Armenia
Confronting Poverty Issues

June 10, 1996

Municipal and Social Services Division
Country Department IV
Europe and Central Asia Region
CURRENCY EQUIVALENTS
(as of January 1996)

Currency Unit = Dram
US$1 = 400 Dram

WEIGHTS AND MEASURES
Metric System

ABBREVIATIONS AND ACRONYMS

CIS - Commonwealth of Independent States
CPI - Consumer Price Index
EU - European Union
ES - Employment Services
EU Tacis - European Union Technical Assistance for Commonwealth of Independent States
FSU - Former Soviet Union
FDD - Fund for Democracy and Development
GDP - Gross Domestic Product
IMF - International Monetary Fund
MLSS - Ministry of Labor and Social Security
MOF - Ministry of Finance
MOT - Ministry of Transport
MSF - Medecins Sans Frontieres
NGOs - Non Governmental Organizations
OECD - Organization for Economic Cooperation and Development
UMCOR - United Methodist Committee on Relief
UNHCR - United Nations High Commissioner for Refugees
USAID - United States Agency for International Development
VOCA - Volunteers in Overseas Cooperative Assistance

ARMENIA - FISCAL YEAR

January 1 - December 31
Preface

The preparation of the poverty assessment was managed by Mr. Alexandre Marc (Human Resources Specialist), with substantial background and analytical assistance from Ms. Jeanine Braithwaite. The study draws on a number of working papers prepared as background documents, among which: "Armenia: A Poverty Profile" by Jeanine Braithwaite, "Socio Economic Monitoring of Armenian Families" by Ludmila Haratunian, "A Qualitative Assessment of the Living Standards of the Armenian Population" by Nora Dudwick, "Using Land as a System of Social Protection" by Sharon Holt, and "Study on the Contribution of the Armenian Communities Abroad to Armenia's Social Sector" by Alen Amirkhanian. On the Bank side the following staff and consultants have participated in field missions and provided substantial inputs in headquarters: Ms. Afsaneh Farzin, Mr. Robert Hall, Ms. Rajshri Jayaraman, Ms. Mohini Malhotra, Mr. Stan Peabody, Ms. Gillian Perkins and Ms. Helen Shahriari. On the Armenian side Ms. Ludmila Haratunian, Ms. Rudik Housepian, Ms. Harnush Kharatian, Ms. Julia Magluchanz, Ms. Nune Mogoyan and Mr. Sasoun Tsirounian contributed, among others, to the preparation of the different working papers and the data analysis. The mission received excellent support from the Department of Statistics on data analysis. The draft report was discussed in a seminar in Yerevan chaired by the Minister of Economy and involving representatives of government, academia, parliament, NGOs, and the Armenian Church. The work was undertaken under the Divisional responsibility of Mr. James Harrison, and later of Mr. Thomas Blinkhorn and Mr. Wafik Grais, and the Departmental responsibility of Mr. Basil Kavalsky. The peer reviewers of the study are Ms. Margaret Grosh and Ms. Lynne Sherburn Benz.
ARMENIA: CONFRONTING POVERTY ISSUES

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For the development of poverty-reducing growth strategies, four key issues are identified, and some suggestions are made concerning possible approaches for addressing these issues. First, the scale of the informal sector and the lack of good poverty indicators present enormous difficulties for both categorical and income targeting of social assistance in Armenia. This, in conjunction with tight budgetary constraints, means that cash transfers can only have a relatively limited impact on poverty reduction in the short to medium term.

Second, ensuring that the poor have access to good quality health and education services presents a particular challenge. It is clear that investment in human resources will be a crucial factor in promoting economic growth and poverty reduction. Lacking abundant raw materials for export, Armenians have depended historically on the strength of their human capital base. Recent erosion of this base, however, due to rapid decline in the quality and coverage of education and health services, is jeopardizing the potential for economic recovery while creating the risk of social instability and longer term structural poverty. Underfunding and inefficiency of these sectors has led to a situation in which parents and patients are paying escalating informal payments for deteriorating services which exclude the very poor. In the context of extremely low levels of public funding to these sectors, reform programs are designed to mobilize private resources and formalize user payments for many services. Considering the difficulties mentioned above in targeting subsidies to the poor, there is a real danger that poor families will find themselves increasingly denied access to educational opportunities and essential health services. Priority should be given, therefore, to improving both the level and the efficiency of public expenditure on health and education, concentrating public resources on ensuring universally affordable, good quality, basic services. This will entail strengthening primary health care and general education systems, and building capacity at the central and local levels in monitoring and assuring standards of quality and accessibility.

Third, restructuring of the economy is liable to leave sections of the population without access to productive assets or employment, unless concerted actions are taken to prevent this. As agriculture moves from subsistence farming to modern productive methods, it will cease to play the role of safety net it has played in the recent past. The process of agricultural modernization will need to be accompanied by specific measures to protect the interests of small farmers and avoid a rapid increase in rural poverty. Such measures include the acceleration of land titling and creation of a transparent market for land, supporting a system of cooperative rural credit, restructuring extension services, and improving rural transportation. Growth of the industrial sector will probably be limited in the medium term, and restructuring of this sector likely will result in a reduction in employment and increase in wage dispersion--strengthening the correlation between unemployment and poverty. Short term measures for broadening income-earning opportunities include keeping the minimum wage low to encourage hiring by enterprises, replacing humanitarian food distribution to the able-to-work poor with food-for-work programs, and piloting public works with external donor funding in areas where unemployment is highly concentrated. Policies for the medium term include reducing the level of the payroll tax, in parallel with restructuring of pensions; encouraging the development of private sector training programs by enterprises, NGOs and specialized institutions; and creating a fiscal and administrative structure that does not impede formal self-employment and small businesses.

Nonetheless, the informal sector will remain important and active in the medium term and it is probably in this sector that most of the poor will continue to find sources of income, mainly in small trade and small businesses. Government controls on the informal sector should focus, therefore, on large businesses, representing the largest losses for state revenues; it may be more affordable for the state to allow the poor to secure their livelihood through informal activities than to provide them with costly social support and encourage a dependency mentality. Emigration and remittances will probably also
EXECUTIVE SUMMARY

Armenia experienced an extremely sharp fall in output and near collapse of its economy following the breakup of the Soviet Union and the blockade which resulted from the conflict over Nagorno-Karabakh. A drop in output of more than 60% between 1992 and 1994 resulted in collapse of household incomes and living standards, as wages failed to keep pace with hyperinflation, as subsidies on energy and food were reduced, and the decline in Government revenue caused drastic cuts in social transfers, essential services, and maintenance of infrastructure. Poverty became widespread and inequities have been growing rapidly. The purpose of this report is to document the recent extent and nature of poverty in Armenia, to assess the implications for policy makers, and to identify potential strategies for poverty alleviation over the short and longer term.

Surveys carried out in 1994 and 1995 revealed unusual characteristics of poverty at that time and pointed to difficulties in identifying good indicators of poverty for targeting social transfers. No strong relation was found between poverty and age, gender, unemployment, level of education, family size, stock of consumer goods, or housing attributes. The factors most strongly related to poverty, especially in urban areas—the lack of extended family support, private remittances, or informal sector earnings—are extremely difficult to measure; and they may also cause families to move into or out of poverty very quickly. Land privatization has provided a safety net for the majority of rural families; most of the severely poor in rural areas are those without access to good quality agricultural land or the means to farm it. Location is one of the strongest poverty correlates and potentially one of the most useful for policy and targeting purposes. Considering the rapidly changing conditions in Armenia, however, it is likely that the poverty profile will change quickly with restructuring of the economy.

With such a drastic collapse in output and widespread transitional poverty, the fundamental priority for poverty reduction is to promote a rapid sustainable growth path for the economy. The first results of the government's policies for economic reform, introduced early in 1994, have been positive, reducing inflation and restoring growth. The prospects for sustaining economic growth over the longer term are also positive; the IMF projects annual growth of around 7% in 1997 and 1998, assuming the resumption of normal trade relations with Armenia's neighbors and the continuation of active policies for stabilization and restructuring of the economy. Armenia's isolation has been eased somewhat by rapid growth in trade with Georgia and Iran. The government's comprehensive reform program, supported by the World Bank and the IMF, is designed to accelerate enterprise restructuring and privatization and to improve the efficiency of public spending.

Economic growth will be essential for poverty reduction, but it may not be sufficient to erase poverty either in the short or long term. In the short term to medium term, growth will not be sufficient to bring all groups out of poverty and, in the course of economic restructuring, inequities may increase. In the longer term, there is a danger that inequities will become entrenched and that structural poverty will emerge, as those families which currently lack both land and human capital assets find themselves trapped in a vicious circle of poverty. As it is not clear at this stage how the profile of poverty will evolve, careful monitoring of this evolution will be extremely important. The vulnerable groups which are most at risk of being excluded from the benefits of restored growth include: households living in geographical areas which suffered from destruction of infrastructure (in the earthquake zone and border areas), or in rural areas where land is scarce and of poor agricultural quality; families whose children drop out of school, or who are unable to afford good quality education; families which are unable to invest in adequate health care; and workers whose skills are not adapted to market demand in the new growth sectors.
continue to be important—for the economy and as coping mechanisms. Although emigration represents a loss of skills for the economy, it is also an important source of transfers and foreign currency for an economy that will not be able in the short and medium term to absorb all the skilled labor on the market. Policies can be adapted so that migration results in increased benefits for the country and for the poor. In particular, improving the performance of the banking sector would facilitate all financial transfers, including the flow of remittances.

Finally, there is considerable scope for strengthening the capacity of organizations involved with poverty alleviation. Despite the inherent difficulties in targeting benefits to the poor in Armenia in the short and medium term, some improvements can be made in existing social assistance programs by testing new approaches to geographical and categorical targeting, exploring self-targeting programs, and institutionalizing regular poverty monitoring. In addition to reinforcing central policy making and monitoring functions, private sector and local group initiatives can be encouraged and expanded, for example by creating NGO partnerships with local and central governments, by supporting small business and NGO activities, and increasing transparency and effectiveness in the distribution of humanitarian aid through improvement of the PAROS program.
CHAPTER 1
RECENT MACRO-ECONOMIC DEVELOPMENTS
AND THEIR IMPACT ON THE LIVING STANDARDS OF THE POPULATION

Recent Economic Developments

1.1 A landlocked country with a land area of 29,800 square kilometers and a population of 3.75 million, Armenia has few natural resources and its people have survived through strong traditions of education and entrepreneurship. Under the Soviet regime, the country exported large volumes of industrial, military and high technology products, mainly for the Soviet market, and relied heavily on imports of critical industrial inputs. Following the break up of the former Soviet Union (FSU) and its independence in 1991, Armenia inherited a distorted, inefficient and obsolete national economy strongly affected by the collapse of the central planning system and the disruption of traditional trading arrangements within the FSU. The consequent economic and social problems were compounded by the devastation caused by the 1988 earthquake, and by the virtual economic siege which resulted from the political conflicts in Georgia and the dispute with Azerbaijan over Nagorno-Karabakh.

1.2 These conditions precipitated a catastrophic decline in output accompanied by hyperinflation which accelerated to 900% in the last two months of 1993 and continued through the first half of 1994, averaging slightly over 1,500% for the year. Real output in Armenia declined by 52% in 1992 and by 15% in 1993. GNP per capita was estimated at US$ 670 in 1994. (It was at this low point that the surveys for this study were carried out). Following the introduction of a national currency (the dram) at the end of 1993, Government policies have been successful in stabilizing the economy. The comprehensive reform program introduced early in 1994 included tight financial policies, price liberalization, privatization, tax reform, and liberalization of the exchange and trade system. Privatization of land had already been achieved: Armenia was the first Republic in the FSU to embark on land privatization in 1991 and, by 1994, more than 90% of the land was in private hands.

1.3 In December 1994, fiscal and monetary restraint was reinforced by elimination of a substantial part of the bread subsidy (estimated to equal 12% of GDP in 1994). As a result of these measures, the fiscal deficit declined to 16% of GDP (from 48% in 1993) and to 9% in 1995. Inflation dropped sharply during the second half of 1994, averaging 2% per month in 1995, the dram stabilized, and there are signs that external adjustment is beginning, with a decline in the current
account deficit and accumulation of foreign exchange reserves in 1995. Armenia's growth performance during the last two years has also been successful with an increase in output of 5.4% recorded for 1994 and a further increase of 5% estimated for 1995. This recovery is encouraging but still too small to compensate the population for past losses.

**Impact on the living standards of the population**

1.4 Living standards of the population have been hit by the collapse in real wages, compounded by the removal of subsidies on essential goods and drastic cuts in spending on social services. Although the government raised the minimum wage a few times during 1992-1994, real wages declined by 60% in 1992, 42% in 1993 and a further 76% in 1994. At the end of 1993, real average wages had fallen to about 6% of their 1991 level. Although positive growth in 1994 and 1995 has since allowed a slight recovery, real wages are still only about one fifth of what they were in 1992. Average monthly wages in 1995 were $18 in the state sector, and half that in the budgetary sector which comprises more than one-third of Armenian job holders. Urban households, highly dependent on wages, have been the most severely affected; for the majority of the rural population, subsistence agriculture has provided a safety net.

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<tbody>
<tr>
<td>Real Minimum Wage (Jan94=100)</td>
<td>1307</td>
<td>735</td>
<td>47</td>
<td>37</td>
</tr>
<tr>
<td>Real Average Wage (Jan94=100)</td>
<td>841</td>
<td>490</td>
<td>118</td>
<td>139</td>
</tr>
<tr>
<td>Nominal Average Wage (in $)</td>
<td>6</td>
<td>7</td>
<td>7</td>
<td>15</td>
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Source: Estimates based on data from State Department of Statistics, Armenia.

1.5 Since 1992, official unemployment has increased from 3.5% to 8.0% of the labor force (high by FSU standards). However, these figures include only those who register for unemployment benefit. What is more, a further 15% to 30% are estimated to be on voluntary unpaid leave or reduced pay for shorter working hours. Employment increased in agriculture, however, following the land privatization, and the share of total employment accounted for by the agricultural sector increased from 18% in the 1980s to 25% by 1993.

1.6 A further problem for the poor was the progressive removal of subsidies, prompted by fiscal pressures. From 1992, there were large reductions in the range of explicit subsidies, and the government adjusted prices periodically on selected basic goods and services that

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1/ Wages refer to the State sector (budgetary and non-budgetary) only. There are no official data available on wages in the private sector.