finance and Economy	2004 To be continued
97.	Reduce opportunities to avoid profit tax	Establish fair taxation principle	Ministry of Finance and Economy	2004
98.	Substitute the progressive scale of income tax and the regressive scale of social payments with a proportional scale	Simplify taxation mechanisms	Ministry of Finance and Economy	2006
99.	Increase of justice of assessed tax usage	Establish fair taxation principle	Ministry of Finance and Economy	2005
100.	Simplify tax accounting for SMEs	Simplify taxation mechanisms	Ministry of Finance and Economy	2004 To be continued
101.	Group tax laws in a Tax Code, following consistency principles.	Simplify taxation mechanisms	Ministry of Finance and Economy	2005
102.	Increase the targeting of family benefits system	Increase the efficiency of social services system	Ministry of Social Security	2004 To be continued
103.	Increase the accessibility and targeting of services to the disabled, orphans, refugees, and displaced people	Increase the efficiency of social services system	Ministry of Social Security	2004 To be continued
104.	Continue increasing pensions	Increase the social protection of pensioners	Social Insurance State Fund	2004 To be continued
105.	Reform the principles of pension assignment	Increase the efficiency of the compulsory social insurance system	Social Insurance State Fund	2005
106.	Radically change the existing policy of unemployment insurance and shift to an active employment policy implementation	Increase the efficiency of the employment policy	Ministry of Social Security	2004
107.	Accelerate the growth of salaries for employees of budgetary and social infrastructures	Increase the efficiency of state governance, improve the quality of social services	Ministry of Finance and Economy	2004 To be continued
108.	Ensure consistency between the number of beneficiary households and the number of very poor households	Increase the efficiency of social services	Ministry of Social Security	2004 To be continued
109.	Remove the one-off allowances and allocate the savings to family benefits	Enhance the targeting of the allowances system	Ministry of Social Security	2004
110.	Gradually shift from the currently existing indirect system of household evaluation (scoring) to a direct one	Enhance the targeting of the allowances system	Ministry of Social Security	2004-2005
111.	Introduce the efficiency assessment of the family allowances system based on integrated household surveys	Increase the efficiency of the assessment of family allowances targeting	Ministry of Social Security	2004-2005
112.	Introducing legal regulations of relationships involving state benefits	Improve the system of state benefits	Ministry of Social Security	2004
113.	Reform the system of appeals and complaints on allowances	Reform the appeals system, creating a simplified, understandable, transparent and fair system	Ministry of Social Security	2004
114.	Elaborate effective mechanisms of monitoring the family benefit appointment and payment system	Prevent corruption and potential preferential treatment	Ministry of Social Security	2004

	Policy	Objective	Responsible Agency	Timing
115.	Continuous growth of one-off allowances to cover the costs related to childbirth	Increase the efficiency of one-off allowances to cover the costs related to childbirth	Ministry of Social Security Ministry of Finance and Economy	2004-2006
116.	Reduce the duration of partially paid leave provided for taking care of infants	Increase the efficiency of allowances to cover the costs related to children	Social Insurance State Fund Ministry of Social Security	2004
117.	Introduce legislation to provide that the temporary incapacity benefit be partially paid by the employer	Partially pay the temporary incapacity benefit by the employer to better control the use of these benefits with more efficiency	Social Insurance State Fund Ministry of Social Security	2004
118.	Eliminate allocations for the provision of free recreational treatment in sanatoriums	Increase the efficiency of the Social Insurance system	Social Insurance State Fund Ministry of Social Security	2003
119.	Develop state assistance programs for graduates from orphanages	Improve social assistance to children	Ministry of Social Security	2004
120.	Improve the living conditions of refugees living in temporary shelters	Improve the social security system for refugees	Department of Migration and Refugees under the Government	2004
121.	Increase opportunities for very poor rural refugees to be engaged in farming and cattle breeding	Create opportunities for refugees equal to those of residents	Department of Migration and Refugees under the Government	2005
122.	Develop post-conflict rehabilitation programs	Ensure conditions for population immigration	Ministry of Regional Government and Coordinating the Operation and Infrastructures	2004
123.	Simplify the mandatory social contributions collection system	Increase the efficiency of mandatory social contributions system	Social Insurance State Fund	2004
124.	Differentiate between social and retirement pension financing	Increase the efficiency of retirement pension system	Ministry of Finance and Economy Social Insurance State Fund	2004
125.	Increase the correlation of retirement pensions according to years of employment	Increase the equitability and fairness of the pension system	Social Insurance State Fund	2004-2006
126.	Increase austerity in terms of pension eligibility	Increase the effectiveness of the pension system	Social Insurance State Fund	2004
127.	Finalize the introduction of the individual (personal) registration system	Accurately account for insurer's payments and liabilities	Social Insurance State Fund	2005
128.	Develop mechanisms of pension appointments based on the data of the individual registration system	Increase the effectiveness of the pension system	Social Insurance State Fund	2005
129.	Increase the minimum wage so that it is equal to the general poverty threshold	Reduce wage inequality and poverty	Ministry of Finance and Economy	2004
130.	Revise the disability categories by differentiation of the functional disability	Increase the effectiveness of the social security system	Ministry of Social Security	2004
131.	Eliminate the new pensions for the 3 rd disability group starting 2004	Increase the effectiveness of the social security system	Ministry of Social Security	2004
132.	Regulate the social protection of disabled people according to law	Increase the social protection of disabled people	Ministry of Social Security	2004

	Policy	Objective	Responsible Agency	Timing
133.	Eliminate the unemployment insurance scheme	Increase the efficiency of the social insurance system	Ministry of Social Security	2004
134.	Abolish the payments which the employer has to make to the social insurance state fund when dismissing an employee	Increase the efficiency of the social insurance system	Ministry of Social Security	2004
135.	Expand the sources of financing for disability insurance	Increase the efficiency of the social insurance system	Ministry of Social Security	2004
136.	Develop mechanisms to finance employment programs	Increase the efficiency of the social insurance system	Ministry of Social Security	2004
137.	Develop mechanisms to train the unemployed	Increase the efficiency of the social insurance system	Ministry of Social Security	2004
138.	Substitute the unemployment benefits with support to the unemployed	Increase the efficiency of the social insurance system	Ministry of Social Security	2004
139.	Discontinue the financial assistance provided to unemployed to engage in business activity and direct the savings thereof to the professional training of the unemployed	Increase the efficiency of the employment programs	Ministry of Social Security	2004
140.	Streamline the procedures of involving people in public works programs	Increase the efficiency of the employment programs	Ministry of Social Security	2004
141.	Unify the procedures to involving people in public work programs funded from international, donor and non-governmental organizations	Increase the efficiency of the employment programs	Ministry of Social Security	2004
142.	Increase public expenditures in the health sector	Increase accessibility and improve the quality of health services	Ministry of Health Ministry of Finance and Economy	2004 To be continued
143.	Introduce state control over wages and capital expenditures in the primary health care system	Improve the quality of health services	Ministry of Health Ministry of Finance and Economy	2004
144.	Increase the share of primary health care in total budget expenditures	Increase accessibility of primary health care (out-patient and polyclinics)	Ministry of Health Ministry of Finance and Economy	2004 To be continued
145.	Develop the family health care system	Increase accessibility and improve the quality of health services	Ministry of Health	2004
146.	Improve ambulance service	Increase accessibility and improve the quality of the health services	Ministry of Health	2004-2006
147.	Continue to improve health conditions of pregnant and nursing women and nutrition of children aged 0-5 years	Improve health conditions of the population and poverty reduction	Ministry of Health	2004-2006
148.	Improve the quality of obstetrician and gynecological medical aid and enhance the equipment of obstetric hospitals	Improve health conditions of the population and poverty reduction	Ministry of Health	2004-2006
149.	Expand the programs on vaccinations and on healthy growth and development of children	Increase the efficiency of medical aid to the children	Ministry of Health	2004-2006
150.	Concentrate limited public resources for hospitals as much as possible to a few health care facilities	Enhance the effectiveness of hospital health care	Ministry of Health	2004-2005
151.	Enhance the efficiency of planning, budgeting and oversight functions at the level of medical institutions	Increase management efficiency	Ministry of Finance and Economy Ministry of Health	2004-2005

	Policy	Objective	Responsible Agency	Timing
152.	Elaborate and introduce quality control standards and revised sanitary norms and regulations	Strengthen the regulatory and supervisory functions of the state in the health care system	Ministry of Health	2004-2005
153.	Accelerate the development of public education	Increase the quality and efficiency of educational services	Ministry of Education and Science	2004-2006
154.	Increase public expenditures in education	Increase the quality and efficiency of educational services	Ministry of Education and Science	2004-2006
155.	Increase remuneration and training provisions for teachers	Improve the quality of education	Ministry of Education and Science	2004 To be continued
156.	Provide text-books for elementary school pupils	Improve the quality of education	Ministry of Education and Science	To be continued
157.	Reconstruct the school buildings and modernize heating systems	Improve the quality of education	Ministry of Education and Science	2004 To be continued
158.	Modernize teaching and learning materials	Ensure quality education	Ministry of Education and Science	2004 To be continued
159.	Improve the quality of professional and training programs	Align training programs with the needs of contemporary education	Ministry of Education and Science	2004 To be continued
160.	Optimize the pupil/teacher ratio and the teacher workloads	Increase the efficiency of educational services	Ministry of Education and Science	2004
161.	Create (rehabilitate) cultural units in communities	Prevent self-isolation of the poor, promote their participation in community cultural activities	Ministry of Culture and Youth Affairs Ministry of Finance and Economy	2004-2005
162.	Public participation in excavation, restoration and exhibition of a number of historic and cultural monuments	Enhance national identity and the image of Armenia	Ministry of Culture and Youth Affairs	2004-2005
163.	Promote national celebrations and festivals	Emphasize social equality, enhance civil participation and social activity	Ministry of Culture and Youth Affairs	2004 To be continued
164.	Improve the legal framework for environment protection and use of natural resources	Prevent environmental impediments to development	Ministry of Nature Protection	2004
165.	Ensure adequate collection of fees and payments for use of natural resources	Prevent environmental impediments to development	Ministry of Trade and Economic Development Ministry of Finance and Economy	2004
166.	Establish a system of environmental standards and norms	Prevent environmental impediments to development	Ministry of Nature Protection	2005
167.	Rehabilitate, protect, and rationally use the ecological system of Lake Sevan	Prevent environmental impediments to development	Ministry of Nature Protection	2004-2006
168.	Strengthen the forest resources management system	Prevent environmental impediments to development	Ministry of Nature Protection	2004-2006
169.	Improve the system of recording hazardous industrial waste	Prevent environmental impediments to development	Ministry of Nature Protection	2004-2006
170.	Gradually reduce subsidies to companies in potable water and irrigation systems	Increase the efficiency of the water supply system	Water Management State Committee under the Government	2004-2006
171.	Shift to a zone tariff definition policy in the irrigation system	Increase the efficiency of the water supply system	Water Management State Committee under the Government	2004-2005
172.	Introduce management contracts with companies in the irrigation system	Increase the efficiency of the water supply system	Water Management State Committee under the Government	2004-2005

	Policy	Objective	Responsible Agency	Timing
173.	Develop the water calculation and recording system	Increase the efficiency of the water supply system	Water Management State Committee under the Government	2004 To be continued
174.	Rehabilitate the roads of the community (local) significance	Expand agricultural products marketing opportunities for farms and increase the accessibility of social services	Ministry of Transportation and Communication	2004-2006
175.	Increase the financing of road-construction – up to 20 % of budget revenues – from fuel taxes	Finance road-construction	Ministry of Finance and Economy Ministry of Transportation and Communication	2006
176.	Introduce local heating systems	Increase accessibility to heating	Ministry of Energy Ministry of Finance and Economy	2004-2006
177.	Develop an energy transmission and coordination system (ArmEnerg, High power energy networks)	Increase the efficiency of the energy system	Ministry of Energy	2004 To be continued
178.	Financially rehabilitate the energy system	Increase the efficiency of the energy system	Ministry of Energy Ministry of Finance and Economy	2004 To be continued
179.	Provide technical and financial support to administer apartment buildings	Strengthen the administration of apartment buildings (communities and owners unions)	Ministry of Urban Development	2004 To be continued
180.	Comprehensively strengthen the institutions of vocational education	Align vocational educational system to contemporary requirements	Ministry of Education and Science	2004
181.	Streamline responsibilities of PRSP implementation bodies and coordination of the main information flows	Establish an institutional and organizational structure	Ministry of Finance and Economy	2003-2004
182.	Establish institutions to assess PRSP implementation results and to further strategy development	Establish an institutional and organizational structure	Ministry of Finance and Economy Ministry of Social Security	2003-2004
183.	Streamline the monitoring indicators and of the main functions of responsible units	Introduce an efficient PRSP monitoring system	Ministry of Finance and Economy	2003-2004
184.	Develop detailed PRSP implementation measures and a time-table	Introduce an efficient PRSP monitoring system	Ministry of Finance and Economy Other ministries and departments	2003
185.	Establish the PRSP Coordination Participatory Committee (CPC)	Supervise the PRSP implementation process	Ministry of Finance and Economy	2003
186.	Form the PRSP Working Group Staff	Supervise the PRSP implementation process	Ministry of Finance and Economy	2003