

WORLD BANK
COUNTRY ASSISTANCE STRATEGY
FOR
THE REPUBLIC OF ARMENIA

JUNE 30, 2004

CURRENCY EQUIVALENTS

(Exchange Rate Effective April 26, 2004)

Currency Unit = Dram
Dram 1000 = US\$1.81
US\$1 = 552 Dram

GOVERNMENT FISCAL YEAR

January 1 to December 31

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYM

AAA	Analytical & Advisory Services	NGO	Non-Governmental Organization
ADA	Armenian Development Agency	NSS	National Statistical Service
BEEPS	Business Environment and Enterprise Performance Survey	OED	Operations Evaluation Department of the World Bank
CAS	Country Assistance Strategy	OSCE	Organization for Security and Cooperation in Europe
CEM	Country Economic Memorandum	PER	Public Expenditure Review
CIS	Commonwealth of Independent States	PRGF	Poverty Reduction and Growth Facility
CPPR	Country Portfolio Performance Review	PRSC	Poverty Reduction Support Credit
DFID	UK Department for International Development	PRSP	Poverty Reduction Strategy Paper
ESW	Economic and Sector Work	SAC	Structural Adjustment Credit
FDI	Foreign Direct Investment	SIL	Specific Investment Loan
FSU	Former Soviet Union	SME	Small- and Medium-size Enterprise
GDP	Gross Domestic Product	TA	Technical Assistance
GTZ	Gesellschaft für Technische Zusammenarbeit (German Overseas Development Agency)	TBD	To be determined
IBRD	International Bank for Reconstruction and Development	UNDP	United Nations Development Programme
IFC	International Finance Corporation	UNHCR	United Nations High Commissioner for Refugees
ICR	Implementation Completion Report	UNIDO	United Nations Industrial Development Organisation
IDA	International Development Association	USAID	United States Agency for International Development
ILCS	Integrated Living Conditions Survey	USDA	United States Department of Agriculture
IMF	International Monetary Fund	WUA	Water Users' Association (for irrigation)
JSA	Joint Staff Assessment	WBI	World Bank Institute
LIL	Learning and Innovation Loan	WTO	World Trade Organization
MIGA	Multilateral Investment Guarantee Agency		

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Executive Summary

i. **Context.** Armenia is a small, landlocked country with few natural resources in a historically volatile part of the world. The country experienced a major economic contraction at the end of the 1980s when the effects of a massive earthquake were amplified by the break up of the Soviet Union and the costs of the conflict with Azerbaijan over Nagorno-Karabagh. Over the last ten years, the Government has shown a strong track record on economic management and reform, and has made good use of the high levels of official donor support it has received. Armenia had the highest IDA performance record in the ECA region in 2003.

ii. **Economic Performance.** The economy has recovered well from the post-1988 collapse, with economic growth reaching 14% in 2003. At the beginning of the recovery, growth was concentrated in a narrow set of industries, but, since 2000, the base has begun to broaden. Although poverty remains widespread, it has been falling since the late 1990s. Extreme poverty has fallen more than overall poverty, but the rate of improvement in both measures has lagged behind economic growth. Most of the reductions in poverty have been seen in Yerevan, with poverty in other urban areas falling less rapidly, and in rural areas remaining stagnant.

iii. **Areas that require further attention.** Despite this substantial progress, there are some key issues that need to be addressed if strong growth is to continue, and poverty reduction is to accelerate.

- *The climate for private sector development needs to improve further.* While Armenia has one of the most liberal business environments in the FSU, the public sector needs to become more of an asset -- rather than an administrative and financial cost -- to the private sector.
- *A larger share of the population needs to benefit from economic growth.* With strong economic growth expected to continue, more attention is needed to increasing jobs, stimulating the rural economy, and improving the social protection systems.
- *The entire population needs better access to basic services.* After independence basic services, including education and healthcare, deteriorated sharply, and the Government needs to persist in its efforts to improve their quality and efficiency.

iv. **Government Program.** In October 2003, the Government published an ambitious yet realistic Poverty Reduction Strategy Paper, which lays out its plan for reducing poverty and inequality, and furthering human development. The policies and actions proposed can be grouped into five categories: (i) promoting sustainable economic growth through macro-economic stability and private sector development; (ii) enhancing human development and improving social safety nets; (iii) implementing prudent fiscal policies; (iv) improving public infrastructure; and (v) improving core public sector functions.

v. **IDA Strategy and Results.** From the range of interventions proposed in the PRSP, the CAS focuses on three areas which best fit the Bank Group's comparative advantage and complement the activities of other donors. In each area, the CAS takes as its starting point long-term country goals, and on that basis defines specific results that can be achieved over the FY05-08 CAS period:

- *Promote private sector led economic growth.* Achieving this goal will require better public services, measured by an improvement in business perceptions of government policies and corruption, and by a strengthening of the judicial system, measured by the level of satisfaction of court users. IDA will also help Armenia strengthen the financial system, measured by an

increase in the ratio of loans to GDP, and improve communications infrastructure, measured by an increase in the number of telecoms licenses issued.

- *Make growth more pro-poor.* Achieving this goal will require accelerated job creation, measured initially by a fall in the share of the informal economy in GDP. It will also require a stronger rural economy, measured by an increase in value-added per hectare. Improvements in the social protection system will be measured by an increase in user satisfaction. Overall, the interventions in this category will contribute to a reduction in extreme poverty.
- *Reduce non-income poverty.* Achieving this goal will require better access to education, healthcare and basic infrastructure services. Education outcomes will be measured by the extent to which children stay in the education system. Health outcomes will be measured by service use among sick people in rural areas, and in the bottom consumption quintile. Improvements in access to basic infrastructure services will be measured by the share of the population with drinking water 24 hours a day.

vi. **IDA Instruments and Cases to Achieve the Results.** IDA will support these goals through the on-going and proposed portfolio, and through AAA services, including programmatic lending and advisory work to be conducted jointly with the government throughout the CAS period. Armenia became a High Case performer during the FY02-FY04 CAS period. It will enter the up-coming CAS in a Base Case, which assumes a continuation of current good performance, and includes IDA lending of US\$170 million over four years. If the improvements in public sector management accelerate, Armenia will move into a High Case of US\$220 million, providing additional resources for structural and public sector reform. It is possible that Armenia's creditworthiness may improve towards the end of the upcoming CAS period, in which case IBRD funds might be available for additional investments in infrastructure. If Armenia is unable to continue its current good performance, it will move into a Low Case, which would restrict new investment operations to those that directly protect the most vulnerable, and would make available IDA lending of US\$90 million over four years.

vii. **Risks.** Political change in the Caucasus region could affect Armenia negatively or positively. Likewise, exogenous economic shocks -- such as sudden changes in the prices of oil or other key commodities -- could also have significant costs or benefits. Within Armenia, political consensus for reform could weaken, undermining progress in key sectors and possibly macroeconomic stability. A deceleration in improvements in tax revenues and/or slower growth could increase the projected financing gap to the extent that expected adjustment lending and donor funding would be insufficient to cover it. In addition, the country remains vulnerable to earthquakes and other natural disasters. IDA aims to mitigate these risks through extensive analytical work and dialogue and, in some cases, investments. If, however, the situation deteriorates to the extent that implementation of the proposed strategy becomes difficult, IDA will consult the Board on a revised strategy.

viii. **Monitoring and Evaluation for Results.** IDA will monitor the effectiveness of its support both at the project level and at the level of the overall assistance program. The success of the CAS program will be measured against the expected CAS results, which are derived from PRSP targets. IDA will use the results framework in its Portfolio Reviews, and will consult with civil society on CAS progress as part of the Government's regular PRSP consultations. At the mid-point of the CAS period, IDA will review the indicators and targets to assess progress in implementing the assistance program, and adjust the strategy as necessary.

WORLD BANK COUNTRY ASSISTANCE STRATEGY FOR THE REPUBLIC OF ARMENIA

1. Introduction

1. Armenia is located in the Caucasus Region, neighboring Georgia, Azerbaijan, Iran, and Turkey. With a GNP per capita of US\$910 in 2003, Armenia ranks in the lower middle-income group of countries. Emigration and declining fertility has reduced its population, which was 3.8 million ten years ago, to about 3.1 million today. Because Armenia is small, landlocked and mountainous, with few natural resources, it faces economic disadvantages compared with many of its neighbors. These disadvantages have, however, been off-set to some extent by the country's high levels of human capital, an active diaspora, and high levels of remittances and external assistance (which averaged 11% of GDP over the last five years). Armenia is vulnerable to a wide range of external shocks arising from its location in a historically volatile geo-political environment, and its susceptibility to natural disasters, such as earthquakes, droughts, frosts, hailstorms, and floods.

2. Armenia achieved independence from the Soviet Union in 1991, and since then the economy has changed profoundly. Heavy industry collapsed as the Soviet Union broke up, and is gradually being replaced by services, light industry, and construction. As this economic transformation has taken hold, GDP growth has accelerated from 3.3% in 1999 to 13.9% in 2003. The Government's forceful steps to create a more favorable business environment and improve public institutions helped accelerate growth rates. Membership of international bodies such as the WTO and the Council of Europe have added impetus to maintaining and deepening reforms. Barring any destabilizing economic shock, the prospects for GDP and export growth remain favorable.

3. The major challenge for the Government during this CAS period will be to create the conditions that will allow growth to benefit a much larger share of the Armenia population. While overall poverty fell from 56% of the population in 1998/99 to 49% in 2002, and extreme poverty from 26% to 17%, a more rapid improvement might have been expected from the rapid GDP growth. The 2003 PRSP emphasizes the Government's commitment to equitable growth and sustained poverty reduction across the whole country. When the World Bank's Executive Board discussed the PRSP, and associated Joint Staff Assessment, in December 2003, it concluded that the PRSP provides a sound basis for IDA concessional assistance. This CAS is accordingly based on the PRSP's priorities.

4. Armenia has had a relatively stable political situation over the past few years, with strong support for reforms from both the executive and legislative branches. Presidential and legislative elections in early 2003 resulted in re-election of President Kocharian and coalition within Parliament, which continues to support the PRSP and medium-term agenda. However, the electoral process itself was criticized at the time, and opposition parties have since stepped up demands for a nationwide referendum of confidence, which has been rejected by the Parliament. While the overall environment is still supportive, there will clearly be a heightened need for consensus building to support the reform program in the years ahead.

2. Economic Management

2.1 Transformation since Independence

5. Armenia's transformation from a centrally planned Soviet system to a successful market economy has had three major phases.

6. The **first phase**, lasting for the first two years after Armenia's 1991 declaration of independence, was marked by a contraction in GDP of 50%. While GDP fell in all FSU economies after the break-up of the Soviet Union, the situation in Armenia was particularly severe, exacerbated by a heavy dependence on uncompetitive Soviet heavy industry, by the after-effects of the 1988 earthquake, and by the direct and indirect costs of the conflict over Nagorno-Karabagh. The full impact of this economic contraction was alleviated to some degree by farm privatization, which took place at this time, and allowed subsistence agriculture to act as a safety net, absorbing many of the displaced workers. Farm output rose to over 50% of a sharply reduced GDP by 1993.

7. The **second phase** of the transformation to a market economy began in 1994, and was marked by a successful stabilization and structural reform program. The program focused initially on fiscal and monetary policies designed to deal with hyper-inflation (which reached 5000% in 1994), and uncontrolled fiscal spending (the budget deficit reached 56% of GDP in 1993). Stabilization was accompanied by liberalization of trade and prices, privatization of small and medium enterprises, and the creation of the basic legal and administrative framework for a market economy. These reforms -- and other positive factors such as the ceasefire over Nagorno-Karabagh -- fostered sustained economic expansion (see Table 1). Growth averaged 5.5% in 1994-2000, and the composition of GDP changed considerably, with agriculture declining again in relative terms, and the construction and trade sectors growing rapidly.

Table 1: Real GDP growth 1994-2003
(percent change over the previous year)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
GDP	5.4	6.9	5.9	3.3	7.2	3.3	6.0	9.6	12.9	13.9
<i>Of which:</i>										
Industry	9.6	2.6	1.1	1.3	-2.2	5.2	6.4	3.8	14.2	15.4
Agriculture	3.1	4.0	2.0	-4.5	12.9	1.3	-2.3	11.6	4.4	4.3
Construction	5.7	-5.8	25.2	3.9	10.6	7.7	28.4	14.5	47.0	44.4
Trans/Comm'n	-4.1	9.6	17.1	9.2	1.4	0.8	-0.6	16.0	6.0	10.1
Trade	60.2	73.0	12.5	5.0	6.7	9.8	8.3	15.5	15.2	8.2
Other services	-2.2	-2.2	14.6	3.2	2.6	4.5	9.1	5.3	7.2	7.5

Source: National Statistical Service (NSS)

8. The **third phase** began in mid-2000, and saw an increased government focus on improving the overall business environment, and the supporting framework for investment. This contributed to rapid growth rates, with GDP expanding by almost 13% in 2002, and 14% in 2003. Much of this growth was driven by construction, and by exports of polished diamonds. Nonetheless the sectoral base of the economy has begun to broaden, with total exports excluding diamonds increasing rapidly (Table 2). Industrial output in particular is starting to grow again, but, unlike in Soviet times, it is now concentrated in light and medium-sized manufacturing and a growing agro-processing sector.

To some degree, the restricted borders with Turkey and Azerbaijan give a greater comparative advantage to goods with a high ratio of value to volume or weight. These restrictions cost an estimated 10-18% of GDP in 2003, either directly (e.g. through higher transport costs), or indirectly (e.g. through a higher perceived risk premium for foreign investment).

Table 2: Armenia: Export performance 1995 to 2003

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total merchandise exports (US\$m)	270	290	232	220	232	300	342	505	678
Growth Rate (%)	25.8	7.2	-19.9	-5.2	5.1	29.7	13.8	47.8	34.2
Exports w/o Diamonds (US\$m)	200	156	185	173	148	202	256	307	n/a
Growth Rate (%)		-21.8	18.6	-6.3	-14.8	36.5	26.9	19.9	n/a
Trade Deficit (% GDP)					31.4	30.6	25.1	20.4	21.1

Source: NSS

2.2 Current Economic Management

9. Macroeconomic management remains sound. Fiscal balances continue to be sustainable, with a budget deficit of 1.5% of GDP in 2003 (below the target of 2.2%, in part because of underruns on projected expenditures). Nonetheless, government revenues remain low by CIS standards, amounting to less than 15% of GDP. The Government is committed to improving tax collection, and reforms introduced at the end of 2003 seem to be having an impact, with tax revenue in the first three months of 2004 18% higher than in the same period in 2003.

10. The principal short-term macroeconomic concern has been inflation, which rose to a relatively high 8.6 percent by the end of 2003. However, the main cause was a sudden increase in the prices of imported wheat flour and cereals, with monetary policy playing at most a minor role. By April 2004, the 12-month rate of inflation had fallen to 7.8 percent, and the Armenian Dram remained broadly stable.

11. The Government has sharply reduced the once burdensome quasi-fiscal deficit. Most of this improvement came from the privatization of the electricity distribution companies, which has turned an energy sector deficit of 2% of GDP in 2000 into a surplus now. In addition the water supply and irrigation sectors are, with IDA support for management contracts and decentralization, reducing their deficits from a combined 1% of GDP in 2001 to a projected 0.4 percent of GDP in 2004.

12. Despite this overall fiscal progress, public revenue management and generation still fall short of what is needed for Armenia to deliver public services commensurate with its rapidly rising GDP. The budget preparation process is insufficiently strategic, and the links between the annual budgets, the MTEF and the PRSP also need to be stronger. Likewise, the line ministries need to play a more active role in budget formulation and to share accountability for budget outcomes. Local governments have insufficient financial management and budgeting capacity, and lack transparency.

13. On the revenue side, administration of VAT, personal income and payroll taxes, and especially customs, need to be greatly strengthened if Armenia's revenue potential is to be realized. Low tax collection is a result of governance shortcomings, a large informal economy, and an unnecessarily complicated tax system, with excessive numbers of specific exemptions and a highly complex corporate tax structure.

14. The investment climate continues to improve. Progress in trade and price liberalization, increased investments in infrastructure, privatization or closure of most state-owned enterprises, and

efforts to streamline government regulation, have enhanced the business environment to the extent that the latest Heritage Foundation Index of Economic Freedom ranks Armenia highest among the CIS countries, and above even some OECD countries.

15. An important challenge for future private sector growth will be to strengthen Armenia's under-developed financial sector. Commercial bank lending, as measured by the stock of debt outstanding, has actually fallen by 11% from December 2000 to March 2004. While deposits have increased significantly, the resulting extra liquidity has not yet found its way into lending to corporate clients. In part this is because of the time it has taken to purge insolvent banks from the system -- it was only in 2003 that the banking system as a whole became profitable. Furthermore, a significant volume of diaspora funding for investment activity is not channeled through the banking system.

2.3 The Economic Outlook

16. The medium-term growth prospects for Armenia are positive, bolstered by continuing sound economic management and the growing dynamism of export sectors, including light industry and agro-processing. Official donor support is likely to remain strong, and recent positive developments in Georgia should also benefit Armenia. The baseline macroeconomic projections shown in Table 3 reflect a convergence of World Bank, IMF and PRSP projections and estimates, and are conservative.

Table 3: Macroeconomic Trends and Baseline Projections

	1999	2000	Actual 2001	2002	2003	Est. 2004	Projected		
							2005	2006	2007
<i>In percent</i>									
Real GDP growth rate	3.3	6.0	9.6	12.9	13.9	6.8	5.7	5.7	5.7
Consumer price index	2.0	0.4	2.9	2.0	8.6	3.0	3.0	3.0	3.0
Growth exports goods & services	6.5	16.6	20.8	19.3	28.2	9.3	10.3	7.8	7.3
Growth imports goods & services	-8.1	5.1	1.2	13.2	26.2	6.7	6.7	6.1	5.9
<i>As percent of GDP</i>									
State budget revenue	19.3	16.7	17.1	19.2	18.0	16.6	17.3	17.6	17.3
State budget expenditure	26.5	22.9	20.8	20.1	19.3	18.7	19.8	19.7	19.7
Fiscal balance, accrual basis	-7.2	-6.2	-3.7	-0.9	-1.3	-2.1	-2.5	-2.1	-2.4
Current account balance	-16.6	-14.6	-9.5	-6.3	-6.7	-6.4	-6.6	-6.7	-6.0
C/A balance, ex. transfers	-21.7	-19.9	-12.9	-8.6	-7.3	-7.2	-6.6	-6.7	-6.6
Foreign direct investment	6.6	5.5	3.3	4.7	4.3	3.2	3.2	3.0	2.8
External debt	46.3	44.0	41.4	43.3	39.3	37.5	35.5	33.8	30.3
<i>In percent</i>									
NPV/exports G&S ^(a)	143.3	119.7	108.8	96.3	48.6	46.4	42.6	39.5	37.0
NPV/fiscal revenue ^(b)	167.1	176.4	176.8	181.2	105.5	94.5	86.2	77.4	75.0
TDS/exports	23.7	11.3	13.7	9.3	13.2	8.6	7.2	6.9	5.7
TDS/fiscal revenue ^(b)	17.8	11.5	14.6	13.0	37.8	22.7	18.6	17.0	13.6
Total debt out'g/disbursed (\$m) ^(c)	855.0	840.4	877.7	1025.0	1097.7	1133.4	1172.8	1213.8	1181.2

(a) Three year moving average centered on the preceding year is used for the denominator.

(b) Central Government revenue excluding grants.

(c) Includes government and government guaranteed medium and long-term debt

Sources: For data: PRSP and IMF tables. For projections: RSMX preliminary projections, IMF and PRSP tables

17. Armenia's external debt is manageable, and is expected to continue to decline over the medium term. The country's external debt profile improved considerably in April 2003, when an agreement with Russia to implement a debt-for-equity swap went into effect. Russian enterprises acquired equity in several major state-owned enterprises in Armenia in exchange for US\$94 million of government debt. This, in addition to the in-kind repayment of the US\$12 million outstanding to Turkmenistan, helped to eliminate the most expensive part of Armenia's external debt burden, and thereby improved the country's external debt indicators. By the end of 2003, government and government-guaranteed external debt was 39% of GDP, with about 80% from multilateral concessional sources, of which IDA accounted for 60%.

18. The PRSP projections of firmly secured financing leave an unsecured gap of about US\$50 million a year for 2004-08 (after projected IDA disbursements for investment projects).¹ IDA adjustment lending would fill about \$15 million a year of this gap in the Base Case, and about \$20 million in the High Case (see Section 6.4 below), leaving a residual financing need of \$30-35 million. This remaining gap is not, however, of immediate concern, since the Government's projections take into account only firmly identified sources of financing -- the projections assume grants of only \$20-25 million a year in 2004-07, considerably less than the actual volume of grant assistance in 2003. Funding from the US Government's Millennium Challenge Account, which Armenia recently qualified for, could also provide significant additional finance for Armenia's investment needs.

3. Poverty

3.1 Poverty Trends

19. In the 1980s, poverty in Soviet Armenia is reported to have been virtually non-existent. The end of the decade, however, saw poverty increase sharply as the 1988 earthquake, the break-up of the Soviet Union, and the Nagorno-Karabagh war cost many people their livelihoods. The war also brought an influx of refugees, adding to the ranks of the poor.

20. Although economic growth resumed in the mid 1990s, poverty did not begin to fall until the end of that decade. By 2002, all measures of poverty and extreme poverty had declined compared to their levels in 1998/99 (Table 4).² Extreme poverty fell considerably faster than did overall poverty.

Table 4: Poverty Rates

	Extreme Poverty (below \$14 a month)			Overall Poverty (below \$21 a month)		
	Incidence	Gap	Severity	Incidence	Gap	Severity
Total						
98/99	26.1%	5.8%	1.9%	56.3%	17.1%	7.0%
2002	17.0%	3.2%	1.0%	49.3%	12.5%	4.5%
Yerevan						
98/99	29.6%	6.6%	2.1%	58.7%	18.8%	7.8%
2002	16.5%	3.1%	1.0%	45.4%	11.8%	4.3%
Other urban						
98/99	34.5%	8.2%	2.9%	66.5%	21.6%	9.4%
2002	21.1%	4.1%	1.3%	59.8%	15.5%	5.7%
Rural						
98/99	18.0%	3.5%	1.1%	47.7%	13.0%	4.9%
2002	14.4%	2.6%	0.7%	44.7%	11.0%	3.8%

Note: Consumption is measured per adult equivalent. Poverty indicators are computed using the 1999 minimum food basket.

Source: ILCS 1998/99 – 2002.

¹ If GDP growth and/or the revenue collection rate are slower than expected, the expected financing gap will grow.

² The incidence of poverty is the share of poor people in the population; the poverty gap indicates how far below the poverty line poor households are; and the severity of poverty captures inequality among the poor.

21. Inequality, as measured by differences in declared income, also fell over the period. Nevertheless, income inequality is still relatively high: the 2002 Gini coefficient³ of 0.45 is one of the highest in the FSU. Inequality, measured by surveys of consumption, however, appears to be much lower (a Gini coefficient of 0.27), although relatively stagnant (Table 5). These large differences between the income and consumption inequality measures may be caused by measurement errors.

	98/99	2002
Gini income	0.64	0.45
Gini consumption	0.30	0.27

Source: ILCS 2001 and 2002

22. Household surveys show that location and household composition affect a family's likelihood of being poor. In 2002, poverty was most severe in urban areas outside Yerevan, where almost 60% of the population lives below the poverty line. Poverty in rural areas and in Yerevan was significantly lower, at 45%, but the rate has been falling much faster in Yerevan than in rural areas. Similar patterns apply to the trends in extreme poverty (see Table 4). Poverty rates were the same for men and women, but higher for children under five, the elderly, and in female-headed households. As in most countries, the higher the education levels of the household head, the lower the household's risk of poverty.

23. Employment is a crucial determinant of poverty in Armenia. Unfortunately, unemployment rates remain high despite the accelerating GDP growth. New job creation has yet to compensate for the volume of labor shedding, which has taken place as a result of the sharp transition process. According to the household surveys, which are based on self-reporting, unemployment overall was 29% in 2002, down only 2 percentage points from 2001, with most of the decline being in Yerevan, where unemployment fell by 7 percentage points between 2001 and 2002 (see Table 6).⁴ Official data gives substantially lower rates than the household survey, as many unemployed people do not register with the Labor Office.

	2001	2002
Total	31	29
Urban	39	35
Yerevan	38	31
Other urban	41	40
Rural	17	20

Source: ILCS 2001 and 2002

24. Social transfers represent the third largest source of income (after labor income and remittances) for Armenia's poorest households, and the family poverty benefit in particular has proved to be an effective mechanism for reaching the poor -- for each percent of GDP spent on the family poverty benefit, extreme poverty falls by 3.4 percentage points, and overall poverty by 2.4 percentage points.⁵ In 2002, the Government reduced spending on poverty benefits by one-third of a percent of GDP, resulting in an 11% fall in the number of beneficiaries, and a 15% decline in the average monthly benefit. This may have slowed improvements in poverty between 2001 and 2002. In 2004, however, poverty benefits were restored to their former levels and social assistance arrears were cleared, which may have a positive impact on poverty in 2004.

³ The Gini coefficient is a measure of inequality, with 0 indicating complete equality of consumption or income, and 1 indicating complete inequality.

⁴ Individuals are defined as unemployed if they did not work in the week of the survey, were actively looking for a job and were willing to start work immediately if a job became available.

⁵ World Bank Poverty Assessment 2004.

25. The health of the Armenian population deteriorated after the economic collapse, but since 2000 there have been indications that conditions are starting to improve. While data problems make definite conclusions difficult, Government figures indicate that under-five mortality fell from 25 per 1,000 live births to 19 per 100,000 between 2001 and 2003.⁶ These trends mask a significant difference between rural and urban areas, with rural infant and child mortality rates exceeding urban rates by 47 percent and 22 percent, respectively, during the 1990s. The Government has embarked on a reform program to increase public expenditure on healthcare, improve its targeting, and reduce excess hospital capacity.

26. Access to basic education is good, with a net enrollment rate of 92% in 2001. In contrast, the net enrollment rate in secondary schools is only 61%, and even lower for the poorest quintile (52%). Boys are particularly likely to drop out because of problems both of supply (poor quality of teaching), and demand (low expectations of jobs after completing education). The Government is working to improve the quality of education, and has begun to make expenditure more efficient, for example by consolidating underutilized schools to improve their effectiveness. Overall public expenditures on education are also rising (by 45% between 1997 and 2001), but they are still low by FSU standards. High quality textbooks are now available to all at a reasonable cost, and 40% of schools now have some managerial and financial autonomy.

3.2 Millennium Development Goals

27. Armenia has already met the gender MDG, and is likely to meet the poverty and education goals, and possibly also the environment goal (see Table 7 below). The health goals, however, appear less likely to be met by the target year of 2015, with child mortality still more than twice the goal, TB rates increasing, and maternal mortality remaining a serious problem. IDA is continuing to support Armenia's efforts to meet and exceed the MDGs, with particular emphasis, both in the current portfolio and in the proposed PRSCs, on the health goals. In addition, IDA is continuing to help finance improvements throughout Armenia in drinking water and sanitation systems, as well as in natural resource management, rural development, and energy reform.

28. A recent exercise to assess the costs of meeting the MDGs estimated that Armenia would need about US\$25 million per year in addition to the currently proposed allocation for the four-year period 2005-08 to cover the costs of public expenditures that would be required to meet the MDGs. This assumes that Armenia would receive US\$35 million annually from private foundations and other donors.

⁶ Other sources indicate higher figures, but also show positive trends.

Table 7: Likelihood of Meeting Millennium Development Goals

Goals	Target	Status	Likelihood of achieving goal by 2015
Eradication of extreme poverty	13% of population living in extreme poverty (baseline year 1998/99)	17% in 2002	Likely
Achieve universal primary education	100% enrollment	92% for grades 1-8 in 2001	Likely
Promote gender equality and empower women	Girls' enrollment equal to boys' in primary and secondary education	Girls' enrollment exceeds boys'	Already met
Reduce child mortality*	7.9/1000 live births	18.8 **	Unlikely
Improve maternal health*	10/100,000 live births	55 in 2000	Unclear
Combat HIV/AIDS, and other infectious diseases	Halt and begin to reverse the spread by 2015	HIV/AIDS rates reasonably constant, but TB cases continue to increase***	Unlikely
Ensure environmental sustainability	Reverse loss of environmental resources; increase access to improved water and sanitation; improve lives of slum dwellers.		Possible

* Armenia has an average of only 25,000 births a year. The rate per 100,000 live births therefore fluctuates widely, making it impossible to determine a trend. In addition, Armenia has child and maternal mortality rates that are low for its income level, which make the MDG targets unrealistic, since they require reducing MMR by 75% and child mortality by 66% over 15 years, which would give Armenia rates better than those in most high-income countries. Therefore, if Armenia manages to bring its child and maternal mortality rates up to those of high-income countries, the country will be considered to have met the targets.

** UNICEF's TransMONEE database. Other sources give much higher figures.

*** HIV/AIDS data from UNAIDS, TB data from Ministry of Health

4. Lessons from Previous CASs

4.1 The CAS Completion Report

29. The FY02-04 CAS focused on promoting private sector development, improving public sector management, and enhancing human development, and was broadly successful in supporting these goals. The Completion Report for the FY02-04 CAS (Annex 2) highlights the following lessons:

- The FY02-04 CAS objectives were appropriate, and should be broadly continued. However, given the continuing disparity between overall growth rates and poverty reduction, this CAS pays more explicit attention to ensuring broad access to the benefits of growth.

- The best results were achieved when IDA was able to exploit the synergies between well-sequenced analytical work and lending (both investment and adjustment), and when it was able to leverage trust funds and other donors' support. This CAS thus pays close attention to the sequencing of initiatives, and ensuring that support for reform will be based on good analytical underpinnings.
- A strong, high caliber multi-sector team in the Yerevan Country Office was important in designing appropriate interventions, and maintaining a high level of dialogue with senior officials. Moving portfolio management and some task management responsibilities to the Country Office also helped improve portfolio performance. Both trends will continue under this CAS.
- The outcome indicators for the FY02-04 CAS should have been linked more clearly to IDA interventions in order to facilitate evaluation of CAS performance. This CAS consequently links all targets to the associated interventions, and indicators in the results matrix (Annex 1) will be used as a management tool throughout CAS implementation.
- The FY02-04 CAS was not realistic enough about staff availability and programming. Though the total number of activities and lending volume were delivered roughly as planned, there was some slippage due to lack of timely availability of key staff. Bank management will pay explicit attention to staff programming during implementation of this CAS.
- The CAS consultation process was extensive, and largely coincided with the even more thorough Government-led consultation process for the PRSP. The Government is committed to continue consultations throughout PRSP implementation, and IDA will participate in that process. Consultations on this CAS have also been coordinated with PRSP discussions, and focused on the most effective way for IDA to support Armenia's PRSP priorities.

4.2 OED's Country Assistance Evaluation

30. The World Bank's Operations Evaluation Department prepared an independent assessment of the role of World Bank Group's assistance to Armenia between 1993 and 2002.⁷ The report found that the substantial levels of assistance was well used: 86% of the projects reviewed had satisfactory outcomes, with high relevance, substantial institutional development impact and excellent linkages between analytical work and lending, as well as mutually supportive investment and adjustment operations. OED found that IDA lending should have focused earlier and more intensively on improving the business climate and public sector management. The evaluation also concluded that Armenia needed to strengthen its aid coordination capacity. The report recommended: (a) preparing a strategy for an eventual transition to IBRD lending; (b) continuing to focus on improving the environment for private sector development; and (c) following through on support for public sector reform. Management agreed with each of the recommendations and has incorporated them centrally into this Country Assistance Strategy.

⁷ Country Assistance Evaluation, March 2004

4.3 Results Achieved

31. The Bank's assistance over the FY02-04 CAS period has, in active cooperation with other development partners, had a tangible impact on the ground in a number of areas. A few examples are:

- **The business environment.** The support provided through Structural Adjustment Credits (SACs) IV and V, as well as other instruments, helped produce a measurable improvement in the business environment. For example, the number of steps necessary to register an enterprise has been cut by one third, and Government inspections have been reduced by half, significantly improving the business environment. Businesses' perceptions of all fields of regulatory and tax-related obstacles have improved since 2000, as reported in regular business surveys.
- **The energy and water sectors.** IDA helped lay the framework for the privatization of the energy distribution companies, which, while it occurred later than expected, has now eliminated the once heavy burden of energy distribution on the budget (2% of GDP in 2001). IDA also helped increase the efficiency of the power utilities with the result that almost the entire population now has uninterrupted electricity supply, and tariff collection is close to 100%. With support from IDA, drinking water services in Yerevan have improved markedly. In 2001, only 10% of the city's population had water for 12 hours per day, whereas by March 2004, half of the population had 24 hour service.
- **Governance.** Civil service reform has begun under a new law, which IDA advised on. In addition, IDA has helped bring government and civil society organizations draft an Anti-Corruption Strategy, which was adopted and launched by the President in January 2004.
- **Rural development.** IDA has assisted in rehabilitating 4,000 km of irrigation canals, which have increased the productivity of some 140,000 hectares of agricultural land, 74% of all irrigated land in the country. In addition, some 760 km of roads are maintained on a routine basis under IDA-assisted projects. IDA has also improved the lives of some 674,000 people through small community projects supporting improvement of schools, local potable water systems, small irrigation systems, and rural health facilities.
- **Education and health.** With IDA assistance, the Government has taken steps to make the healthcare more responsive to the needs of the poor. It has designed, and is about to implement, a major reform strategy to rationalize excess facilities that will free up funds for increased spending on essential services. It has set up a system of family doctors, and is shifting more public spending to primary healthcare. To improve education outcomes, IDA has helped the Government begin a major reform program to increase efficiency and improve the quality of education. Forty percent of schools now have some managerial and financial autonomy, and parents are increasingly involved in school management. With the support of an IDA credit, high quality textbooks are now available in all schools at reasonable cost.
- **Social protection.** IDA has helped the Government design and implement a family benefit system, which is an effective and well-targeted means to support poor households. IDA has helped the Government clear its arrears and improve social insurance, social welfare and employment services. With support from IDA, the Government has drafted a new Labor Code to facilitate job creation and a more flexible labor market.

5. Government Program

32. In October 2003 the Government published its Poverty Reduction Strategy Paper (PRSP), which promotes the goals of: (i) reducing poverty; (ii) lowering inequality; and (iii) improving human development.⁸ The World Bank-IMF Joint Staff Assessment (JSA) of the PRSP concluded that the strategy was a significant achievement in the Government's effort to foster growth and reduce poverty, and endorsed its analysis and recommendations.⁹ The JSA concluded that the PRSP was prepared through a broad participatory process, was based on a comprehensive analysis of poverty, contained a sound diagnosis of needed short- and long-term reforms and investments, and used realistic costing and financing assumptions. The JSA recommended additional work on monitoring and evaluation, further prioritization of proposed interventions, and close integration of the PRSP with the Medium-Term Expenditure Framework and the annual budgets.

33. The PRSP sees growth and poverty reduction coming primarily from a more dynamic and competitive private sector, with the Government's role focusing on promoting a better business climate, improving the level and efficiency of social sector expenditures, and reducing waste and corruption. The PRSP also identifies infrastructure investments (including in health) as having an especially high return.

34. The policies and actions proposed in the PRSP can be grouped into five categories: (i) promoting sustainable economic growth through macroeconomic stability and private sector development; (ii) enhancing human development and improving social safety nets; (iii) implementing prudent fiscal policies; (iv) improving public infrastructure; and (v) improving core public sector functions. Table 1 in Annex 7 divides the policy actions (p1-p186 as described in Annex 7 of the PRSP) among the three PRSP goals, and Table 2 in the same annex groups them into the five themes identified in the JSA.

6. Bank Strategy

From the broad range of interventions proposed in the PRSP, the CAS focuses on three areas which best fit the Bank Group's comparative advantage and complement the activities of other donors: (i) promoting private sector growth by strengthening the financial sector, improving public sector management, and reducing infrastructure bottlenecks; (ii) making growth more pro-poor by improving the labor market, promoting a more dynamic rural economy, and making social assistance more effective; and (iii) reducing non-income poverty through better health, education and basic services. The main results that this CAS aims for, and the strategies for achieving them, are shown in the summary results matrix, Table 8 below. Annex 1 provides a more detailed version, with additional baselines and targets for use during CAS implementation.

⁸ Paras 23 and 34 of the PRSP Executive Summary, and Section 2, Chapter 3.

⁹ Report 27133-AM

Table 8: Summary of Results Matrix

Goal One: Promote private sector led economic growth		
Long-term country goals	Principal Problems	Outcomes that IDA will influence in CAS period
<p>Private sector continues to grow, and becomes more diverse.</p> <ul style="list-style-type: none"> • Diversify sectoral composition of the private sector (PRSP Table 6.2). • Increase export volume from 30% of GDP in 2003 to 32% in 2009 (PRSP Table 6.1). 	<ul style="list-style-type: none"> a) Public institutions lack motivated staff and transparent procedures; governance is weak; judicial system does not reliably enforce decisions. b) Financial services under-developed, with sluggish credit growth, high interest rate spreads, unreliable debt recovery, and weak corporate governance of the banking sector. c) High cost and unreliable infrastructure, especially telecommunications. 	<ul style="list-style-type: none"> a) Government agencies provide better services, measured by: (i) improvement in business perceptions of government policies; (ii) improvement in business perceptions of crime and corruption as obstacles to company growth; and (iii) improvement in court users' satisfaction with judicial performance and services. b) Financial system intermediates an increasing volume of investment capital. Measured by the loans/GDP ratio increasing from 6% in 2003 c) Communications infrastructure less of a constraint to private sector development. Measured by increase in telecom licenses issued; other indicators tbd at CAS mid-term.
Goal Two: Make Growth More Pro-Poor		
Long-term country goals	Principal Problems	Outcomes that IDA will influence in CAS period
<p>A larger share of the population benefits from economic growth and the vulnerable are adequately protected.</p>	<ul style="list-style-type: none"> a) Slow growth in formal sector employment b) Stagnant rural economy. c) Administration of social protection transfers could be improved. d) Poverty is pervasive, despite strong economic growth. 	<ul style="list-style-type: none"> a) Reduction in share of informal economy. b) Rural economy more productive. Measured by increase in value-added per hectare from US\$1,370 in 2003. c) More effective social transfers. Measured by increase in user satisfaction with social protection system. d) Reduction in extreme consumption poverty from 17% in 2002.
Goal Three: Reduce Non-Income Poverty		
Long-term country goals	Principal Problems	Outcomes that IDA will influence in CAS period
<p>Population has adequate access to basic services (health, education, water, wastewater treatment, heat, transport)</p>	<ul style="list-style-type: none"> a) Education, particularly at secondary levels, of poor quality. b) Financing of the healthcare system skewed towards the better off. c) Poor financial condition of utilities, constraining infrastructure investments and service improvements. 	<ul style="list-style-type: none"> a) More children stay in the education system. Measured by increase in net secondary enrollment rates from 0.61 in 2001. b) More of the population has access to healthcare system. Measured by share of those who are sick and who use healthcare services rising in bottom consumption quintile from 22% in 2001, and in the total rural population from 26%. c) Population has better access to basic infrastructure services. Measured by share of population connected to piped water with 24 hour a day service increasing from 22% in 2003.

6.1 Goal One: Promote private sector led economic growth

35. **Long-term strategic goal.** The Government regards the private sector as the main driver of the economic growth needed for employment creation and poverty reduction. The CAS aims to help improve the environment for private sector growth, with an emphasis on facilitating economic diversification (both in terms of the number of sectors and the number of enterprises).

36. **Principal constraints.** Although the business climate has improved greatly in the past few years, three areas will require continued close attention over the CAS period:

(a) **A weak public sector constrains private sector entrepreneurship.** Despite the improvements in the business climate, interactions with the public sector can often be a time-consuming and unproductive burden on enterprises. Surveys indicate that business perceptions of public sector performance worsened somewhat between 2001 and 2003. Public agencies at central and local levels tend to lack motivated staff and transparent procedures. Fiscal revenues are low and budget systems, while improved, need to become more efficient and transparent. Furthermore, public procurement remains opaque to potential bidders. The judicial system is not yet completely independent, suffers from long backlogs, does not reliably enforce its decisions, and has outdated procedures to manage courtrooms and integrate new legislation. Petty corruption is commonplace, corporate accounting standards vary considerably, and some sectors of the economy are dominated by powerful businesses with close links to the Government, which restricts competition and raises prices.

(b) **The financial sector remains underdeveloped.** Armenia has made progress in consolidating its banks (which dominate the financial sector) mainly through increases in minimum capital requirements. Banking assets, deposits and credit have increased somewhat, but the banking system remains small compared to the size of the economy, and still suffers from low public confidence. The sector suffers from inefficiencies, weak corporate governance, and poorly developed mechanisms for enforcing secured transactions, including a difficult debt recovery process. The insurance sector, even in comparison with other CIS countries, remains small and other financial services, such as credit bureaus and mortgages, are not available.

(c) **The high cost and/or unreliability of key infrastructure hinder growth.** While much of Armenia's highway system is in good condition, many rural roads have not been maintained. This restricts farmers' ability to market their crops and stifles the off-farm rural economy. In addition, Armenia's restricted borders with Turkey and Azerbaijan have increased the costs of external trade. However, the area where Armenia is at the largest comparative disadvantage is telecommunications. A long-term monopoly license to ArmenTel has contributed to high cost and low quality telecommunications, with restricted coverage in rural areas and a limited range of services (corporate networks and internet access are particularly problematic).

37. **Results achievable in CAS period.** The CAS proposes a range of interventions to help the Government overcome these constraints, with the degree of success measured by progress towards the results identified below:

(a) **Government agencies provide better services.** Improvements in the performance of public sector agencies will be measured by whether and at what rate business perceptions of

government policies and corruption improve (from a base of 2.98 and 2.84, respectively, in 2003 on a 4-point scale where 1 indicates no obstacle). Improvements in the judicial system will be measured by an increase in court users' satisfaction with judicial performance and services. Several intermediate indicators are essential to achieving an improvement of this score (see the Results Matrix, Annex 1). The current portfolio contributes to these results through the FY04 Public Sector Reform Credit, which tackles civil service reform, public procurement, e-government, and local government reform. Results relating to the judicial system will be achieved through the FY01 Judicial Reform Project. Future lending, advisory and analytical activities will also contribute. The series of PRSCs and the PRSC Technical Assistance credit¹⁰, are likely to tackle tax reform, increased transparency of the budget process at central and local levels, and application of accounting standards amongst other things. An FY07 Public Sector Project in the High Case would address a broad range of problems and thus contribute to further achievement of these and related results. In the AAA program, the follow-up to the Country Financial Accountability Assessment will help resolve budget and auditing issues; financial sector advisory services will help improve corporate governance, as will IDFs on public procurement and competition policy. WBI's planned capacity-building program for local governments and training for civil servants will complement the efforts of the Public Sector Reform Credit. The Programmatic Public Expenditure Reviews, and the Country Economic Memorandum, will help diagnose problems and monitor outcomes, and the regular business surveys will help monitor results.

- (b) **The financial system intermediates an increasing share of investment capital**, as measured by the loans to GDP ratio increasing from 6% in 2003. IDA will influence this result by supporting improvements in banking regulation and banking supervision, supporting development and modernization of the financial infrastructure including the payments system and credit information bureaus. It will also support efforts to develop the non-bank financial sector and the overall business environment, such as improving creditors' rights. IDA's will provide this support through advisory services and analytical work (such as the Financial Sector Advisory Notes and the CEM on pro-poor growth) carefully sequenced with programmatic support to reforms through the series of PRSCs. These new initiatives will leverage reforms supported by the recently completed SAC V and on-going advisory and capacity building activities. IDA will also support anti-money laundering and combating the financing of terrorism by helping the Government adopt comprehensive legislation, establish a Financial Intelligence Unit, and train government and financial institution officials.
- (c) **Communications infrastructure is less of a constraint to private sector development.** Progress in removing infrastructure bottlenecks will be measured by the increase (from a current baseline of 1) in the number of telecoms licenses issued in the CAS period, and by indicators relating to transport, which will be developed during the CAS period. Ongoing work to address these issues includes the FY00 Transport Project; PPIAF grants to strengthen the multi-sector utility regulator and to assess telecommunications in rural areas; and a regional study on rural infrastructure. The proposed portfolio includes PRSC support for the telecoms sector, a renewable energy project, a third Social Investment Fund, and an FY07 Infrastructure Project.

¹⁰ The Government intends to mobilize grant resources to fund technical assistance for key elements of the reform agenda to be supported by the PRSCs. Depending on the extent of the grant support, the PRSC TA credit may be reduced or even dropped.

6.2 Goal Two: Make growth more pro-poor

38. **Long-term strategic goal.** The PRSP puts a major emphasis on ensuring that a larger share of the population benefits from economic growth. The CAS program accordingly has a focus on helping make the benefits of growth more widely available by improving formal sector jobs and stimulating the rural economy. For those who are not yet able to share in these benefits, the CAS focuses on improving social protection.

39. **Principal constraints.** Three obstacles to ensuring that the poor benefit more from Armenia's rapid economic growth will require close attention during the CAS period.

- (a) **Job creation has been sluggish and the informal sector is large.** The economy is not creating enough formal sector jobs, because firms appear to have expanded by exploiting under-utilized capital rather than increasing employment, and because governance problems help sustain a high informal economy. Furthermore, labor skills are not always a good match for the jobs that are available (see Section 6.3 below). These structural problems are in themselves a major obstacle to fostering pro-poor growth, but even where there is a potential match between a job vacancy and an appropriately qualified person, deficiencies in the information systems available to employers and job seekers often prevent the match actually being made. Very few agencies effectively link employers with potential employees.
- (b) **Rural livelihoods have stagnated.** Although there are some dynamic developments in agriculture overall, the livelihoods of the rural poor have stagnated over the past few years. Agriculture supports around 25% of the country's population, having absorbed the bulk of labor displaced by the economic contraction of the 1990s. Production, however, remains mostly at subsistence levels, with farmers relying on barter much more than cash transactions to dispose of the small surpluses they do produce. Most farming is low intensity (both capital and labor), so underemployment in rural areas is pervasive. Some areas of the country are simply not viable for agriculture over the long term, but, even in the fertile areas, there is limited farm specialization and intensification. Market infrastructure is lacking (road conditions are poor, there are no wholesale markets, and few cold or dry stores); marketing institutions are underdeveloped; and machinery and input supplies are poorly organized. Land holdings are small, and, as land markets have recently been established, consolidation is only just beginning. Farmers will need additional support to improve management of irrigation systems, and agriculture remains vulnerable to natural disasters. Although a growing number of successful agro-processing enterprises have emerged, and tourism is developing in some parts of the country, most rural areas provide few opportunities for work outside agriculture.
- (c) **The social protection system could be more efficient.** Social protection has improved markedly in the past few years, with most benefits now well targeted and no arrears in payments to beneficiaries – indeed the 2001 Household Survey showed that transfers accounted for 15% of the income of the poorest quintile. Nonetheless further improvements in efficiency and effectiveness could produce marked benefits for the poorest: administration of many benefits needs to be more efficient to reduce waste and delays; the poverty benefit needs to reach more of the poor, particularly in rural areas; knowledge of the benefit system and clarity about its rules need to improve so more eligible beneficiaries register; and the level

of pensions needs to be increased, since average pensions have fallen relative to average wages from 33% in 1996 to 21% in 2003.¹¹

40. **Results achievable in CAS period.** The CAS proposes to help the Government overcome these constraints through an integrated series of analytical work, capacity building, programmatic and investment lending designed to achieve the following measurable results:

- (a) **The importance of the informal sector in the economy declines.** According to the PRSP, the informal sector accounts for an estimated 45% of the total economy, and the goal is for this to fall over the CAS period. As formal sector employment grows, people will move away from informal sector jobs, gaining legal status, benefits, job security. The change will also benefit Armenia's investment climate and fiscal revenues. The current portfolio contributes to this goal through the FY04 Public Sector Reform Credit and the FY01 Judicial Reform Credit, coordinated with capacity building work on anti-corruption and procurement as well as advisory work to improve corporate governance. In the future portfolio, the PRSCs and PRSC TA will influence this objective, as will the Country Economic Memorandum, the Programmatic Poverty Assessments, the Programmatic Public Expenditure Reviews and the Labor Market Study. The FY04 Social Protection Administration Project will help strengthen the regional employment agencies, which link applicants and potential employers.
- (b) **The rural economy is more productive.** Since a viable agricultural sector is key to a dynamic off-farm economy, the indicator of a more productive rural sector will be an increase of value-added per hectare from US\$1,370 in 2003. On-going work towards this outcome includes the FY98 Agricultural Reform Support Credit, the FY99 Title Registration Project, the FY99 Irrigation Dam Safety, and the FY02 Irrigation Development project, as well as studies on rural productivity and on rural infrastructure. The FY04 Health and Education projects are addressing the quality of rural services, and the Trans Caucasus Tourism Initiative is helping promote the off-farm economy in select rural areas. Proposed new interventions include the FY05 Rural Development Project, with a second rural operation in FY08. The FY08 Project could include substantial support for irrigation and/or for land titling work, and its scope will be clarified in the CAS Progress Report. Advisory support to the telecoms sector will help improve services in rural areas, and the FY07 Infrastructure Project is likely to improve key rural infrastructure, including roads.
- (c) **Social transfers are more effective.** The effectiveness of social transfers will be measured by improvement in the satisfaction of users with the social protection system from a baseline to be determined. A prerequisite for improvements in this measure will be better tax collection so that more funds are available for transfers, including the family poverty benefit. The FY04 Social Protection Administration Project is the primary tool to affect this result. The proposed PRSCs and PRSC TA, as well as a WBI program to support pensions administration will support these objectives, and analytical work in the Programmatic Public Expenditure Reviews, the Country Economic Memorandum and Programmatic Poverty Assessments will also help achieve the goal.

¹¹ In contrast, the average notional pension as a share of average wages was 25% in Georgia, 32% in Azerbaijan and 37% in Russia.

- (d) **Extreme consumption poverty falls.** The goal is for extreme consumption poverty to decline from 17% in 2002. Many interventions in the on-going and future portfolios contribute to this goal. Because it is not yet clear why economic growth has not led to deeper reductions in poverty, analytical work to address this issue (the Labor Market Study, the CEM on pro-poor growth and the Programmatic Poverty Assessments) will be a major element of the CAS work program. Additional results and measures may be developed in the CAS Progress Report in the light of the conclusions of those studies. The PRSCs and PRSC TA will be major IDA vehicles for influencing these results, but many on-going and future interventions will also contribute.

6.3 Goal Three: Reduce non-income poverty

41. **Long-term strategic goal.** The PRSP and this CAS focus on the need to increase the well-being of the poor by improving their access to affordable healthcare, education, drinking water, sanitation and heating.

42. **Principal problems.** Although essential reforms in healthcare, education and infrastructure have begun, and basic services in some parts of the country have improved significantly, they still do not come close to meeting the needs of a rapidly growing and modernizing economy.

- (a) **Poor quality education.** The education system does not meet the country's new needs. Armenia's public expenditures on education are very low (among the lowest in the FSU), and available resources are not used efficiently -- for example the school system has not adapted to the decline in Armenia's population since independence, resulting in an excessively high teacher/pupil ratio. Furthermore, the school curriculum is not properly equipping children for the labor market, since the curriculum has not yet been fully revised to meet the needs of a market economy. Facilities are inadequate and teachers are not properly skilled or motivated.
- (b) **Unaffordable health care.** The healthcare system does not generally provide affordable services, nor are they of adequate quality. Public expenditures on healthcare are low and poorly targeted, with the excessively large hospital network absorbing more than half of public health expenditures. As a consequence primary health care is starved of funds, with unofficial side-payments large and frequent (half of all households using healthcare services report making unofficial payments). The need for such unofficial payments is an important reason that only 22% of the poor report using the healthcare system when they are sick. Staff are not properly skilled or motivated, school buildings have been inadequately maintained, and much of the equipment is outdated.
- (c) **Lack of investment in infrastructure.** The poor financial condition of many of the country's utilities has precluded adequate investment in infrastructure. Few people have 24-hour supply of drinking water, and even fewer have adequate wastewater services. An increasing number of water supply pipelines fail to comply with sanitary standards, leading to emerging outbreaks of water-borne diseases. Since 2002, Yerevan has seen improvements in water availability and quality, but further improvements are required. Other parts of Armenia have seen almost no progress. Performance of the electricity utilities has improved substantially, with collections rising and tariffs increasing. These higher tariffs may make it difficult for some of the poorest consumers to afford these services. Many Armenians suffer during the

harsh winters, since it is difficult for them to heat their houses adequately. People are forced to use inefficient and expensive electricity, or wood, which is scarce in Armenia. The poor are particularly likely to burn wood, often in apartment buildings without proper stoves and chimneys, which causes health problems. Transport is a major constraint in rural areas, leading to difficulties gaining access to agricultural and labor markets, as well as to health facilities and schools, particularly in winter. Furthermore, problems with vehicle licensing and road safety lead to unduly high numbers of traffic deaths.

43. **Results achievable in CAS period.** The CAS proposes to help overcome these constraints through an integrated series of interventions designed to achieve the following measurable results:

- (a) **More children stay in the education system.** This would be measured by an increase in the net secondary enrollment rate from 0.61.¹² The FY04 Education Quality and Relevance Credit is the primary vehicle to influence this indicator in IDA's current portfolio. Activities in the future, such as the PRSCs and PRSC TA will also contribute. The proposed Social Investment Fund III will rehabilitate some school buildings, and the proposed urban heating project will help modernize heating systems in selected schools. The programmatic Public Expenditure Reviews (PERs) will identify relevant issues and propose solutions.
- (b) **More of the population uses healthcare services.** Better access to healthcare will be measured by an increase in the share of the sick who use healthcare services, from 22% for the bottom consumption quintile, and from 26% in 2001 in the entire rural population. The FY04 Health System Modernization Project will contribute to improvements in this indicator backed up by the proposed PRSCs and PRSC TA. Public health will also benefit from other proposed interventions: the FY05 Yerevan Water and Sanitation Project, the FY06 Urban Heating Project, and, if it improves transport in remote areas, the FY07 Infrastructure Project should improve access to healthcare facilities. The programmatic PERs will identify issues and propose solutions relating to healthcare spending.
- (c) **The population has better access to basic infrastructure.** This will be measured by the share of the population connected to 24-hour piped water increasing from 22% in 2003, and by the share of households with gas-based heating systems increasing by 20% from a baseline to be determined. In the on-going portfolio, the FY98 Municipal Development and FY04 Armenia Water projects will contribute to improving drinking water services, and a PPIAF grant is supporting the multi-utility regulator. Proposed new interventions include the FY06 Urban Heating, the FY05 Yerevan Water and Wastewater, and the FY07 Infrastructure Projects.¹³ A poverty and social impact assessment, associated with the PRSCs, will assess the impacts on the poor of utility tariff increases, and suggest potential mitigation mechanisms. In addition, IDA will work with the Government to seek co-financing for work on road safety and vehicle licensing.

¹² Source: Education, Poverty and Economic Activity Survey, 2001

¹³ Given that diaspora donors and the US-funded Millennium Challenge Account are likely to provide substantial resources for infrastructure, the scope of the FY07 Infrastructure Project and potential support for road safety will be determined once spending plans for those expected resources have been finalized.

6.4 Resource Levels and Triggers

44. Since the early 1990s, Armenia has benefited from a high level of international assistance. Over the last five years, official donor assistance and remittances represented 11% of GDP, with bilateral donors accounting for about 60% of this assistance. Of the remaining 40% of aid provided by multilateral donors, IDA provided about two-thirds, and the European Union a fifth.¹⁴ Substantial unofficial assistance has also been available, mainly from diaspora sources. One US-based foundation has been particularly prominent, providing support averaging 6% of GDP for the last three years.¹⁵

45. It is not yet clear whether high levels of donor assistance from existing sources will continue over the CAS period. However, Armenia will have access to a new source of investment finance -- the Millennium Challenge Account -- being established by the US Government. The CAS projections assume that Armenia will continue to enjoy strong donor support, possibly declining as the country's per capita income increases, and that IDA will remain an important source of assistance.

46. Although it is currently not creditworthy for IBRD lending, Armenia could potentially become so towards the end of the CAS period. This would require good macroeconomic performance, continued political stability, sustained progress in economic, fiscal and financial reform, improvements in the business and financial climate leading to steady private sector growth, and reduced reliance on preferred creditors to satisfy financing needs. Armenia's progress towards IBRD eligibility will be monitored over the CAS period, and an update, with specific creditworthiness benchmarks, provided at the time of the CAS Progress Report. Preparing the way for IBRD lending is particularly important given Armenia's rapidly rising per capita income, which could lead to it being given blend (of IDA and IBRD) status in the next CAS period.

47. Armenia became a High Case performer during the 2002-2004 CAS period, having achieved the highest IDA performance coefficient in the ECA region. It will enter the new CAS in a Base Case scenario for IDA support, which assumes a continuation of the existing good performance and provides IDA lending of US\$170 million. If Armenia makes further improvements in public sector management (see triggers in Table 9) it will move into the High Case, which will support accelerated reforms of the public sector through an additional Public Sector Modernization Credit, additional PRSC resources, and additional funding for rural development and infrastructure. IDA resources of about US\$220 million will become available in the High Case. In the unexpected event of deteriorating performance, a Low Case scenario would reduce IDA lending to about US\$90 million. This will involve halting new PRSC lending, and restricting new investment operations to those that directly protect the most vulnerable.

48. The triggers for moving to the High Case are based mainly on the Government's ambitious targets for social sector spending and tax collections, and improvement in the performance of public sector agencies.

¹⁴ Source: World Bank Operations Evaluation Department, Country Assistance Evaluation, March 2004, Annex A.

¹⁵ Source: International Monetary Fund, Staff Report on the Fifth Review under the Poverty Reduction and Growth Facility, March, 2004, p14.

Table 9: Armenia CAS Triggers

Policy Area	To Stay in the Base Case	Means of Verification
Private Sector / Pro-Poor Growth	Satisfactory implementation of the PRSP	Annual PRSP progress reports
Non-Income Poverty	Maintain spending on education, health, social security and social insurance at no less than 40% of total consolidated budget expenditure	Macro monitoring
Macro-Economic Management	Satisfactory macro-economic management	Macro monitoring, including IMF staff reports on the PRGF
Governance	Satisfactory implementation of the National Anti-Corruption Strategy	Regular reports of the Anti-Corruption Monitoring Group
Portfolio	Maintenance of good portfolio performance	Portfolio monitoring
Policy Area	Additional Actions to Move to the High Case	Means of Verification
Macro-Economic Management	Strong performance in improving the tax/GDP ratio	Macro monitoring
Public Sector Management	Satisfactory progress with reform of the civil service and the health and education sectors	Supervision reports from FY04 Public Sector Modernization Credit, FY04 Education Quality and Relevance Credit and FY04 Health System Modernization Project

49. Follow-on interventions to continue the reforms supported by the FY04 Health and Education programmatic credits are expected soon after the close of this CAS period. If, however, implementation of the reforms proceeds faster than expected, and the appropriate institutional and policy changes are made, it may be possible to accelerate processing of these follow-on activities

50. **CAS Progress Report.** Since this Country Assistance Strategy covers four years and focuses on the results of the overall program, it will be necessary to review progress towards those results at the mid-point of CAS implementation. This review will allow a stocktaking of Armenia's progress towards the intermediate and CAS outcomes, and refinement of those outcomes and quantitative goals. It will also allow reformulation of goals in light of changing circumstances and new information. The Progress Report will be coordinated closely with the government's PRSP monitoring process as well as with IDA's portfolio review.

6.5 Summary of Work Program

51. Table 10 below presents the proposed work program. Where the exact content and scope of an IDA-supported project are yet to be determined, a lending range is given, with a credit at the high end of the scale for one operation necessitating a lower level for one of the others. The overall focus of the FY08 Rural Development II and FY07 Infrastructure Projects has yet to be decided, and a more specific proposal will be provided at the time of the CAS Progress Report.

Table 10: Proposed Work Program

Fiscal Year	Lending	Low Case \$m ¹	Base Case \$m ¹	High Case \$m ¹	AAA
FY05	PRSC/PRSC TA ²	20-25 ³	20-25	20-25	CEM on Pro-Poor Growth
	Rural Development I	15-25	15-25	15-25	Rural Productivity
	Yerevan Water II		20	20	Programmatic Poverty Assessment Programmatic Public Expenditure Review Private/Financial Sector Services Business Survey TA Support for Donor Coordination
Total FY05		35-50	55-70	55-70	
FY06	PRSC II		20	25	Competition Policy IDF
	Social Inv. Fund III	15-25	15-25	15-25	Labor Market Dynamics
	Urban Heating	15	15	15	Programmatic Poverty Assessment Programmatic Public Expenditure Review Private/Financial Sector Services Business Survey TA Support for Donor Coordination
Total FY06		30-40	50-60	55-65	
FY07	PRSC III		20	25	Public Procurement IDF
	Renewable Energy		5	5	Programmatic Poverty Assessment
	Public Sector II		0	10-20	Programmatic PER
	Infrastructure		10-20	10-30	Private/Financial Sector Services Business Survey TA Support for Donor Coordination
Total FY07			35-45	50-80	
FY08	Rural Development II	10-15	10-20	10-30	CPAR
	PRSC IV			15	Country Environment Assessment Programmatic Poverty Assessment Programmatic Public Expenditure Review Private/Financial Sector Services Business Survey TA Support for Donor Coordination
Total FY08		10-15	10-20	25-45	
TOTAL FY05-08⁴		90	170	220	

¹ Assumes SDR1=US\$1.4

² This range includes \$5 million of funding for PRSC-related technical assistance; if sufficient grant financing is secured for this purpose, the PRSC TA could be reduced in size or even dropped (see footnote 10 on page 14).

³ A first PRSC is projected for FY05 in the Low Case on the assumption that Armenia is unlikely to drop-out of the Base Case so early in the CAS period.

⁴ Some IBRD funding may be possible towards the end of the CAS period, if Armenia becomes creditworthy.

52. A carefully sequenced program of Analytical and Advisory Work (AAA) will provide the underpinnings for lending and dialogue with the Government and civil society. The program includes three types of products:

- Freestanding studies, such as those on rural productivity and labor markets, and the Country Economic Memorandum on pro-poor growth.
- Programmatic analytical work, especially the Poverty Assessments and the Public Expenditure Reviews. Programmatic AAA will rest on a joint work-program involving IDA, Government and other donors, and be undertaken continuously to produce a series of joint, related products rather than one discrete report. This is a new form of partnership, which will be employed during this CAS period, with the goal of encouraging a steady building of consensus over the AAA's conclusions, promoting broad ownership of the recommendations and strengthening analytical capacity in government agencies.
- Advisory work, such as a series of discussion notes on improving the institutional, legal and bureaucratic environment for the private and financial sectors. Further support for the Business Survey would allow continued monitoring of progress in improving the environment for the private sector.

6.6 Specific Issues

6.6.1 The PRSCs

53. The program includes a sequence of three to four Poverty Reduction Strategy Credits (PRSCs) for FY05, 06 and 07 (and a fourth in FY08 in the High Case). These will support the PRSP objectives, and link closely with the IMF's Poverty Reduction and Growth Facilities. The PRSCs are likely to have three areas of focus, with indicative content as follows:

- **Improving the environment for private sector growth:**
 - Governance, including anti-corruption policies and their implementation; making licensing, permitting and certification procedures more transparent; empowering citizens to be active in making institutions accountable; improvements in the judiciary system; and strengthening government capacity to enforce environmental protection legislation.
 - Financial sector reforms, including payment system infrastructure; development of the insurance sector; improving corporate governance of banks; improving court proceedings for debt recovery; enforcement of bankruptcy legislation; and possibly development of a housing finance market.
 - Standards, metrology and consumer protection as well as improving legislation and enforcement of intellectual property rights.
- **Improving public sector financial management:**
 - Tax collection, including an annual increase in tax collection of 0.4 percentage points of GDP during the CAS period, to be achieved in part through much improved administration of VAT, personal income and payroll taxes, and, most importantly, customs.
 - Greater budget accountability including increased transparency of the budgeting process at central and local levels; line ministry accountability for budget outcomes; increased use of

internal and external audits; and a consolidated system of financial reporting by state enterprises, including public sector entities in education and health.

- More strategic approach to budgeting, including introduction of stronger links between the annual budgets, the MTEF and the PRSP.
- **Addressing priority social sector issues:**
 - A steady increase in expenditure and/or efficiency of spending on education, health and social security following targets set in the PRSP.

6.6.2 Cross-cutting themes

54. The CAS will place major emphasis on **learning and capacity building**. Given Armenia's good track record making effective use of IDA resources, this CAS puts significant emphasis on programmatic work, conducted collaboratively between IDA, Government and other donors continuously over the course of CAS implementation. Complementing IDA's planned activities, the World Bank Institute (WBI) has developed a comprehensive work plan for additional capacity enhancement support (see paragraph 64 and Annex 3). The Institute will work with local partners and NGOs to leverage their local knowledge and improve cost-effectiveness.

55. Armenia's **capacity for poverty monitoring and analysis** is reasonably good, as the National Statistical Service (NSS) has conducted regular household surveys for a number of years. Improvements could be made in a number of areas: (i) strengthening the linkages between different household surveys; (ii) improving the measure of household welfare by adjusting for regional prices and economies of scale within households; (iii) updating questionnaires to reflect current policies (e.g. on social assistance) and provide better information (e.g. on employment and earnings); (iv) developing poverty maps as a policy tool; and (v) improving monitoring of non-income dimensions of poverty, particularly health, education and labor markets. The PRSP follow-up process is helping the Government improve its capacity for monitoring and evaluation of development **results**, and helping the Statistical Service better tailor its data for the needs of policy evaluation. UNDP, in coordination with IDA, has a program to further develop that capacity.

56. **Gender** is integrated into many areas of the work program. The Programmatic Poverty Assessments will disaggregate all relevant data by gender. One of the most important gender issues in Armenia is **maternal health**, since the country has relatively high rates of maternal mortality and abortion; the FY04 Health project addresses both of these problems directly. Some issues, such as why so many boys drop out of secondary school, will be addressed under the FY04 Education Project. The proposed Labor Market Study will pay particular attention to differences in how men and women fare in the labor market, and the business survey may include a module to address the specific issues faced by women entrepreneurs.

57. **Environmental issues** are also well mainstreamed in the program. In addition to on-going work on natural resource management, and a proposed Country Environmental Assessment, many interventions will improve environmental conditions. The Renewable Energy Project aims to reduce Armenia's dependence on imported fossil fuels, and plans to leverage grant funding from GEF, the Prototype Carbon Fund and related instruments, as well as possibly from the EBRD, USAID and others. Other instruments likely to have a positive environmental impact include: the Urban Heating

project, which should reduce demand for fuelwood for heating; the Rural Development Project, which will assess the options for sustainable forestry, natural resource based income generation activities and for reducing Armenia's vulnerability to many natural disasters. The water supply and sanitation projects, together with any additional investment in irrigation (through the FY08 Rural Development II or FY07 Infrastructure projects) will improve water resource management in line with guidance provided by the Water Resource Plan prepared during the last CAS period.

58. **Labor Standards.** Armenia has a good record on core labor standards, including: (i) elimination of all forms of forced or compulsory labor; (ii) effective abolition of formal use of child labor; (iii) equal opportunity and non-discrimination in employment; and (iv) freedom of association and the right to collective bargaining. Laws regulating trade unions and collective bargaining have substantially met the core labor standard goals, and the Confederation of Trade Unions of Armenia has negotiated agreements on job security, salaries, pensions, and social assistance. Binding contracts between workers (with representation from grass-roots union organizations) and employers are common in large enterprises, but have not yet taken firm root in smaller enterprises. The Government of Armenia does not yet comply with the minimum standards for the elimination of trafficking in persons, but in 2003 it acknowledged the need for increased action, and focused more law enforcement resources on the problem.

6.6.3 Sequencing

59. The CAS Completion Report (Annex 2) and OED's Country Assistance Evaluation (SecM2004-0090) both emphasize that appropriate sequencing between analytical work and investment/adjustment operations was an important factor in achieving successful outcomes. This CAS endeavors to continue that careful sequencing as follows:

- The programmatic poverty assessments and PERs, the CEM, advisory work on the financial and private sectors, and the business environment surveys will feed into the PRSCs. Grants from the Institutional Development Fund to support procurement and financial accountability link to related analytical work to form the basis for PRSC measures in those areas. The labor market study and CEM on pro-poor growth will provide analytical input into PRSC initiatives to help make growth more pro-poor. The Country Environmental Assessment will complement PRSC work on enforcement of environmental legislation.
- ESW on rural productivity and on rural infrastructure are being undertaken ahead of design of the FY05 Rural Development Project, so that the operation can build on a sound analytical footing, and benefit from strong government ownership of the measures to be supported. The Rural Development Project will also benefit from practical lessons from the agricultural, land cadastre, irrigation and natural resource management projects currently underway.
- The public sector project (High Case) will build on experience of several projects currently under implementation, IDF grants relating to public procurement, and WBI capacity building efforts.
- The IDF to strengthen the multi-utility regulator will feed into PRSC work on telecoms, the ongoing and future investment projects for drinking water as well as the planned FY07 Renewable Energy and Infrastructure Projects.

6.7 Other World Bank Group Support

60. The **International Finance Corporation (IFC)**. IFC's held portfolio in Armenia as of April 1, 2004 amounted to US\$7.09 million. IFC made its first investment in Armenia in March 2001, a US\$3.57 million quasi-equity investment for the renovation of Hotel Armenia, and in August 2003, participated in a capital increase by investing an additional US\$1.25 million.

61. IFC's strategy in Armenia focuses on the development of small and medium sized enterprises (SMEs). In FY03, the Corporation supported the development of the first privately-owned leasing company in Armenia by providing US\$2.27 million in loan and equity finance to ACBA Leasing. It has also approved the SME Risk Capital Fund (US\$5 million in equity and quasi-equity), which is pending commitment. IFC's first investment in an Armenian bank, Armeconombank, is pending circulation to the Board. It involves a \$2 million loan for on-lending to SMEs and for residential mortgages, and includes an option to purchase equity.

62. The Corporation continues to actively explore further opportunities. It will continue to focus its efforts on financial intermediaries that can reach SMEs through a combination of investment and tailored advisory work. In line with the World Bank Group's strategy for the financial sector, IFC will consider support to development of housing finance and possibly insurance markets. IFC will continue to seek opportunities for small direct investments in export-oriented enterprises and high-impact projects in sectors where Armenia may have a comparative advantage, including the manufacturing, agribusiness, technology and mining sectors.

63. Armenia has been a member of the **Multilateral Investment Guarantee Agency (MIGA)** since 1995. Over that period, MIGA guarantees have facilitated approximately US\$3.0 million of FDI into Armenia, through a project in the financial services sector. In 2000, a \$2.7 million guarantee was issued to the Commercial Bank of Greece for its equity investment in the establishment of a subsidiary branch, International Commercial Black Sea Bank (Armenia) S.A., which will operate as a wholesale bank, focusing its activities in the areas of project finance, trade finance, advisory work and privatization of local companies. MIGA has also played a central role with the World Bank in implementing a loan, which finances a \$1 million capacity-building program for the Government's FDI and trade arm -- the Armenian Development Agency (ADA). In addition to direct support, MIGA also provides online information services that connect investors to current information on investment opportunities, business operating conditions, potential partners, and other resources, which currently contain over 90 documents relating to Armenia. Over this CAS period, MIGA will continue to respond to market demand in Armenia.

64. The **World Bank Institute (WBI)** has developed a detailed program to support CAS objectives (see Annex 3). WBI will build knowledge and capacity relating to fiscal decentralization, pension reform, utilities regulation, anti-corruption and training of civil servants. It will also facilitate Armenian delegates participating periodically in regional initiatives that cover decentralization, pension reforms and PRSP implementation.

65. Other services related to the World Bank Group are also active in Armenia, providing support relating to private sector development. The **Foreign Investment Advisory Service (FIAS)** is a joint service of the IFC and the World Bank. It has supported annual administrative and regulatory cost

surveys, as well as provided expert review of key legislation. It is working with the Government to build its capacity to conduct such studies in the future. In the future, FIAS is planning to continue this support in the areas of administrative barriers to investment and competition policy. The **Public-Private Infrastructure Advisory Facility (PIIAF)** is a multi-donor technical assistance facility that aims to promote best practices on issues related to private sector involvement in infrastructure in developing countries. It plans to continue its current support for support for the multi-sector regulator and for development of telecommunications services in rural areas.

66. Armenia is also eligible for support under two funds established by the World Bank that provide grant finance to help reduce global carbon emissions: the **Community Development Carbon Fund** and the **BioCarbon Fund**. The first finances small-scale projects that benefit local communities as they abate carbon emissions, while the second finances eligible afforestation and reforestation projects. The FY07 Renewable Energy Project has already been identified as having potential for carbon fund financing. Other opportunities will be explored during CAS implementation, particularly relating to sustainable forestry, land management, transport and waste management.

6.8 Partnerships

67. A large number of donors have extensive programs in Armenia, requiring active management and coordination. The Government's role in managing and coordinating donors has weakened since the late 1990s, when the office in the Ministry of Finance and Economy designated to monitor donor activities began to play a less central role in the process. Since preparation and implementation of the PRSP, however, the Government has resumed a more active role. The PRSP process has helped clarify the Government's priorities, and the Ministry of Finance and Economy is increasingly using it to attract financing for priority investments and activities. UNDP and IDA are helping strengthen this function. In the last few years, independently of the Government, donors have been meeting regularly to share information, coordinate plans and programs, and reduce duplication. Fourteen sector-specific Partner Groups have been established for this purpose, and an umbrella Donor Coordination Group meets on a monthly basis in Yerevan. These meetings will continue over the next few years, but will increasingly take their lead from the Government. Annex 4 on partnerships summarizes donor programs.

68. **UNDP** supports a broad range of activities in Armenia, and works closely with IDA on many of its programs. It has a major program helping the Government develop systems to monitor development results. Another key area of focus is improving delivery of public services at central and local levels, including governance, judicial reform, local government strengthening and improvement of social protection administration. UNDP also promotes support infrastructure for small and medium sized enterprises. In rural areas, it has a program to promote agro-based employment opportunities and agricultural services, as well as helping protect Armenia's biodiversity. UNDP programs help rehabilitate community infrastructure, build capacity for monitoring quality of drinking water, and improve energy efficiency. In the area of healthcare, UNDP concentrates on improving access to HIV/AIDS prevention and treatment, and on helping communities and healthcare professionals get involved in the policy-making process.

69. **EBRD** concentrates on private sector development through a line of credit for SMEs, a Business Advisory Program, and trade facilitation. It may cooperate with IDA and GEF on the FY07 Renewable Energy Project.

70. **UNICEF** has important programs dealing with several aspects of child welfare. It is helping the Government develop effective mechanisms for registering births and infant deaths. It has programs to improve administration of juvenile justice; to establish local organizations responsible for child protection; to help youths who have been in orphanages and similar institutions integrate into society; and to promote policies relating to children and families at risk. In the education sector, UNICEF is helping build capacity, improve learning materials, and make education more inclusive (including special education). For healthcare, UNICEF is providing basic supplies to health posts, as well as promoting early intervention and early identification of childhood disability.

71. **USAID** has a large program that focuses primarily on public sector management and private sector development. To improve central Government functions, USAID has a major program to improve tax and customs administration, and is also helping to: strengthen the Armenian bar and judiciary; improve public sector accounting; improve the transparency of national accounts, and strengthen the payment and accounting systems for healthcare. It also supports activities at the local government level, particularly to make local authorities more accessible to their citizens. USAID has a major program to improve social assistance and social insurance. In healthcare, USAID is working to refocus health services on family medicine and reproductive health, as well as providing equipment and pharmaceutical supply. USAID has a community works program to rehabilitate community infrastructure and a school heating program, and is promoting environmental protection in Armenia through a program to improve energy efficiency, helping develop renewable energy and supporting water resources management. USAID is helping Armenia's private sector development improving access to finance and improving the capacity of medium sized enterprises and is currently designing a program of additional support to private enterprise. The **US Department of Agriculture** is also active in rural Armenia, supporting extension and outreach to farmers, micro credit, support for agro-processing. In each of these areas, IDA is coordinating closely with USAID and USDA.

72. **The European Union (EU)** has a broad range of activities in Armenia. It provides financial assistance for macro-economic management, as well as technical assistance to improve public administration, particularly tax and customs administration, and has detailed programs to help improve local government in two marzes (counties). The EU has a private sector development program. It also plays a major role in rural development through a food security program, and support to the Ministry of Agriculture and the State Cadastre. Vocational education and training is an important area of EU focus, as is promoting use of technology in education. To improve environmental conditions, the EU is helping to: develop hydropower; improve management of municipal solid waste; disseminate environmental information; and establish regional environmental centers.

73. **DFID** focuses on major programs on public sector reform and on integrated regional development in two marzes. It has supported both the PRSP and MTEF process, including through initiatives to develop marz level poverty reduction strategies in the two poorest marzes.

74. **GTZ** concentrates on development of local governments and on promoting SMEs, including through credit lines. It also has training and education programs for vocational education, improving agricultural knowledge and training bankers. To protect the environment, GTZ is helping the

Government establish a protected area. **KfW** is, amongst other things, helping develop a local water and wastewater company, which currently operates in twelve cities and villages and serves more than 100,000 people. KfW is now beginning similar projects in other parts of the country.

75. **UNHCR** is helping the Government develop legislation adequate for the needs of refugees. This includes training the judiciary in international refugee law, systems for asylum and for acquiring citizenship. It is also supporting social service, education and health measures that benefit refugees. **IFAD** has a program to promote on- and off-farm economic activity in rural areas, and the **World Food Programme** has several food-for-work and food-for-training activities, mostly in rural and vulnerable areas. It also has a school feeding program. **FAO** is helping the Government develop a national agricultural strategy and providing technical assistance to build capacity in the Ministry of Agriculture and related organizations. It provides assistance to farmers afflicted by natural disasters, and also has a mountain areas program to help develop some of the poorest and most isolated areas of the country. In addition, **UNAIDS** and the **Global Fund** are working to prevent the spread of HIV/AIDS in Armenia.

76. The **Netherlands** has cofinanced the Structural Adjustment Credits, adding significantly to their impact through support totaling US\$44 million to date. The Netherlands has assisted with the PRSP process through Trust Fund financing executed by the World Bank. The Netherlands has also worked with IFC to support corporate governance reform, providing training to 80 percent of Armenia's active corporations.

77. **Japan** has co-financed with IDA the Electricity Transmission and Distribution Project through a credit from the Overseas Economic Cooperation Fund (now part of the Japan Bank for International Cooperation). Japan has also supported, through grants from the Ministry of Foreign Affairs, road maintenance and cultural preservation. The Japan-funded, World Bank-executed, Policy and Human Resources Development Fund (PHRD) grant program has provided support for structural adjustment, rural development and utility restructuring.

6.9 Risks of the strategy

78. The situation in and around Armenia could change in a number of ways that would affect development in the country both for better and for worse.

- i. **Political change in the Caucasus region.** Both positive and negative developments in the region are possible over the CAS period. IDA's FY05 Country Economic Memorandum will analyze how Armenia can best prepare itself for possible improvements, including investments that would allow the economy to reap the fullest benefits from developments such as a normalization of trade relations. Although it is not considered likely at this time, renewed instability in the Caucasus is possible, and it would make implementation of much of the proposed strategy difficult. In this event, significant adjustments in the work program would be unavoidable, and the Executive Directors would be consulted on a revised strategy.
- ii. **Political consensus in Armenia.** Armenia's very impressive reform track record has depended on strong political consensus, both within and between the executive and legislative branches. As discussed earlier, the domestic political context is becoming more complicated, and this could affect reform momentum by reducing public, investor and/or donor confidence.

A deceleration in improvements in tax revenues and/or slower economic growth could increase the financing gap to the extent that expected levels of IDA adjustment lending and donor funding could not cover it. The CAS program aims to mitigate this risk by outreach and knowledge activities, and encouraging active participation and dialogue with Government and civil society around the PRSP process generally, and on a range of specific reform priorities, including health and education revitalization, local government development, strengthening of governance and anti-corruption efforts, and improvements in social protection arrangements.

- iii. **Exogenous economic shocks.** Any decline in global demand would likely hamper Armenia's export growth and reduce workers' remittances and perhaps diaspora assistance. An oil price shock would also affect the Armenian economy – every \$5 increase in the price of a barrel of oil increases Armenia's import bill by the equivalent of 1 percent of GDP. If exogenous shocks cause a major shift in Armenia's economic situation, IDA would revisit the prioritization of its lending and AAA and amend the portfolio as necessary.
- iv. **Unexpected natural resource shock,** such as an earthquake, major drought, flood, landslide, or frost. IDA is helping the Government reduce Armenia's vulnerability to natural disasters through the various ongoing and planned rural and natural resource management interventions, by ensuring that major construction financed by the Bank complies with earthquake-compatible building codes, and through a dam safety program that reinforces the country's important barrages.

Annex 1: Country Assistance Strategy Results Matrix

Goal One: Promote private sector led economic growth				
Long-term country goals	Issues that hinder Armenia's ability to achieve its long-term goals	Outcomes that IDA expects to influence in CAS period	Intermediate indicators	IDA program to support Government
<p>Private sector grows and becomes more diverse.</p> <ul style="list-style-type: none"> * Increase export volume from 30% of GDP in 2003 to 32% by 2009 (PRSP table 6.1) * Diversify sectoral composition of private sector (Table 6.2 of PRSP). 	<ul style="list-style-type: none"> (i) Public sector institutions lack motivated staff and transparent procedures; governance is weak and the judicial system does not reliably enforce its decisions. (ii) Financial services are underdeveloped. (iii) High costs and unreliability of key infrastructure deters business expansion. (iv) Growth comes at unnecessarily high cost to the environment. 	<ul style="list-style-type: none"> (i) Government agencies provide better services. (ii) Financial system intermediates an increasing share of investment capital. (iii) Communications infrastructure less of a constraint to development. (iv) Growth based on more sustainable use of natural resources. <p><i>Detailed measures of each outcome are included in the sections below</i></p>	<p><i>See detailed indicators for each section below</i></p>	<p><i>See below</i></p>
<p>(i) Public sector agencies serve population efficiently; governance improves; judicial system enforces laws and contracts fairly.</p> <ul style="list-style-type: none"> * Levels of informal payments for public services decline. * Shadow economy falls from estimated. 45% in 2003. * Companies listed on the stock exchange apply international 	<ul style="list-style-type: none"> * Government agencies at central and local levels lack motivated staff and efficient systems. * Public procurement system lacks transparency. Rate of single source contracts is too high, and companies do not perceive decision-making processes on awards of contracts as predictable and open. * Budget system still has problems, especially for budget classification, expenditure rationalization and reallocation, budget formulation, and financial reporting of noncommercial enterprises. * Variable accounting and reporting practices * A small number of powerful players retain control of certain 	<p>Government agencies provide better services</p> <ul style="list-style-type: none"> * Gradual improvement in business perceptions of government policies (2.98 in 2003 on a 4-point scale, where 1=no obstacle) * Gradual improvement in citizens' perceptions of quality of local service delivery (baseline tbd in Public Sector Modernization Project). * Gradual improvement in business perceptions of crime and corruption as obstacles to company growth (2.84 in 2003 on a 4 point scale). * Court users more satisfied with judicial performance and 	<ul style="list-style-type: none"> * Tax revenues/GDP increase (Targets in PRSP Table 6.1) * Criteria for evaluating the performance of civil servants published and applied. * Register of land and property transferred to local governments and updated by end 2006 * Law on municipal civil service passed and applied by end 2006 * Corporate governance procedures relating to managers' and owners' responsibilities introduced * Judicial enforcement services using automated case 	<p>On-going: Public Sector Modernization Project (04), Judicial Reform Project (01), FY02 FIEF LII; IDF grant to support anti-corruption strategy; IDF grant to build capacity for public procurement, financial sector AAA</p> <p>Proposed: PRSCs and PRSC TA to tackle tax collection, governance, public sector management. FY07 Public Sector Reform Project (High Case)</p> <p>AAA: CEM; PERs; Business Surveys; CFAA; IDF grant to support Treasury system; IDF grant on Competition Policy; WBI capacity building for local governments.</p>

Goal One: Promote private sector led economic growth

Long-term country goals	Issues that hinder Armenia's ability to achieve its long-term goals	Outcomes that IDA expects to influence in CAS period	Intermediate indicators	IDA program to support Government
<p>accounting practices.</p> <ul style="list-style-type: none"> * Businesses have confidence that contracts and other laws will be fairly enforced. 	<p>sectors of the economy.</p> <ul style="list-style-type: none"> * First phase of judicial reforms has not yet led to completely independent judiciary. * Enforcement of court decisions often delayed and inconsistent. * Large backlogs in court system. * Unclear and inefficient procedures to enable citizens to protest against government agency actions. 	<p>services (baseline tbd in Judicial Reform Project)</p> <ul style="list-style-type: none"> * Share of judicial decisions fully or partially enforced by enforcement service increases from 68% in 2003. 	<p>management system by end 2006.</p> <ul style="list-style-type: none"> * Public awareness programs on citizens' rights and the courts implemented nationally. 	
<p>(ii) Financial services adequate for private sector growth.</p> <ul style="list-style-type: none"> * Insurance premiums market increases from US\$4.6m in 2003 to US\$10m by 2009. 	<ul style="list-style-type: none"> * Low loans/GDP ratio reduces stability of the banking sector. * Corporate governance of the banking sector is weak. * Debt recovery through the judicial system is unreliable. * Financial intermediation is available only at very high cost. * There are no credit bureaus to monitor credit operations, which reduces confidence in banks. 	<p>Financial system intermediates an increasing share of investment capital</p> <ul style="list-style-type: none"> * Loans/GDP ratio increases from 5.9% in 2003 to 8% in 2007. * Number of accounts held in private banks increases from 407,00 in 2003 to 500,000 in 2008 	<ul style="list-style-type: none"> * Legislation for payment system and for insurance and other non-bank financial institutions passed. * Countrywide private credit bureau established and beginning to operate. * Creditor rights strengthened and collateral foreclosure mechanisms simplified. * Minimum capital requirement for commercial banks increases from US\$2m in 2003 to US\$5m by 2005. 	<p>Proposed: PRSCs and PRSC TA. Urban heating project to encourage utilities to pass consumer financial information to credit bureaus.</p> <p>AAA: JSDF on strengthening efficiency of micro-finance system. Business Surveys. AAA to assess options for strengthening corporate governance</p>
<p>(iii) Communications infrastructure promote economic growth</p> <ul style="list-style-type: none"> * More telecom users, and reduced costs of services. * Transport services adequate. 	<ul style="list-style-type: none"> * Telecoms are a constraint to private sector growth because lack of competition has led to: low quality, high cost services; limited range of services, especially corporate networks and internet; limited reach, especially in rural areas. * Transport of people and goods is time consuming and expensive, especially in rural communities 	<p>Communications infrastructure less of a constraint to growth</p> <ul style="list-style-type: none"> * Increased number of telecoms licenses issued from 1 in 2004. * Indicators relating to road transport to be developed under FY08 Infrastructure Project 	<ul style="list-style-type: none"> * Telecoms policy approved that allows for progressive licensing of additional service providers. * Information Society strategy designed and implemented, with emphasis on service in rural areas. * Modern regulatory framework for utility regulator in place. Staff recruited and/or trained 	<p>On-going: FY00 Transport project; PPIAF grant for multi-sector regulator; PPIAF grant for rural telecoms; education project includes IT in schools</p> <p>Proposed: PRSCs and PRSC TA; FY07 Infrastructure Project; FY06 SIF III.</p> <p>AAA: Rural Infrastructure study; CEM will assess infrastructure needs if geopolitical situation changes; WBI support to utilities regulator.</p>
<p>(iv) Economic growth based on more sustainable</p>	<ul style="list-style-type: none"> * Capacity to enforce environmental impact assessment legislation is weak 	<p>Growth based on more sustainable use of natural resources</p>	<ul style="list-style-type: none"> * Sustainable forest management practices adopted (at least 70,000 ha with forest 	<p>On-going: FY02 Natural Resource Management Project,</p> <p>Proposed: PRSCs and PRSC TA.</p>

Goal One: Promote private sector led economic growth

Long-term country goals	Issues that hinder Armenia's ability to achieve its long-term goals	Outcomes that IDA expects to influence in CAS period	Intermediate indicators	IDA program to support Government
<p>use of natural resources</p> <ul style="list-style-type: none"> * A larger share of the population benefits from economic growth and the vulnerable are adequately protected. 	<ul style="list-style-type: none"> * Deforestation and poor land management further impoverish poor people, and increase impact of natural disasters 	<ul style="list-style-type: none"> * Government enforcing its national environmental safeguard policies better (indicator to be determined in PRSCs). * Appropriate watershed management practices adopted in target areas 	<p>management plans, # ha with forest certification, # ha afforested)</p>	<p>FY05 and FY08 Rural Development Project; FY06 SIF III may finance sustainable use of natural resources. AAA: Country Environmental Assessment</p>

Goal Two: Make growth more pro-poor

Long-term country goals	Issues that hinder Armenia's ability to achieve its long-term goals	Outcomes that IDA expects to influence in CAS period	Intermediate indicators	IDA program to support Government
<p>(i) More people benefit from economic growth</p> <ul style="list-style-type: none"> * Non-agricultural formal sector employment to grow by approx. 3% per year (PRSP Table 6.2, or as revised by GoA) * Average wage increases from US\$51 Jan-Oct 2003. 	<ul style="list-style-type: none"> (i) Slow growth in formal sector jobs (ii) Poverty rates have stagnated in rural areas. (iii) Administration of social protection transfers could be more efficient. 	<ul style="list-style-type: none"> (i) Reduction in share of informal economy and drop in extreme consumption poverty (ii) Social transfers are more effective. (iii) The rural economy is more productive <p><i>Indicators described below</i></p> <p>Poverty rates fall</p> <ul style="list-style-type: none"> * Share of informal sector falls from approximately 45% of formal economy. * Extreme poverty declines from 17% in 2002. * Efficiency of employment agencies increases (measure and baseline tbd in Social Protection Administration Project). 	<p><i>See below</i></p> <ul style="list-style-type: none"> * Key recommendations of labor market study followed up. * Additional indicators will be developed in the CAS Progress Report once key studies completed and understanding of the problems is more advanced. 	<p><i>See below</i></p> <p>On-going: FY04 Social Protection Admin Project; FY04 Education Quality and Relevance Project</p> <p>Proposed: PRSCs and PRSC TA</p> <p>AAA: Labor market study; CEM on pro-poor growth; PERs; Poverty Assessments.</p>

Goal Two: Make growth more pro-poor

Long-term country goals	Issues that hinder Armenia's ability to achieve its long-term goals	Outcomes that IDA expects to influence in CAS period	Intermediate indicators	IDA program to support Government
<p>(ii) Rural areas do not have entrenched poverty.</p> <ul style="list-style-type: none"> * Poverty incidence in rural areas falls significantly from 45% in 2002 * Share of income of rural households that comes from sources other than agriculture increases from 47% in 2002 * Share of farmers (households that use land and produce net agricultural output) that sell commercial surpluses increases from 29% in 2001. 	<ul style="list-style-type: none"> * Population's skill base is inappropriate for needs of market economy (addressed under Goal 3 below). * Only a small share of farmers produce agricultural surpluses because of unreliable irrigation, a lack of improved inputs and technologies and marketing difficulties. * Few opportunities for off-farm income generation because of lack of access to markets, credit, and communications infrastructure. * Agriculture vulnerable to natural disasters. * Institutional reform of irrigation not yet complete. Associations of user groups exist, but are not sufficiently trained, supported etc. 	<p>The rural economy is more productive</p> <ul style="list-style-type: none"> * Value added per hectare increases from US\$1,371 in 2003. * Share of agricultural production processed in Armenia increases (baseline tbd by Rural Development Project). 	<ul style="list-style-type: none"> * Increased number of producer groups established. (baseline tbd by FY05 Rural Development Project). * Irrigation users more satisfied with services they receive. 	<p>On-going: FY99 Irrigation Dam Safety; FY02 Irrigation Development; FY98 Ag. Reform Support; FY99 Title Registration; Proposed: PRSCs; FY05 and FY08 Rural Devpt Projects; FY06 SIF 3; FY07 Infrastructure Project may include rural areas. AAA: Advisory work on private sector development; ESW on rural productivity; regional ESW on rural infrastructure</p>
<p>(iii) The vulnerable are adequately and efficiently protected</p>	<ul style="list-style-type: none"> * Pensions, at 21% of average wage in 2003, are too low. * Administration of cash transfers is not efficient enough, leading to wastage and unnecessary delays. * Benefit system is not transparent enough, leading to confusion amongst potentially eligible beneficiaries. 	<p>Social transfers are more effective</p> <ul style="list-style-type: none"> * Satisfaction of users with social protection system increases (baseline tbd in Social Protection Project). 	<ul style="list-style-type: none"> * Tax collection is improved so revenues increase to levels predicted in PRSP. * Public spending on family poverty benefit is maintained as envisaged in PRSP. 	<p>On-going: FY04 Social Protection Administration Project Proposed: PRSCs and PRSC TA. AAA: PERs, CEM; Poverty Assessments, Labor Market study; WBI work on pension administration</p>

Goal Three: Reduce Non-Income Poverty

Long-term country goals	Issues that hinder Armenia's ability to achieve its long term goals	Outcomes that IDA expects to influence during CAS period	Intermediate indicators	IDA program to support Government
<p>Population has adequate access to basic services (health, education, water, wastewater treatment, heat, transport)</p>	<p>(i) Education system does not meet the country's needs (ii) Financing of the healthcare system is skewed away from the needs of the poor (iii) Poor financial condition of utilities has prevented investment in infrastructure</p>	<p>(i) More children stay in the education system. (ii) More of the population uses healthcare system. (iii) Population has better access to basic infrastructure services</p>	<p><i>See below</i></p>	<p><i>See below</i></p>
<p>(i) Education Maintain well educated population with increased share of people completing appropriate skills training and finding employment in changing economy</p> <p>* All children receive 12 years of quality education</p>	<p>* Curriculum is not appropriate * Skills of, and incentives for, teachers do not match needs of a market economy * Inadequate facilities and equipment (including heating, information technology) * Children, especially lower-income boys, are not motivated to stay in secondary school. * Enrollment in pre-school is low, particularly among the poor, and particularly outside Yerevan</p>	<p>More children stay in the education system. * Net secondary enrollment rates increase from 0.61 in 2001, based on survey data.</p>	<p>* Share of government budget allocated to education rises in line with that in PRSP and MTEF * Procedures for compensating teachers that have been made redundant agreed and former teachers receiving their compensation. * More resources available for improving education quality by increasing pupil-teacher ratio from 11 in 2003. * New curricula for secondary education adopted and being used in all schools for some topics at some grades</p>	<p>On-going: FY04 Education APL</p> <p>Proposed: FY06 SIF 3 will improve some school buildings; Urban Heating project to include school heating</p> <p>AAA: Labor Market study to track graduates of various institutions and assess their employment paths; also to study informal sector</p>
<p>(ii) Increase overall health status of population:</p> <p>* Reduce incidence of non-communicable diseases (e.g. premature mortality from cardiovascular disease)</p>	<p>* People cannot afford services because formal and informal payments are high. * Public expenditures on health services are low and poorly targeted (hospitals absorbed 53% of public health expenditures in 2001). * Staff is not properly skilled or motivated. * Women's reproductive health may be deteriorating.</p>	<p>More of the population uses the healthcare system * Share of those who are sick and who use healthcare services rises in bottom consumption quintile from 22% and of entire population in rural areas from 26% in 2001 (ILCS). * Public attitudes towards unhealthy behaviors begin to</p>	<p>* Budget allocated to health system follows targets established in MTEF and PRSP. * Share of population covered by newly trained and qualified family doctors and community nurses rises from 19% in 2003 * Hospital sector consolidated so that a smaller number of providers are operating on adequate volumes for econo-</p>	<p>On-going portfolio: FY04 Health Systems Modernization Project; FY98 Municipal Development and FY04 Armenia Water improve public health by investing in water supply Proposed: PRSCs; FY06 Urban Heating project will improve health for people in apartment buildings currently burning wood for heating; FY06 SIF 3 may improve some</p>

Goal Three: Reduce Non-Income Poverty

Long-term country goals	Issues that hinder Armenia's ability to achieve its long term goals	Outcomes that IDA expects to influence during CAS period	Intermediate indicators	IDA program to support Government
<ul style="list-style-type: none"> * Reduce child and maternal mortality * Reduce child stunting and wasting * Reduce the differences in key health outcomes of the poor and the non poor 	<ul style="list-style-type: none"> * HIV/AIDS and TB rates, while no worse than other countries in the region, threaten improvement in overall health indicators * People engage too often in high-risk behavior. * Transport to facilities in remote areas is difficult. 	<p>change in response to information campaigns and some evidence of early use of lower risk behaviors is observable (smoking, drinking alcohol, not using seatbelts, etc)</p>	<p>mies of scale and quality. Measured by reduction of contracts by State Health Agency for hospital services</p>	<p>healthcare facilities; FY05 Yerevan Water will improve availability of water and wastewater collection and treatment; FY07 Infrastructure Project may improve access to remote facilities. AAA: Regional rural infrastructure study.</p>
<p>(iii) The population has increased access to basic infrastructure services, improving their quality of life</p>	<ul style="list-style-type: none"> * The poor financial conditions of the utilities have prevented investment in maintaining infrastructure. * Crumbling water and sanitation infrastructure is leading to increasing rates and/or sudden outbreaks of water borne diseases. * Many urban households are forced to heat with wood, which is expensive, and has environmental costs. 	<p>Population has better access to basic infrastructure services</p> <ul style="list-style-type: none"> * Proportion of population connected to piped water that has service 24 hrs a day increases from 22% in 2003. * Share of households heating with gas-based systems increases by 20% from 2003/04 baseline to be determined in July 2004. 	<ul style="list-style-type: none"> * Apartment buildings adopt new heating systems and payment mechanisms 	<p>On-going: FY98 Municipal Development Project; FY04 Armenia Water; FY99 Electricity T&D Project, PPIAF grant to support the multi-utility regulator Proposed: FY05 Yerevan water and sanitation; FY06 Urban Heating Project; FY06 SIF III, FY07 Infrastructure Project; AAA: JSDF on urban heating; Regional rural infrastructure study</p>

Annex 2: FY02-04 CAS Completion Report

Armenia 2001 CAS Completion Report

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Executive Summary

Introduction

In 2001, IDA's board approved a country assistance strategy (CAS) for Armenia for the period FY2002-2004. This completion report evaluates progress implementing that CAS.

CAS Objectives

The 2001 CAS had three broad objectives: (i) creating jobs through private sector development; (ii) improving governance and public sector services; and (iii) rebuilding human capital. These objectives complemented the goals of the Interim Poverty Reduction Strategy Paper, which was published shortly before the CAS.

Country Outcomes

Armenia has made substantial progress over the CAS period. The economy grew by 13% in 2002 and 14% in 2003, with increasingly diverse sources of growth. Manufacturing exports grew by 50% over the period and Armenia increased exports to countries outside the CIS. According to surveys, the business environment – registration, licensing, inspections, customs clearances, tax requirements and corruption – have improved since 2000. The number of firms increased by 15% between 2001 and 2003 and small and medium enterprise growth was about 7% per year during the CAS period. However, formal sector employment has not grown at the same rate as output. This is because redundancies from state owned enterprises have continued, and because many firms appear to have expanded by using surplus capital rather than hiring new employees.

Armenia has seen some progress in reducing poverty, which fell from 55% in 1998/99 to 48% in 2001. Between 2001 and 2002, however, overall poverty increased slightly (poverty in Yerevan continued to fall, rural poverty remained stagnant and poverty in other urban areas increased). The increase in poverty in other urban areas is puzzling. The stagnant poverty situation in rural areas appears to be the result of worsening domestic agricultural terms of trade, with resulting declines in returns to labor in some rural areas, since the agricultural labor force remains high. Subsistence farming still dominates, despite some commercial successes in agriculture, particularly in the fertile Ararat valley.

Over the CAS period, public sector services and governance both improved, although further progress is still necessary. The Government completed the first stage of civil service reform and prepared and began implementing an anti-corruption strategy. The average pension increased by 30%, and pension arrears were cleared. Targeting of social protection schemes has improved and leakage is low. The quasi-fiscal deficit associated with the power sector (equivalent to 2% of GDP) was eliminated and most of the country now has uninterrupted power supply. By 2003, nearly half of the population of Yerevan (close to one fifth of the country's population) had at least 12 hours supply of good quality water compared to only 10% in 2001. By March 2004, half of the city's population had service 24 hours per day.

Human capital has improved. Health outcomes are better, although the improvement was not as great the 2001 CAS had targeted. Differences between outcomes in urban and rural areas are marked. People are not using health services, at least in part because formal and informal payments can be unaffordably high. Social protection mechanisms introduced in 1999, however, do appear to be helping the poor access healthcare to some extent. Participation in basic education remains high, but children, especially boys, are dropping out of secondary school. This is a particular problem in rural areas and for poorer children. The Government is working to improve the quality of education. Public expenditure on both health and education has increased but remains low in both sectors.

IDA's contribution to country outcomes

The 2001 CAS set a series of outcome targets, all of which have either been met or have seen substantial progress. In many cases, IDA interventions, often in a mutually supportive package of analytical work, investment and policy-based lending, made direct contributions towards the country results discussed above. Measuring the precise contribution of IDA activities to those outcomes is difficult, however, because the CAS did not explain the mechanisms, and some indicators did not fit the interventions.

Evaluation of CAS performance

IDA's performance was satisfactory. The focus of the CAS, the mix and design of interventions were all appropriate. The quality of IDA's work appears to have been good, judging from internal reporting systems as well as OED and QAG reports. Many of the products were not delivered at the time planned. In some cases this was a deliberate decision in response to changing circumstances, but in other cases, delays resulted from key staff members not being available at the right time.

Lessons for future CAS design

- The areas of focus and the mix of interventions were appropriate and should be continued. Future work should perhaps put more effort into ensuring that growth leads to as much employment and poverty reduction as possible.
- Outcome indicators should be linked more clearly to IDA interventions and should be used as a management tool throughout CAS implementation.
- Devolving responsibility for portfolio management to the country manager helped improve portfolio quality and should be continued.
- A strong multi-sectoral team with some task management responsibilities in the country office was important for achieving results and future work should be designed to benefit from this team as much as possible.
- During implementation of future CASs, management needs to pay particular attention to ensuring availability of key staff at the appropriate time.
- Consultations on the next CAS can benefit from recent discussions concerning the PRSP, allowing the CAS discussions to concentrate on how IDA can best help the Government implement its poverty reduction priorities.

Completion Report for IDA's Country Assistance Strategy for Armenia FY02-04

1. Introduction

This document reviews the experience implementing the International Development Association (IDA)'s Country Assistance Strategy (CAS) approved in April 25, 2001, (Report No. 22111-AM). The CAS covered financial years 2002-2004.

2. Armenia's Objectives

The CAS intended to support the following objectives stated in Armenia's Interim Poverty Reduction Strategy Paper (March 2001, report No. 22131):

- Sustainable and equitable economic growth driven by a more dynamic private sector. The public actions proposed involved reducing administrative barriers to investment and entry, building effective public-private consultative mechanisms and creating a level playing field for new and existing companies.
- Public administration reform and an anti-corruption program. Public actions included streamlining the civil service and key regulatory agencies, advancing judicial reform and improving domestic revenue collection.
- Enhanced human development. Public actions included additional financing for school education, basic health and infrastructure maintenance (assuming improved utility revenues and savings from reduced subsidies to utilities), and improved targeting of social protection and education expenditures.

Neither the CAS nor the I-PRSP made an explicit link to the Millennium Development Goals (MDGs), but the objectives overlapped with MDG targets. The interventions to promote the private sector, to improve public administration, and to reduce corruption were intended to reduce extreme poverty, as were the proposed interventions to improve social protection. Interventions to promote human development clearly help Armenia meet the goals relating to health and education. The CAS's proposed investments in natural resource management, water supply and urban heating would all help Armenia meet the MDG relating to environmental sustainability. Armenia has already met Goal 3 on gender equality.

Armenia's current status against the MDG targets and the World Bank's evaluation of the likelihood of the country meeting the goals are listed in Table 7 of the FY05-08 Country Assistance Strategy.

3. CAS Objectives

The CAS aimed to help Armenia achieve results in the following areas:

- **Private sector development**, through:
 - Improving the entrepreneurial climate by reducing regulatory and administrative barriers to starting new and expanding existing businesses; improving the tax and customs administration; improving land markets; and strengthening the mechanisms for privatization and bankruptcy.
 - Promoting the private sector by improving local managerial capacity.
 - Direct support for foreign investment, by guarantees and advice as well as IFC investments.

- **Improved governance and public sector services**, through:
 - Strengthening public administration by increasing the capacity for executive decision-making in Government; streamlining and modernizing the civil service; making the civil service more accountable; improving public expenditure management; reforming intergovernmental finance; improving audit functions; and continuing reforms of the judicial system.
 - Improving the performance of utilities by creating a single public services regulatory body; shifting management of water companies to private operators; securing private financing for new investments in the power sector; and promoting gas rather than electricity as the primary source of heating.
 - Improving rural services by increasing cost-recovery in irrigation; improving property rights and land markets; and promoting small credit associations.
 - Improving natural resource management by helping communities manage their watersheds; promoting environmentally sustainable farming practices; and improving managements of forests and protected areas.

- **Rebuilding human capital**, through:
 - Education by improving financing for primary and secondary education, increasing supplies of textbooks; getting communities involved in schools; improving the quality of teaching; making school budgets more transparent; improving the access of the poor to schools; and improving the quality of education.
 - Health by improving access to health services especially for the poor; improving health financing to give greater priority to primary healthcare; rationalizing the healthcare system; and helping the Government develop HIV/AIDS strategy.
 - Social Protection by helping reform the public pension system; promoting better administration and targeting of the family benefit; developing the overall framework for social protection; and promoting policy reforms to create more flexible labor markets.

4. Armenia's progress towards its goals

The country made substantial progress towards these results, based on the following:

- *Armenia's economy grew strongly, driven by the private sector.* Real GDP grew by 10% in 2001, 13% in 2002 and 15% in the first nine months of 2003, and the basis of the economy has begun to diversify. More than 70% of GDP was generated by the private sector. Manufacturing exports grew by more than 50% in two years, and Armenia has expanded its export markets beyond those of the CIS. The business climate has improved: firms' overall confidence in the government and in the business environment improved from an average of 2.6 in 2000 to 3.3 in 2001 (on a 6 point scale, where 1 = total lack of confidence). Businesses report improvements in business registration, licensing, inspections and the tax system. New firm growth was good: the stock of firms grew by 15% between 2001 and 2003, and small and medium enterprise growth was approximately 7% p.a. over the same period. Formal sector employment did not match growth in output. Aggregate employment remains lower than it was in 1990 although it did increase in 2002 and 2003. There are two reasons for this. First, the massive job shedding from state owned enterprises has continued to the present day. Second, business surveys indicate that new firms initially had surplus capacity because investments needed to be of a minimum economic scale. As domestic and export demand increased, companies used that surplus capacity and then they plus additional new entrants began to increase the demand for labor.
- *Armenia has made some progress in reducing poverty.* Poverty fell from 55% in 1998/99 to 48% in 2001, with the sharpest drop seen in Yerevan. Preliminary data indicate that between 2001 and 2002, this progress may have halted, as the overall poverty incidence appears to have increased slightly. Over the latter period, poverty appears to have continued falling in Yerevan, to have remained stagnant in rural areas but to have increased in other urban areas. The 2002 results may be affected by government policies that caused the poverty family benefit to fall considerably in 2002 (the number of beneficiaries fell by 11% and the average level of benefit by 15%). These policies were reversed in 2003 with expenditure returning to 2001 levels.
- *Governance has improved.* Between 2000 and 2002, Business Environment and Enterprise Performance Surveys (BEEPS) indicate that Armenia has seen improvements in political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. However, the country's ratings for voice and accountability fell over the same period. On all measures except political stability, Armenia performs better than the average for the CIS. Transparency International's Corruption Perceptions Index rates Armenia as 78th of 133 countries surveyed, the highest ranking in the FSU apart from the Baltic countries and Belarus. Freedom House rated Armenia at 4/7 for political rights in 2000, up from 3/7 in 1998, and rated Armenia at 4/7 in both years for civil liberties. Annual business surveys similar to BEEPS also indicate improvements in governance. For example, the share of firms reporting making bribes frequently declined from

40% in 1999 to 14% in 2002, and the average bribe as a share of revenue declined from 4.2% to 1% over the same period.

- *Civil service reform has begun.* The Government passed a civil service law and similar laws for the diplomatic, tax, customs and police services. It established a Civil Service Council to oversee management in line agencies. In addition, a law on remuneration of civil servants was passed in July 2002, which requires, among other things, that all senior civil servants publicly declare their assets. With assistance from DFID, the Government has reviewed all central executive bodies and has reorganized and written charters for most ministries. It has also moved many agencies from direct central control to line ministries, to clarify accountability and strengthen oversight. The first phase of reform is thus complete, but substantial work remains to bring about changes in the actual functioning of government institutions.
- *Energy and water services have improved considerably.* Water services have improved considerably, but the improvements have all been in Yerevan (which accounts for almost 40% of the country's population). By mid 2003, 39% of the population had 24 hours supply and an additional 7% had it for at least 12 hours per day. This compares to only 10% of Yerevan's population that had 12-hour supply in 2001. The utility is working more efficiently; 80 percent of the households have meters, and collections have risen from 33% of billed water in the period May-July 2002 to 84% in the same period in 2003.¹⁶ Drinking water quality is good; 98% of the water supply in Yerevan meets quality standards, but the deteriorating infrastructure is beginning to compromise these standards. In the power sector, the whole country has benefited from major improvements. Almost the entire population now has uninterrupted electricity supply. Tariff collection has increased from 80% in 2001 to 98% in 2003. The quasi-fiscal deficit associated with the electricity sector (2% of GDP in 2001) has been effectively eliminated since the distribution company was privatized in November 2002. The Energy Regulatory Commission has been transformed to a multi-utility regulator, although the agency needs to develop additional capacity. The Government adopted an Urban Heating Strategy in September 2002; it has removed some of the barriers to sustainable heating services, and is now piloting efficient and less polluting approaches to heating large apartment buildings. As a result of increased electricity prices and improved collection rates, 50,000 households switched to gas for heating, which is more efficient and less polluting.
- *The country's social protection system has improved.* The Government has cleared its arrears, and the average pension increased by 30% between 2001 and 2003. Surveys indicate that targeting of the social protection schemes has improved and that leakage is low, although further improvements are still necessary. The Government has set up a personal identification system for all the Armenians (more than 250,000 people now have PIN numbers) for automating the social insurance, social welfare offices and employment services. Almost all people in formal employment now make their social insurance contributions, with

¹⁶ OECD Study on Consumer Protection in Urban Water Sector Reforms in Armenia

the number increasing by 100,000 between 2001 and 2003. The Government has begun to modernize the pension administration system, setting up a management information system with individual records for those covered by social insurance (contributors to the system) and their employers, as well as computerized records for current pensioners. They are expected to complete this modernization in 2006. However, the pension administration needs additional human resources capacity and improved accounting and administrative systems. To address labor market problems, the Government has prepared Draft Labor Code and developed a new system for training the unemployed to better match the labor supply and demand.

- *Human capital has improved.* According to administrative data, between 2001 and 2003, maternal mortality fell from 47 per 100,000 live births to 34. Other sources give higher figures, but also show positive trends. Under-five mortality fell from 25 per 1,000 live births to 16 over the same period. These figures mask a significant difference between rural and urban areas. According to survey data (ADHS 2000), rural infant and early childhood mortality rates exceeded urban rates by 47 percent and 22 percent, respectively, during the 1990s. The healthcare system has improved as the Government has increased the share of spending allocated to primary healthcare and established a system of family doctors. Substantial problems remain, however. Official and unofficial payments are high and because there is no insurance mechanism, these costs often deter people from using services. The poverty family benefit does appear to have helped some people use healthcare services, but on the whole use rates are low. The country still has excess hospital capacity and public spending on the sector remains low. Participation in basic education is high, with a net enrollment rate of 94% in 2001, spread fairly evenly across quintiles. Secondary education, however, is more problematic. Surveys indicate that the net enrollment rate in secondary education is 61%, and is lower for the poor (52% for the poorest quintile versus 64% for the richest). Public spending on education increased by 45% between 1997 and 2001 but remains low. IDA helped ensure that high quality textbooks are available to all at a reasonable cost, helped create some managerial and financial autonomy in 40% of all schools and encouraged greater parent involvement in schools. It also helped begin consolidation of underutilized schools.
- *Rural areas have not grown as much as urban areas.* Poverty rates in rural areas stagnated between 1998/99 and 2001, while they dropped considerably in urban areas. There are few off-farm opportunities and subsistence farming still dominates (only 29% of farming households had commercial surpluses in 2001) indicating that agriculture is still a basic safety net for many families. Domestic agricultural terms of trade worsened every year between 1997 and 2002 and agriculture's share of GDP declined consistently over the same period. Since the size of the agricultural workforce remained constant, returns to labor in some rural areas may have declined. While on average rural areas have stagnated, some sectors, particularly those located in the fertile Ararat valley, have seen some progress. Agricultural exports increased from \$220mn in 1998 to \$354 million in 2001. Since 1999, agricultural exports have grown as a share of exports, representing 14% in 2001. Land titling is almost complete (the Government plans

to complete it in 2004), and about 500,000 land title certificates have been issued to farmers. Transactions in the land market are beginning to increase. For example, the number of business transactions with agricultural land plots increased from about 2,000 in 2001 to more than 4,500 during the first 8 months of 2003. Many irrigation systems are now more efficient and farmers are increasingly taking over responsibility for managing and financing operations and maintenance of their systems.

Armenia's good performance means that the country has met all of the triggers for moving to the high case. However, because privatization of electricity distribution took longer than expected (due mainly to changing market conditions rather than lack of government commitment) it did not meet them in time to develop a PRSC, the high case deliverable, within the period.

5. How IDA contributed to Armenia's progress

The 2001 CAS contained a list of indicators that it expected to influence and targets for meeting them. Table 2 outlines the targets and the current status as well as the IDA instruments that affected each indicator. It shows that Armenia has met almost all of the targets, with significant assistance from IDA interventions.

Table 2: Outcome Indicators for CAS Period (FY02-04)

Target in 2001 CAS	Current Status 2003	Bank instrument that affected or helped monitor outcome
Poor as percent of total population reduced from 55% to 50%.	48% (2001).	Most interventions promoted investment and economic growth: SAC IV (01), SAC V (03), SATAC II (98) (see below for specific areas of support); AAA work in the financial sector (03); Country Economic Memorandum (02); ESW on Trade Facilitation (02). Sectoral interventions contributed to reducing corruption, improving fiscal management and services to the poor. The poverty update (02) and poverty assessment (04) helped monitor poverty outcomes.
Regular payment of social insurance and social assistance transfers.	No arrears.	SAC IV (01) helped improve targeting of family benefits. The Public Expenditure Review (02) and AAA on social protection (03), highlighted problems and potential solutions. IDF support to Treasury budgetary system (03) helped improve government financial management.
At least 15% real increase in average pensions.	Pensions rose by more than 30%	SAC IV (01) supported the first phase of pension reform and SAC V (03) helped continue reforms. SAC IV supported privatization of electricity distribution companies, which eliminated a quasi-fiscal deficit and freed up funds for increased spending on social protection, health and education, etc.

Target in 2001 CAS	Current Status 2003	Bank instrument that affected or helped monitor outcome
Private sector		
Reduced average time for business registration.	The time taken to register a business fell on average from 27 days in 2000 to 21 days in 2001	SAC IV (01), SAC V (03), SATAC II (98) supported new laws on business registration and trademarks, improvements in the bankruptcy law and implementation of other specific actions to improve the business environment. Annual FIAS business surveys helped monitor results.
Reduced customs clearance time for importers.	In 2000, importers needed 8 days to clear customs, versus 5 days in 2002.	SAC IV (01), SAC V (03), SATAC II (98), included support for implementing action plans to improve customs administration. Annual FIAS business surveys helped monitor results.
Reduction and streamlining of licensing requirements.	The time taken for licensing fell from 24 days in 2000 to 19 in 2001.	SAC IV (01), SAC V (03), SATAC II (98), included support from improvements in the licensing law and the business inspection regime. Annual FIAS business surveys helped monitor results.
Governance		
Greater reliance on the judicial system to resolve bankruptcy cases.	Ongoing.	Judicial reform project (01) is helping improve case management, educate court personnel and develop a legal information system for the public. SAC V (03), supported improvements in the bankruptcy law. The Institutional and Governance Review (IGR) workshop (01) helped build consensus for reform.
Public perception of progress in improving governance, and reducing corruption.	Armenia's ranking for rule of law in BEEPS increased slightly between 2000 and 2002, and the BEEPS ranking for government effectiveness more than doubled over the same period.	Judicial reform project (01) is helping improve enforcement and promote public awareness of laws; SAC IV (01) and SAC V (03) supported a series of specific actions to reduce corruption and improve governance. An IDF grant (01) helped the Government develop its anti-corruption strategy; Annual FIAS business surveys monitor results and an IGR workshop (01) helped build consensus for reform.
Social Sectors		
Girls' school enrollment maintained at least the same level as boys.	Girl's enrollment remains higher than boys.	Education (98) improved conditions in schools for all children. No specific interventions were necessary.
Real average teacher salary up by 40%.	Increased by 30%.	SAC IV and SACV (03) included provisions for education financing, the PER (02) helped improve expenditure management.
Enrollment rates in elementary education at least 95%.	100%. Net enrollment rate for grades 1.8 is 94%.	The Education Project (98) helped improve parent involvement, create school boards. The Social Investment Fund II Project (00) helps poor communities rehabilitate schools.
Maternal mortality reduced from 47 to 22 per 100,000 live births.	Rates improved (maternal mortality was 34.4 per 100,000 live births in 2002) but measurement is difficult	SAC IV (01) supported rationalization of the health sector thus freeing up funds for essential health services. The Health Project (98) helped improve access to primary healthcare, including antenatal care.

Target in 2001 CAS	Current Status 2003	Bank instrument that affected or helped monitor outcome
Increase or maintain share of fully immunized one year olds at 95% or more	Rates maintained	Health Project (98) helped improve access to primary healthcare.
Reduce under-5 mortality from 25 per 1,000 to 20 per 1,000 live births.	Continued improvement. Survey data give different figures from official data although both show the same positive trends	Health Project (98) helped improve access to primary healthcare. The Social Investment Fund II Project (00) helped rehabilitate key services in poor communities.
Energy		
Quasi-fiscal cost of energy sector reduced to a quarter its current level.	The quasi-fiscal deficit was 2% of GDP in 2001 and has effectively been eliminated since November 2002	SAC IV (01) supported privatization of the electricity distribution company and eliminated the quasi-fiscal deficit. The Electricity Transmission and Distribution Project (99) supported much of the technical preparation.
Resumption of natural gas supply to additional 40,000 households.	Gas supply extended to an additional 50,000 households	Energy T&D project and SACIV supported increased tariffs and improved collection, giving incentives to switch to gas. SAC V helped establish a single utility regulator to ensure that the privatized distribution company complies with its license requirements. The Urban Heating Strategy (03) proposed solutions for heating, particularly in large apartment buildings.
Agriculture		
Completion of titling of rural land -- all farmers have titles.	In process, mostly achieved.	Title Registration Project (99)
20% increase in Water User Associations receiving at least 5,000m ³ of irrigation water per hectare.	Not available. In 2000 Armenia had no functioning Water Users Associations (WUAs) and no bulk water meters to measure delivery. In 2003 12 WUAs are functioning.	The Irrigation Dam Safety (00) and the Irrigation Development Project (02) both helped communities form water users associations and finance key rehabilitation of systems including major efficiency improvements.
Cost recovery in irrigation water supply increases by 25%	Currently irrigation operation and maintenance cost recovery is 25.2%.	Irrigation Development Project (02) helped water users associations become financially stable by improving cost recovery. Irrigation Dam Safety (02) helped make key systems less costly to operate.
Infrastructure Services		
Decrease in proportion of drinking water with above allowable contaminant levels from 14% to 8% (urban), and from 22% to 15% (rural).	The State Water Committee reports in 2003 that 4% of the total population connected to piped water is receiving water above allowable contamination levels.	Municipal Development Project (98) financed some system rehabilitation. Social Investment Fund II (00) rehabilitated drinking water systems in poor communities. No projects for other urban populations.

Target in 2001 CAS	Current Status 2003	Bank instrument that affected or helped monitor outcome
For households with piped water, increase in number with at least 12 hrs supply from 10% to 20% (urban) and from 40% to 55% (rural).	46% of customers in Yerevan have at least 12 hours supply. Service outside Yerevan has not improved. The average daily water supply was 8 hours per day in urban areas and 14 in rural areas in 2003 (PRSP)	Municipal Development Project (98) financed rehabilitation and institutional reforms for drinking water in Yerevan outcomes. No projects for other urban populations, although the Social Investment Fund II (00) rehabilitated drinking water systems in poor communities.

Evaluating IDA's specific contribution to specific country outcomes is difficult for several reasons:

- The precise links between long-term goals, outcomes that could be achieved during the CAS period, and the mechanisms by which IDA aimed to help Armenia meet those goals were not specified in the 2001 CAS.
- The indicators were not used as a management tool during CAS implementation.
- Some indicators were not appropriate: one (quality of water in rural areas) was not associated with any IDA interventions; another (girls' school enrollment rates) was never a problem; and another (share of irrigation water users' associations receiving 5,000m³ water per hectare) was not measurable at the time.
- The effects of some planned interventions (e.g. the Natural Resources Management Project) were not captured in any indicators.

Future CASs will endeavor to make the indicators and their baseline data clearly accepted by all involved, the links to the interventions more explicit and to use the indicators as a management tool throughout CAS implementation.

There were no severe exogenous shocks over the period of the last CAS that affected the achievement of those outcomes. The price of wheat coming from Russia increased markedly in the summer of 2003 but did not raise inflation rates or otherwise affect macroeconomic indicators. The severe frost in winter of 2002-2003 severely damaged wine and fruit crops for several agricultural areas but this does not seem to have affected the CAS outcomes.

CAS implementation did not have any unintended negative impacts that the team is aware of. There was no unanticipated environmental damage; indeed the irrigation, water supply, energy and natural resource management projects have contributed to environmental improvements by reducing wastage of natural resources and helping the Government reorganize its environmental management system.

The primary gender issue for women in Armenia relates to poor reproductive health behavior (over half of all pregnancies end in abortion). IDA interventions during the 2001

CAS period made significant progress in improving the health and education systems in general, but have not yet included specific actions to improve women's reproductive health behavior, nor have they specifically addressed HIV/AIDS, in part because other donors have programs in these areas. A forthcoming study has assessed the problem of reproductive health and will propose potential actions, some of which will be followed up in the FY04 Health project. Changes in the labor market appear to have hit women hard, as the female share of employment fell in the 1990s and the gender wage gap was 80% in 2000.¹⁷ Armenia also has two important male gender issues: excess male mortality (men have a life expectancy around ten years lower than that of women) and boys dropping out of secondary school, particularly in rural areas. The FY04 health and education projects include specific measures to tackle this problem.

6. IDA's performance

IDA's performance overall was satisfactory. In consultations, government officials consistently state that they value their relationship with IDA highly. The 2002 client survey indicates satisfaction with IDA, with a mean favorability rating of 7.8 on a scale of 10. Staff continuity was good in most sectors, with the possible exception of public sector modernization. OED's CAE was released in late December 2003 and broadly confirms this assessment.¹⁸

Quality. The quality of IDA's products and services was generally good. Internal reporting systems (PSRs, CPPRs) indicate that the portfolio is performing well. All projects are rated satisfactory and there are no problem projects. The disbursement ratio¹⁹ is satisfactory. At the end of FY03 it was 20.2% compared to an ECA average of 19.8%. The portfolio is relatively young, with an average age of 3.3 years. Sixty percent of projects are in the first three years of implementation with the remainder are in the final stages of implementation. ESW has mostly been well received by the Government and many of the recommendations are being implemented. The team has produced four Implementation Completion Reports (ICRs) over the CAS implementation period, three of which have been reviewed by OED.²⁰ QAG has reviewed 9 activities that are covered by the 2001 CAS, and all are rated satisfactory or above.²¹

¹⁷ Armenia gender profile

¹⁸ The Executive Summary of the CAE noted "the Bank's assistance has made a major contribution to the maintenance of macroeconomic stability, which facilitated the economic recovery and growth." "...the Bank has had a significant impact through its AAA and lending in helping to establish a new social benefit system, well targeted to the poor. The Bank has also had a major impact on improvements in the efficiency of the education sector and on the increased availability of energy. In transport and agriculture, the Bank's assistance has likewise made important contributions...but major problems were left unresolved." "The Bank's program had some success in private sector development...but much remains to be done to improve the business environment, especially in the promotion of small and medium job-creating enterprises." "On balance...OED rates the outcome of the Bank's assistance strategy as *satisfactory*." "The Bank's overall contribution to institutional development is rated as *substantial*." "Balancing the risks and benefits suggests that the sustainability of the Bank's assistance program should be considered *likely*."

¹⁹ Disbursements during the fiscal year/undisbursed balances at the beginning of the fiscal year

²⁰ SAC IV ICR rated the outcome as satisfactory; OED has not yet reviewed. The Structural Adjustment Technical Assistance Credit II rated the outcome as satisfactory; OED concurred. The Education Financing

Use of AAA work. IDA made good use of analytical and advisory work during the CAS period. Strong analytical work complemented adjustment and investment projects particularly effectively in the energy and education sectors. IDA's understanding of poverty issues in Armenia is relatively good, and the work is well integrated into the program. The data are disaggregated by gender, which allows the team to mainstream gender issues where relevant, and to follow up when particular issues arise, such as the detailed analytical work on women's reproductive health currently underway. The portfolio has also benefited from thorough analytical work on the environment, which has been mainstreamed into many sectoral and capacity-building interventions, such as water supply and sanitation, energy, heating and irrigation.

Capacity enhancement. The World Bank Institute (WBI) program was relatively limited. WBI has focused on a South Caucasus regional program on fiscal decentralization and development of local government capacity over the last two years, and on PRSP dialogues among the CIS-7 countries. They have recently started a training program on pension reform that will complement the forthcoming FY04 pension credit. Participants have generally rated the activities as very successful and relevant, but asked that activities be broadened and made more continuous.

Delivery of products. As Table 4 shows, by the end of FY04, the planned lending program will have been delivered. The 2001 CAS planned 10 new investment projects and, by the end of FY04, 10 will have been delivered -- eight that were planned in the CAS and two that were not envisaged. One project (Urban Heating) has not yet been approved but the Government is already piloting operations under a PPF. IDA delivered the planned number of AAA activities proposed in the 2001 CAS, though they covered a somewhat different mix of topic areas (see Table 5).

The program did however suffer from substantial slippage. Around half of the activities were delivered at least one fiscal year later than planned. Some delays resulted from decisions deliberately taken in response to changing circumstances. For example, the Municipal Water and Wastewater project was moved from FY02 to FY04 because responsibility for the sector within the Government shifted, the Bank's policy changed, and country management wanted to assess progress implementing the Municipal Development Project. Other delays, however, were caused by insufficient availability of key Bank staff and/or staff turnover. This was a particular problem for the Public Sector Reform Project. Given the centrality of improving public sector management to the 2001 CAS, delivering the related project at the end of the FY04, rather than in FY02 as planned, is an important omission.

and Management Reform Project rated the outcome as highly satisfactory; OED concurred. The Enterprise Development Project rated its outcome as satisfactory; OED rated it as moderately unsatisfactory with unsatisfactory Bank performance and unlikely sustainability. They conclude that project design was poor.

²¹ QESW: Water Resources Plan; QAE: Judicial Reform Project, SACIV, Natural Resources Management Project, Health Project, Municipal Development Project, Dam Safety Project; QSA: Electricity Transmission and Distribution Project, Agricultural Reform Support Project.

The work of different parts of the World Bank Group has been mutually complementary, though IDA has dominated. The IFC has only a small program in Armenia, with two active projects and one fund, which has yet to be capitalized. The IFC has had difficulties finding industrial investments of sufficient scale and has only recently begun to find creditworthy banks to which it can make significant line-of-credit investments. IDA is working with MIGA on the Foreign Investment and Export Facilitation Project, with MIGA leading the capacity building program, although MIGA does not yet have any active guarantees in Armenia.

7. Aid coordination

Over the 1990s, Armenia had reasonably high levels of official development assistance per capita at an average of US\$16 per person per year or around 11% of GDP. IDA has successfully worked with donors to maximize development impact in many areas. A donor consultation process was established in the CAS and followed up during implementation, including a Consultative Group meeting in FY02.

Donor coordination has not been without difficulties, however. The ICR for the SATAC project concluded that better donor coordination at the outset would have allowed the borrower to leverage more grant funding, allowing IDA technical assistance to better complement that bilateral support by financing the use of local consultants. The high availability of donor funds has caused particular problems in areas, such as public sector modernization, that require substantial technical assistance. The Government was reluctant to borrow, when considerable grant financing is available for these purposes.

Cooperation with the IMF has been excellent. Fund conditionalities blended well with those of IDA. The IMF program has been in line with I-PRSP and now with the recently published PRSP and remains broadly on track.

8. Overall assessment of CAS performance

The team judges the CAS performance as satisfactory in those areas where IDA influenced results directly. Armenia made significant progress towards all of the planned CAS outcomes and IDA played a significant role in helping the country achieve results.

Although rural areas did not progress at the same rate as urban areas, Armenia has seen some success, and IDA was instrumental in those successes. Furthermore the improvements in the social assistance programs probably prevented actual worsening of poverty in rural areas. Given the limited resources, it is hard to assess what else IDA could have done to help in the rural areas.

Progress in rationalizing health and education infrastructure has perhaps proceeded more slowly than envisaged. However, a stronger emphasis on this would possibly have detracted from the more immediate needs of improving the quality and access to primary healthcare and forestalling any further declines in the quality of basic education. IDA

was unable to help the Government forestall the growth of private payments for healthcare, which is a major reason that people, especially the poor, do not use health services. Recent evidence, however, indicates that the poverty family benefit has protected the poor and increased the probability that they will use healthcare services if they fall sick. IDA did not help the Government develop a strategy to tackle HIV/AIDS as planned in the 2001 CAS, because UNAIDS and the Global Fund led these initiatives.

The delivery schedule proposed in the 2001 CAS was over-optimistic about staff time availability, particularly for AAA work. This meant that many deliverables slipped one or more fiscal years.

9. Lessons for subsequent CAS design

(a) The areas of focus in the CAS were appropriate and the mix of interventions supported the objectives well. Both should be continued. Given the substantial progress Armenia has made and the contributions that the IDA program made to that progress, the team concludes that IDA selected its goals appropriately. The activities all contributed to the desired outcomes and no activities were redundant. Given resource and capacity constraints both in IDA and in the Government, it is hard to see what additional activities IDA should have undertaken. The future CAS will, however, need to pay explicit attention to ensuring that the benefits from economic growth have wider impact.

(b) The best results were achieved when IDA was able to exploit the synergies between well-sequenced analytical work, investment and adjustment lending, and to leverage trust funds and donor activities. The chosen blend of policy based and investment lending worked well for the most part. Substantial levels of trust funding enabled the team to prepare projects and analytical work and maintain a substantive dialog. Other donors also had a vital role in achieving many of the CAS objectives, providing long-term technical assistance in areas that require sustained efforts. During the 2001 CAS period this was particularly noticeable in the energy sector, in tax and customs reform, agricultural extension, Treasury implementation, civil service development, and macroeconomic and monetary policy formulation. These initiatives will need to be duplicated and perhaps intensified in the forthcoming CAS.

(c) The outcome indicators for the 2001 CAS should have been linked more clearly to IDA interventions to facilitate evaluation of CAS performance. Future CASs will endeavor to make the indicators and their baseline data clearly accepted by all involved, the links to the interventions more explicit and to use the indicators as a management tool throughout CAS implementation.

(d) Devolving responsibility for portfolio management to the country manager and some task management responsibilities to country office staff improved portfolio performance considerably. The country manager and field office staff are close to the projects and the counterparts. For that reason, and because they work exclusively on Armenia rather than on several countries, they were able to focus on the Armenia

portfolio and remove obstacles to progress and highlight potential problems before they materialized.

(e) A strong team in the country office was important for achieving results. High caliber staff working as a multi-sectoral team in Yerevan, with some responsibility for task management, helped provide efficient quality services to the client and to maintain a good dialog with senior officials. Future work should be designed to benefit from this team as much as possible

(f) The CAS was not realistic enough about staff availability and programming. Many of the interventions programmed in the previous CAS were delivered one or two fiscal years behind schedule, although the total number of activities and lending volume remained roughly as planned. Many factors caused this, some not within the control of country team members. In some cases, however, slippage was the result of key staff not being available at the right time. During preparation and implementation of the future CAS, management needs to pay explicit attention to advance staff planning to ensure that key people are available at the right time for key deliverables.

(g) In a country experiencing rapid economic growth, it is difficult to ensure that all geographic areas and segments of the population benefit equally. Clearly, some parts of the country have progressed faster than others, but it is far from clear what could have been done to avoid that. Indeed, without the improvements in social assistance programs, the situation in lagging regions would probably have been even worse.

(h) Knowledge and capacity gaps remain. Although IDA's interventions together with those of other donors were reasonably effective in addressing capacity issues, much remains to be done. Armenia could probably have benefited from an expanded World Bank Institute (WBI) program for this purpose. The primary knowledge gaps relate to constraints to increasing on- and off-farm incomes in rural areas, and to the dynamics of the labor market (this was identified in the previous CAS, but dropped because of staff availability). The latter would help IDA understand gender issues in the labor force. IDA will tackle these issues in the next CAS period.

(i) The CAS consultation process was extensive and coincided largely with the even more thorough government-led consultation process for the PRSP. The Government has committed to continue consultations throughout PRSP implementation, and IDA will be part of that process. Therefore, consultations on future CASs can benefit from the PRSP consultations, can be more focused, and consider how IDA can best support the Government's PRSP priorities.

Table 3: CAS Completion Matrix

Goal or status at CAS Development	Status at Completion	Lessons Learned
<p>Progress on Armenia's Development Results</p> <p>Sustainable and equitable economic growth</p> <p>Public administration reform and an anti-corruption program</p>	<p>Real GDP grew by 10% in 2001, 13% in 2002 and 15% in the first 9 months of 2003. But growth has not generated enough formal jobs to offset job losses in public sector. By end-2002, 5% fewer people were employed in the formal sector than in 2000. The latest poverty figures available cover less than half a year of the CAS period and indicate that poverty fell from 55% in 1998/99 to 48% in 2001. Poverty only fell in urban areas; rates in rural areas remained the same.</p> <p>Public administration has improved. The Government has restructured central agencies, passed a civil service law and requires all senior civil servants to declare their assets. The Government has made steady progress with public expenditure management, and has a comprehensive, functioning treasury system in place. Most domestic arrears were eliminated by mid-2003.</p> <p>Corruption has lessened. The Government has taken many measures to implement its anti-corruption strategy. Business surveys indicate that the need for private sector to make bribes has fallen considerably, as has the amount of bribes.</p> <p>The business climate has improved. Companies report improved satisfaction with regulations and the business environment. The average time for business registration fell from 27 days in 2000 to 21 days in 2001. Similar progress was seen in business licensing processes. The number of inspections also fell between 2000 and 2001, and companies reported a 20% improvement in their evaluation of the tax system over the same period. Businesses' perceptions of enforcement vary in different parts of the country. Businesses in Yerevan are substantially more satisfied than those located elsewhere.</p>	<p>The benefits of economic growth may take time to reach the majority of people even as the structure of the economy begins to broaden. In transition economies, strong positive economic growth will not necessarily result in equitable benefits across all regions and population categories. In Armenia, areas outside Yerevan have benefited less from growth than has Yerevan itself. In future, public policy needs to pay particular attention to the needs of the population outside Yerevan and to increasing the employment effects of growth.</p> <p>Armenia's recent entry into the Council of Europe and the WTO may have helped strengthen government commitment to tackling governance issues.</p>

Goal or status at CAS Development	Status at Completion	Lessons Learned
Enhanced human development	<p>Health indicators have remained stable and reasonably good, although there is a discrepancy between some official and survey data. Survey data indicates worse outcomes than does official data. In all cases, rural indicators are significantly worse than urban ones. Under 5 mortality during the 1990s was on average 37% higher in rural areas than in urban areas (31 per 1,000 live births in urban areas compared to 59 overall) (AMPA p69).</p> <p>94% of children of the relevant age group are enrolled in basic education (grades 1-8) and 61% in secondary education (AMPA p58 based on EPEAS survey data)</p> <p>IDA estimates based on survey data, that Armenia is likely to meet the MDGs for gender and education, may meet those on poverty, infectious diseases and environmental sustainability but is unlikely to meet those on child mortality, maternal health.</p>	Children are dropping out of secondary school at least in part because education quality is low. The Education Quality and Relevance Project (04) will focus on improving education quality
Status of CAS outcomes that IDA expected to influence through its interventions		
Private sector development: <ul style="list-style-type: none"> * improve the entrepreneurial climate * promote the private sector 	Domestic Investment remained constant between 1996 and 2002 at around 20% of GDP and FDI remained at about 5% of GDP over the same period. The ratio of exports/GDP increased from 23% in 2000 to 30% in 2002. Importers in 2002 required 5 days to clear customs compared to 8 days in 2000.	
Improve governance and public sector services: <ul style="list-style-type: none"> * Governance 	BEEPS surveys indicate that between 2000 and 2002, Armenia's governance has improved on all measures except voice and accountability. It performs better than the average for the Former Soviet Union on all measures except political stability. Transparency International's Corruption Perception Index 2003 ranks Armenia 78 out of 133 countries; the highest FSU country apart from the Baltics and Belarus.	When a government is serious about tackling corruption it can make a big difference in a reasonably short time.
<ul style="list-style-type: none"> * Utilities 	Utility performance has improved dramatically. By 2003, the quasi-fiscal deficit relating to energy sector (equivalent to 2% of GDP) had been eliminated. Practically	Utility reform works well when the government is committed. Bank

Goal or status at CAS Development	Status at Completion	Lessons Learned
<p>* Rural development</p>	<p>the whole country had uninterrupted power supply. Tariff collection improved from 80% in 2002 to 98% in 2003. Drinking water services have improved dramatically in Yerevan where by 2003 46% of the Yerevan water utility's customers had service for 12 hrs a day or more compared to 10% in 2001. By March 2004, half of the city's population had 24 hour a day service. Services have not improved outside Yerevan. The Government has expanded the role of the Energy Regulatory Commission to also cover water and telecommunications, although the body needs strengthening.</p> <p>Rural areas have not developed to the same extent as urban areas. Rural incomes remained more or less constant between 1998/99 and 2001. Subsistence farming still dominates (for 71% of farming households in 2001). Nevertheless, some agricultural sub-sectors have grown. Agricultural exports increased from US\$229 million in 1998 to US\$354 million in 2001, and have grown as a share of total exports since 1999, reaching 14 of all exports percent in 2001.</p>	<p>support is effective as a package of AAA, adjustment and investment operations.</p> <p>The early privatization of land provided a safety net during the economic crisis, but a large number of people are employed in agriculture because they lack alternatives. This may explain why agriculture as a whole is not growing even though commercial agriculture is improving in some areas. The new CAS will need differentiated interventions to address both types of rural population.</p>
<p>* Natural resource management</p>	<p>Surveys indicate that Armenia has lost approximately 10% of forest cover since 1990. The Government has begun actions to make forest management sustainable. They have also restructured institutions dealing with the water sector.</p>	<p>Economic hardship, particularly in cold climates, can force people to use natural resources unsustainably.</p>
<p>Rebuilding human capital: * Improve the quality of education and make the financing system more sustainable</p>	<p>All first grade pupils and socially vulnerable elementary school pupils receive free textbooks. Average teacher salary has increased by 30% between 2001 and 2003. The Government has adopted a coefficient-mechanism for allocating funds to schools, and has begun to rationalize the school facilities and staffing. It has an action plan for improving financial management in higher education and has developed a higher education strategy.</p>	<p>A combination of continuous dialogue, investment and adjustment operations and AAA can be effective, especially when there is continuity of staff</p>

Goal or status at CAS Development	Status at Completion	Lessons Learned
<p>* Increase access to the healthcare system, rationalize the facilities and improve healthcare system financing.</p> <p>* Improve the design of the social protection mechanism and improve targeting of family benefits. Rationalize social insurance</p> <p>* make labor markets broader and more flexible</p>	<p>According to administrative data, between 2001 and 2003, maternal mortality fell from 47/100,000 live births to 34 although it did not meet the CAS target of 22. U5M fell from 25/1000 live births to 16 against a CAS target of 20. The Government has agreed to consolidate hospitals in Yerevan and has adopted an action plan for improving financial management in the healthcare system</p> <p>Social insurance and social assistance transfers are now paid on time (zero arrears). The average pension has increased by 30%. Almost all employed people contribute by paying social insurance; the number of employed people making contributions has increased by over 100,000. The Government has made significant progress in modernizing pension administration by introducing a Management Information System, with more than 250,000 personal identification numbers distributed. The targeting of transfer programs has improved and leakage is low. The Government has also piloted an expansion in community-based social services.</p> <p>The Government has completed a new Labor code that is compatible with a market economy</p>	
<p>Key country issues which may have influenced the ability of the CAS to achieve its desired outcomes</p>		
<p>Geopolitical instability. Renewed conflict may have disrupted all economic developments</p> <p>Governance reform may have been affected by political changes.</p> <p>Population. New census may have revealed far lower population and thus</p>	<p>Relationships with neighboring countries have been stable</p> <p>Political changes did not affect commitment to governance.</p> <p>The new census did show that the population fell over the 1990s, but this has not yet affected donor assistance. The rate of migration appears to have slowed since 1999.</p>	<p>Armenia is extremely vulnerable to manmade and natural disasters. In some respects the country was lucky that none of the shocks identified as risks materialized during the CAS period. The country did experience an unexpected frost in the spring of 2003, which devastated many farmers' crops, particularly grapes and tree fruit. Given the frequency with which natural disasters (earthquakes, floods, mudslides, droughts etc) occur in Armenia, it seems that the 2001 CAS</p>

Goal or status at CAS Development	Status at Completion	Lessons Learned
reduced donor funds	Did not materialize	should probably have considered those risks. Other major events such as the terrorist attacks of September 11, 2001 do not appear to have affected Armenia considerably and were not predictable.
Reduced commitment to improving the business environment	Debt sustainability has improved considerably. By the end of 2002, the Armenian government and government-guaranteed external debt was 43 % of GDP.	
Debt sustainability		
Summary of Bank Performance		
In March 2001, none of the 13 active projects was rated unsatisfactory for DO or IP, though four were rated unsatisfactory for counterpart funding.	The portfolio is 100% satisfactory. OED and QAG ratings for activities completed in this CAS period have been favorable, with the exception of one project rated by OED as moderately unsatisfactory because of poor design.	Moving responsibility for portfolio management to the country office helped to improve performance.
	The 2002 client survey indicates that the clients are reasonably satisfied, with a mean favorability rating of 7.8 on a scale of 10.	
Consultation and Coordination		
Many agencies are active in Armenia, with 14 sector-specific Partner Groups and an umbrella Donor Coordination Group.	IDA co-chaired a CG meeting in July 2001. The strong aid coordination unit within the Ministry of Finance is no longer in operational, which may have reduced the extent to which donor activities are coordinated. The PRSP process, however, has helped clarify government objectives and priorities and may make up for this deficiency.	

Table 4: Planned Base Case Lending Program and Actual Deliveries

Planned in 2001 CAS		Status		
		IDA US\$m	IDA US\$m	
FY02	Natural Resource Management	\$10	Actual	8.3 [†]
	Municipal Water/Wastewater	20	Moved to FY04	
	Private Sector Development II	5	IT Enterprise Incubator LIL	5.0
			Irrigation Development	24.9
			Foreign Invest/Export Fac'n LIL	1.0
	Subtotal FY02	35		39.2
FY03	Public Sector Reform Project	10	Moved to FY04	
	Irrigation Development	20	Moved to FY02	
	SAC V	40	Actual	40.0
	Subtotal FY03	70		40.0
FY04	Health/Social Protection	15	Health II*	19.0
	Urban Heat	10	Moved to FY07	
	Private Sector Development III	10	Moved to FY06	
	Education II	10	Education Quality/Relevance	19.0
			Public Sector Modernization	10.2
			Ag. Reform Support Supplement	1.7
			Municipal Water/Wastewater	23.0
			Social Protection Admin*	5.2
			Irrigation Dam Safety II*	6.8
	Subtotal FY04	45		84.8
TOTAL FY02-04		150		164

[†] Additional financing of US\$ 5.1 provided by GEF

* To be presented to the Board along with this CAS

Table 5. Status of Planned and Actual Non-Lending Services

	Planned in 2001 CAS	Status as of November 2003
FY98	Childrens' Initiative IDF (for completion in FY01)	Completed FY02
FY00	Cultural Heritage IDF (for completion in FY02) Strengthen Statistical System IDF (for completion in FY02)	Completed FY02 Completed FY03
FY01	CEM growth study Trade Facilitation Workshop Anti-corruption IDF Institution and Governance Review Workshop Restructuring Education Expenditures Water Resources Plan	Delivered FY01 Delivered FY02 Supervision on-going Delivered FY01 Delivered FY00 Delivered FY02
FY02	Poverty Study Country Financial Accountability Assessment Financial Sector TA Client Survey Procurement Assessment Public Expenditure Review Poverty Study Child Welfare Note Social Protection Note Urban Heat Strategy CG meeting	Poverty Update Delivered FY02 Delivered FY04 Delivered FY03 Delivered FY03 Delivered FY03 Delivered FY02 Poverty Update delivered FY03 Delivered FY02 Not yet delivered Delivered FY03 Delivered FY02
FY03	Labor Markets Strengthen Policy Capacity IDF Social Protection Study Anti-corruption strategy IDF Strengthening Policy Capacity (Treasury) IDF	Dropped Ongoing Not yet delivered Ongoing Ongoing FSAP Follow-up delivered FY03 Public Procurement System IDF on-going
FY04		Poverty assessment delivered FY04 Fiscal study. Delivered FY04

Note: the schedules reported in the 2001 CAS in Table 4 and Annex 4 differ somewhat

Annex 3: Proposed WBI Program FY05-08

The World Bank Institute (WBI) is the learning and capacity-building arm of the World Bank Group, and supports the building of institutional and human capacity in client countries to fight poverty and reach development objectives.

WBI activities for Armenia currently implemented or planned form part of the broader Caucasus or other regional programs:

- As part of the Caucasus program, Armenian participants take part in (i) workshops on territorial and administrative decentralization and financial viability of local self-governments. This ongoing support will be complemented by further activities on intergovernmental relations and urban management; and (ii) videoconferences on pension reform options for current systems, with a proposed follow-up program on related implementation issues.
- Within the CIS-7 program, Armenia participates in periodical workshops or videoconferences where various aspects of the PRSP process are discussed among PRSP teams or other agencies from the seven selected countries.

During the implementation of the CAS, WBI will align its activities with the development objectives identified in the CAS. This will be done through close collaboration with the Southern Caucasus Country Unit and other relevant ECA units with the aim to deliver client responsive and demand driven activities, possibly integrated in current and future Bank supported projects. In doing so:

- Efforts will be made to make activities broader and more continuous. The events carried out to date are generally well received by participants, but often judged to be too short and self-standing, and therefore not to have the desired impact or sustainability. By pursuing additional local and regional partnerships with NGOs, civil society, Government and donors, a more sustained presence of learning activities should be sought. This could involve a greater number and variety of learning events including distance learning and web based training courses, as well as locally sponsored workshops. Discussions to identify national partners in Armenia that would join the GDLN network will continue, with the aim of having a suitable agency identified in the early part of the CAS period.
- Priority will be given to sub-regional activities, either in the South Caucasus or CIS-7 context.

WBI activities during the CAS period will support both the growth and poverty alleviation related CAS goals. They include follow-up activities based on the current program in local government and fiscal decentralization for the South Caucasus, and the continuation of the PRSP dialogues. The work on pension reform will also continue.

To the extent possible, depending on resource availability and a continued good policy climate, WBI would consider becoming engaged in selective additional activities. Related to public management issues, this would include but not necessarily be limited to implementation of the

Government’s anti-corruption strategy, and support to the recently expanded utilities regulator (commission on natural monopolies). Further training of civil servants in areas of economics, finance and impact analysis (including environmental) is also desirable. To further support the private sector led growth goal, possible additional activities would include corporate governance programs in collaboration with local partners and support to the committee on competition policy.

The preliminary program of learning activities that WBI will deliver over the CAS period is presented in Table 1. Actual learning events will be carried out following the preparation of annual programs tailored to the rest of the Bank and other donor agencies, and defined in collaboration with the CMU and the Government.

Table 1: Armenia – tentative WBI program		
	<i>Private sector</i>	<i>Public sector</i>
Core program		Local government and fiscal decentralization; PRSP dialogues; Pension reform implementation
Expanded program if resources permit	Corporate governance; Support to the committee on competition policy	Anti-corruption strategy implementation; Utilities regulator support; Civil servants training in economics, finance and policy impact analysis (including environment)

Annex 4: Partnerships

SECTOR	LEAD NATIONAL AGENCY	PARTNERS
Donor Coordination	Ministry of Finance, PRSP Steering Committee	All donors
Poverty Reduction	PRSP Steering Committee	IMF/UNDP/USAID/UNHCR/NGOs/EU/GTZ/DFID/UNICEF
Governance/ Corruption	Public Sector Reform Committee	IMF/EU/DFID/USAID/GTZ/UNDP/NGOs
Health	Ministry of Health	USAID/UNDP/WHO/UNICEF/UNHCR/GTZ/Global Fund
Transport	Ministry of Transport and Communications	Lincy Foundation/EU/UNDP/USAID/IFAD
Education	Ministry of Education and Science	UNICEF/EU/UNHCR/WFP/GTZ
Agriculture/ Food Safety/Rural Development	Ministry of Agriculture, Ministry of Territorial Administration	EU/FAO/WFP/IFAD/USDA/GTZ/UNHCR/DFID/UNDP/USDA/USAID UNIDO/NGOs
Decentralization	Ministry of Territorial Administration	USAID/EU/UNDP
Energy/Heating	Ministry of Finance and Economy; Ministry of Energy	EBRD/IBIC/EU/USAID/GTZ/IMF/UNDP
Private Sector	Ministry of Industry and Trade, Armenian Development Agency	USAID//GTZ/UK/EBRD/EU/Eurasia Foundation/IMF/UNDP
Natural Resources Environment (including water resources management)	Ministry of Nature Protection	UNDP/EU/FAO/UNIDO/USAID/EBRD/GTZ/UNEP/NGOs
Refugees/ Housing	Department for Migration/Urban Construction Ministry	UNHCR/WFP/NGOs
Financial Sector	Central Bank/Ministry of Finance & Economy/Securities Commission	IMF/USAID/USDA/GTZ/EBRD
Water	State Committee on Water Economy	USAID/UNDP/UNHCR/IFAD/WFP/KfW
Social Protection	Ministry of Labor and Social Issues	UNDP/UNHCR/USAID/EU/UNICEF/NGOs

Annex 5: Core Labor Standards

- 1. The Right of Association.** The Constitution provides employees with the right to form and join trade unions, although it stipulates that the right to form associations, including political parties and trade unions, may be limited for those persons serving in the armed services and law enforcement agencies. In practice, labor organization remained weak because of high unemployment and the weak economy. The absence of active unions and of accurate employment data precluded a reliable estimate of the percentage of the workforce that is unionized. Unions are free to affiliate with international organizations; however, none had done so to date.
- 2. Labor Rights.** Although the law provides for the right to organize and bargain collectively, collective bargaining does not occur in practice. Factory directorates generally set the pay scales without consultation with employees. Labor disputes are arbitrated in regular or economic courts. The Constitution provides for the right to strike; however, workers had neither the financial resources to maintain a strike nor enforceable legal protection against retaliation, and existing unions play a relatively passive role. The standard legal workweek was 40 hours; however, many persons work multiple jobs in order to provide for basic necessities. The law provides for annual and sick leave; however, there were no mandated rest periods. Compensation for overtime work is required; the amount depends on the position and type of employment.
- 3. Forced, Bonded and Child Labor.** The Constitution and the law prohibit forced and bonded labor, including by children, and there have been no reports that such practices occur. According to the law, 16 years is the minimum age for employment. Children may work from the age of 14 with the permission of a medical commission and the relevant labor union board. The law is enforced by local community councils, unemployment offices, and, as a final board of appeal, the courts. The Government has not ratified ILO Convention 182 on the worst forms of child labor.
- 4. Trafficking in Persons.** Armenia is a country of origin for international trafficking of girls and women for prostitution. Trafficking appears to come from orphanages and from families who allegedly press their daughters to sell themselves into prostitution. The Government of Armenia does not yet comply with the minimum standards for the elimination of trafficking. In 2003, however, the Armenian Government acknowledged the need for increased action against trafficking, and has focused more law enforcement resources on the problem. A new inter-agency task force has coordinated public awareness efforts throughout the country, including pamphlet distribution at the borders. The Government's Refugee and Migration Service included information on trafficking in an edition of its journal on legal migration, and houses an IOM-funded Migration Service Point with a hotline, allowing people to call or come in to ask about migration issues, including trafficking. The Office advertises the hotline in newspapers. In April 2003, Armenia amended its criminal code to include a specific criminal prohibition against trafficking for sexual exploitation. Before then, traffickers could be prosecuted under such articles as illicit seizure, falsification and selling of personal documents, extortion, bogus marriages and divorces, and coercion into sexual intercourse. The Government has instituted anti-corruption efforts in the Customs Committee and upgraded the technology at the borders to combat trafficking. In 2002, 26 criminal cases were brought against pimps, including four charges against traffickers involved in organizing illegal border crossings with false documents. Subsequent figures are not yet available.

Annex 6: Matching Development Priorities of Government and Bank

Issue	Country performance	Major issue	Country priority	Bank priority	Reconciliation of country and Bank priorities
Poverty Reduction & Economic Management					
Poverty reduction	Fair	Poverty levels remain high, particularly outside Yerevan	High	High	
Economic policy	Excellent	Maintaining good performance	High	High	
Public sector	Fair-Good	Administrative efficiency and corruption	Moderate	High	Ongoing dialogue, including Public Sector Reform Credit
Gender	Good	Low labor force participation; reproductive health; boys dropping out of secondary school	Low	Moderate	Diagnosis and dialogue through Labor Market study; Health System Modernization Project; Education Quality and Relevance Project; Business Surveys.
Human Development Department					
Education	Good	Poor quality, low levels of funding, efficiency of resource use	High	High	
Health, nutrition & population	Good	Quality, cost-efficiency	High	High	
Social protection	Good	Improve effectiveness of administration; reach more eligible beneficiaries	High	High	
Environmentally & Socially Sustainable Development					
Rural development	Fair-Good	Access to markets; access to improved inputs; degraded infrastructure (including irrigation); low quality social services.	High	High	
Environment	Fair	Depletion/degradation of natural resources; vulnerability to natural disaster; capacity to implement environmental safeguards	Moderate	High	On-going dialogue in context of Natural Resource Management Project; several rural operations and PRSCs.
Social development	Fair-Good	Civil society participation	Moderate	High	Dialogue in context of PRSP
Finance, Private Sector & Infrastructure					
Financial sector	Fair-Good	Consolidation, better regulation	Moderate	Moderate	
Private sector	Good-Excellent	Administrative corruption	High	High	
Energy & mining	Good	Fiscal	Moderate	Moderate	
Infrastructure	Good	Water supply	High	High	

Annex 7: PRSP Policies and Investments

Table 1: Grouping of Planned PRSP measures by PRSP goal

PRSP Goal (Section 2)	Planned Measures (PRSP Annex 9)
<p>Promoting private-sector led growth:</p> <ul style="list-style-type: none"> * promoting a dynamic private sector * improving public sector management * reducing corruption 	<ul style="list-style-type: none"> •P67 adopt anti corruption strategy •P68 prevent profits from illegal activities •P71-72, p83, p85 Improve regulation and oversight of businesses •P76-78 Simplify licensing requirements procedures •P79 privatize admin of several professional qualifications •P81, p91-94 venture financing and credit expansion •P82 legislation on labor standards •P84 provide consulting services to SMEs •P88-90 reduce shadow economy •P95-101 simplify tax mechanisms 139-141 improve employment programs •P1 Increase PRSP awareness •P4, p37-39, p5, p60, p73-75 increase involvement of civil society in decision-making processes •P5-6, p181-186 introduce PRSP monitoring system •P8 create knowledge based institutions •P29-30, p32, p47-50, p53, p54-59, p143 public sector and civil service reforms incl. sub-national bodies •P31, 41-46 improve public sector budgeting and financial management •P33, p35-36 new technologies in public sector, including e-governance •P34, p107 increase public sector salaries •P61-66 judicial reforms •P69-70 strengthening tax and customs administration and legislation •P2 maintain GDP growth of 6% p.a. •P3 increase level of investment •P80 accelerate bankruptcy of loss making state enterprises •P164-170 improve environmental standards, charges and practices, including charging adequate fees and phasing out subsidies for use of environmental resources •P175 finance road construction from fuel tax revenues •P177-178 energy transmission and coordination system and financial rehab of energy system
<p>Making growth more pro-poor:</p> <ul style="list-style-type: none"> * reducing income inequality * reducing differences between urban and rural areas * reducing differences in access to basic services 	<ul style="list-style-type: none"> •P21, p174 Rural and community roads •P52 Make tariffs and duties charged by local governments affordable •P87 micro finance to promote off farm income opportunities •P103-106, p108-112, 114-128, 130-138 Increase efficiency of and/or increase levels of family benefits, pensions, assistance to vulnerable groups, and unemployed •P113 reform system of complaints about benefits •P129 link minimum wage to poverty line •P176, p179 introduce local heating systems including support to apartment blocks

	<ul style="list-style-type: none"> •P9, p23 increase availability of agricultural credit •P10, p17-20, p171-173 optimize land and water use •P11 create commodity markets •P12, p26 crop insurance •P13, p27-28 increase off farm income opportunities •P14-16, p23 improve land market •P22 promote farm cooperatives •P25 private extension services
Reducing non-income poverty	<ul style="list-style-type: none"> •P142, p144 Increase public expenditures in health sector •P145, p147-149 improve quality of healthcare services •P146 improve ambulance service •P150 consolidate hospitals •P153-160 increase quality and efficiency of education system •P180 improve vocational education •P151-152 improve planning budgeting and oversight in healthcare institutions •P40 increase female participation in government •P161-163 cultural preservation

Table 2: Grouping of Planned PRSP measures by theme identified in the JSA

Theme identified in the JSA	Planned Measures (PRSP Annex 9)
Sustainable Economic Growth	<ul style="list-style-type: none"> •P2 maintain GDP growth of 6% pa •P3 increase level of investment •P80 accelerate bankruptcy of loss making state enterprises •P71-72, p83, p85 Improve regulation and oversight of businesses •P76-78 Simplify licensing requirements procedures •P79 privatize admin of several professional qualifications •P81, p91-94 venture financing and credit expansion •P82 legislation on labor standards •P84 provide consulting services to SMEs •P9, p23 increase availability of agricultural credit •P11 create commodity markets •P12, p26 crop insurance •P13, p27-28 increase off farm income opportunities •P22 promote farm cooperatives •P25 private extension services •P68 prevent profits from illegal activities •P87 micro finance to promote off farm income opportunities •139-141 improve employment programs
Enhancing Human Development and Safety Nets	<ul style="list-style-type: none"> •P151-152 improve planning budgeting and oversight in healthcare institutions •P103-106, p108-112, 114-128, 130-138 Increase efficiency of and/or increase levels of family benefits, pensions, assistance to vulnerable groups, and unemployed •P113 reform system of complaints about benefits •P129 link minimum wage to poverty line •P142, p144 Increase public expenditures in health sector •P145, p147-149 improve quality of healthcare services •P146 improve ambulance service •P150 consolidate hospitals •P153-160 increase quality and efficiency of education system •P180 improve vocational education
Prudent Fiscal Policies	<ul style="list-style-type: none"> •P95-101 simplify tax mechanisms •P88-90 reduce shadow economy •P31, 41-46 improve public sector budgeting and financial management •P69-70 strengthening tax and customs administration and legislation •P52 Make tariffs and duties charged by local governments affordable
Improving Public Infrastructure	<ul style="list-style-type: none"> •P175 finance road construction from fuel tax revenues •P177-178 energy transmission and coordination system and financial rehab of energy system P21, p174 Rural and community roads•p176, p179 introduce local heating systems incl. support to apartment blocks

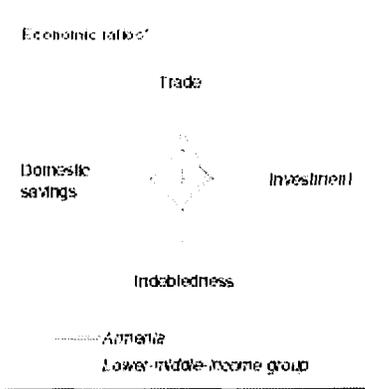
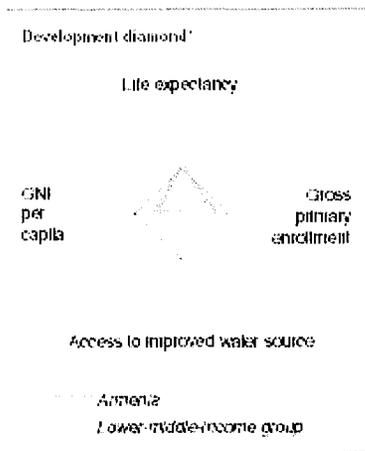
<p>Improving Core Public Sector Functions</p>	<ul style="list-style-type: none"> •P67 adopt anti corruption strategy •P1 Increase PRSP awareness •P5-6, p181-186 introduce PRSP monitoring system •P4, p37-39, p5, p60, p73-75 increase involvement of civil society in decision-making processes •P8 create knowledge based institutions •P29-30, p32, p47-50, p53, p54-59, p143 public sector and civil service reforms incl. sub-national bodies •P33, p35-36 new technologies in public sector, including e-governance •P34, p107 increase public sector salaries •P40 increase female participation in government •P61-66 judicial reforms •P10, p17-20, p171-173 optimize land and water use •P14-16, p23 improve land market •P161-163 cultural preservation •P164-170 improve environmental standards, charges and practices, including charging adequate fees and phasing out subsidies for use of environmental resources
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Annex 8: Country at a Glance

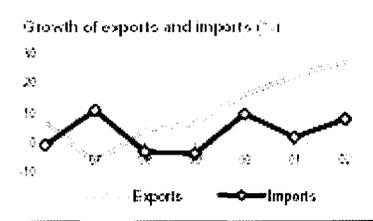
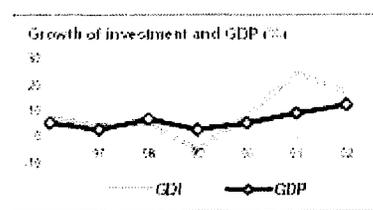
Armenia at a glance

8/20/03

	Armenia	Europe & Central Asia	Lower-middle-income		
POVERTY and SOCIAL					
2002					
Population, mid-year (millions)	3.1	4.76	2.411		
GNI per capita (Atlas method, US\$)	790	2,160	1,390		
GNI (Atlas method, US\$ others)	2.4	1,030	3,352		
Average annual growth, 1996-02					
Population (%)	-1.1	0.1	1.0		
Labor force (%)	1.1	0.1	1.2		
Most recent estimate (latest year available, 1996-02)					
Poverty (% of population below national poverty line)	48	..	..
Urban population (% of total population)	67	63	49		
Life expectancy at birth (years)	75	69	69		
Infant mortality (per 1,000 live births)	34	26	30		
Child malnutrition (% of children under 5)	3	..	11		
Access to an improved water source (% of population)	..	91	81		
Literacy (% of population age 15+)	1	3	13		
Gross primary enrollment (% of school-age population)	99	102	111		
Male	99	103	111		
Female	99	101	110		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1982	1992	2001	2002	
GDP (US\$ billions)	..	1.1	2.1	2.4	
Gross domestic investment/GDP	..	1.6	18.6	19.8	
Exports of goods and services/GDP	..	39.8	25.6	29.2	
Gross domestic savings/GDP	..	-19.8	-1.7	3.2	
Gross national savings/GDP	9.5	14.2	
Current account balance/GDP	9.5	-6.8	
Interest payments/GDP	0.8	1.0	
Total debt/GDP	46.7	48.5	
Total debt service/exports	7.4	9.0	
Present value of debt/GDP	30.9	..	
Present value of debt/exports	88.8	..	
	1982-92	1992-02	2001	2002	2002-06
<i>(average annual growth)</i>					
GDP	..	5.4	9.6	12.9	6.3
GDP per capita	..	6.8	10.4	13.5	-0.7
Exports of goods and services	..	-4.0	22.9	27.3	15.6



	1982	1992	2001	2002
STRUCTURE of the ECONOMY				
<i>(% of GDP)</i>				
Agriculture	..	31.0	27.7	25.9
Industry	..	39.4	34.2	33.2
Manufacturing	..	33.1	22.1	21.6
Services	..	29.6	38.1	40.9
Private consumption	..	101.3	91.0	85.3
General government consumption	..	18.5	10.7	10.5
Imports of goods and services	..	61.3	45.9	45.8
	1982-92	1992-02	2001	2002
<i>(average annual growth)</i>				
Agriculture	..	2.7	11.6	4.4
Industry	..	4.2	6.8	24.2
Manufacturing	..	3.7	3.8	14.2
Services	..	4.4	9.3	9.7
Private consumption	..	3.3	15.2	-7.9
General government consumption	..	-0.3	3.3	8.6
Gross domestic investment	..	7.7	24.8	17.7
Imports of goods and services	..	-2.9	2.1	8.2

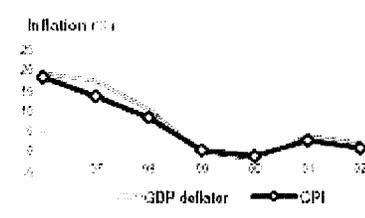


Note: 2002 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

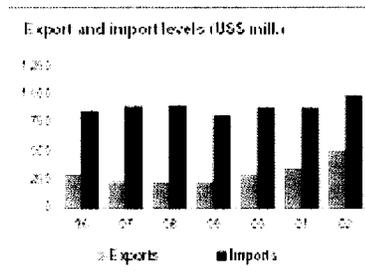
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices	..	728.7	3.1	1.1
Implicit GDP deflator	..	568.8	4.0	2.3
Government finance (% of GDP, includes current grants)				
Current revenue	..	4.0	16.3	16.7
Current budget balance	..	-7.7	0.3	0.6
Overall surplus/deficit	..	-7.7	-4.3	-2.6



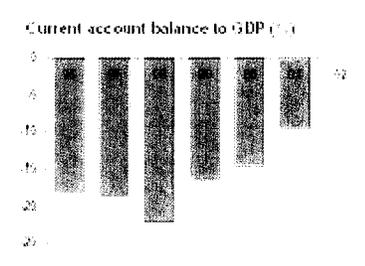
TRADE

	1982	1992	2001	2002
(US\$ millions)				
Total exports (fob)	..	220	342	507
Gold, jewelry, and other precious stones	123	259
Machinery and mechanical equipment	28	21
Manufactures	89	..
Total imports (cif)	..	334	877	991
Food	211	200
Fuel and energy	..	60	187	..
Capital goods	62	..
Export price index (1995=100)
Import price index (1995=100)
Terms of trade (1995=100)



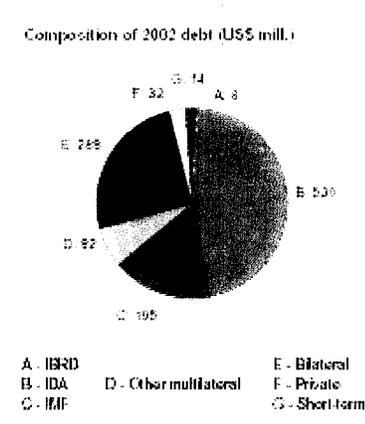
BALANCE of PAYMENTS

	1982	1992	2001	2002
(US\$ millions)				
Exports of goods and services	..	230	540	700
Imports of goods and services	..	364	978	1,117
Resource balance	..	-135	-438	-417
Net income	..	-30	64	88
Net current transfers	174	109
Current account balance	-201	-160
Financing items (net)	217	234
Changes in net reserves	-16	-73
Memo:				
Reserves (including gold) (US\$ millions)	334	300
Conversion rate (DEC. local/US\$)	..	0.3	555.1	573.4



EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
(US\$ millions)				
Total debt outstanding and disbursed	989	1,149
IBRD	7	8
IDA	428	520
Total debt service	56	74
IBRD	1	1
IDA	3	4
Composition of net resource flows				
Official grants	42	0
Official creditors	59	63
Private creditors	0	-4
Foreign direct investment	70	0
Portfolio equity	0	0
World Bank program				
Commitments	75	9
Disbursements	56	66
Principal repayments	0	0
Net flows	56	66
Interest payments	3	4
Net transfers	51	62



Annex 9: IMF- IDA Relations

Partnership in Armenia's Development Strategy

1. The IMF has taken the lead in assisting Armenia in enhancing macroeconomic stability and advancing reforms to sustain high rates of economic growth. In this regard, the Fund has encouraged the authorities to pursue a prudent fiscal policy (including by increasing tax revenues and reducing domestic expenditure arrears), implement a number of tax and expenditure measures, and proceed with key reforms on the banking and energy sectors. The IMF Board approved a new three-year program under the Fund's Poverty Reduction and Growth Facility (PRGF) in May 2001. The fifth review was completed in May 2004. The Government met all of the program's quantitative and structural performance criteria at end-December 2003, as well as two of the five structural benchmarks scheduled for implementation up to March 2004.

2. IDA has taken the lead in the policy dialogue on structural issues, focusing on: (i) strengthening public expenditure management; (ii) deepening and diversifying sources of growth, (iii) protecting the environment; and (iv) reducing poverty. Table A below summarizes the division of responsibility between the two institutions. In a number of areas – for example the social sectors, rural development, environment, and infrastructure (other than energy) – IDA takes the lead in the dialogue and there is no cross conditionality with the IMF-supported program. IDA is also leading the dialogue on private sector reform, and IDA analysis serves as inputs into the Fund program. In other areas – structural reform, private sector development, the financial sector, public expenditure management, and revenue and customs – both institutions work together. Finally, in areas like monetary policy the IMF takes the lead with little IDA involvement.

Areas in which IDA leads and there is no direct IMF involvement

3. Areas in which IDA leads and there is no direct IMF involvement include the social sectors, infrastructure and environment.

- In **social investment and protection**, IDA is focusing, through Social Investment Fund credits in particular, on helping to provide basic infrastructure to the poorest communities. Assistance has also been provided to the government in designing and implementing a family benefit system, which has become an effective and well-targeted means to support poor households. IDA is preparing a Social Protection Administration Credit to improve the efficiency and effectiveness of the delivery of social protection benefits. A focus on the vulnerable will also be provided through a Labor Market Study and Programmatic Poverty Assessments. The Social Protection Administration Project will also help strengthen the regional employment agencies, which will allow the government to help qualified applicants find potential employers. IDA conducts periodic updates of the Poverty Assessments based on household survey data.
- In **education** IDA has been helping the Government make the healthcare system more responsive to the needs of the poor. An Education Quality and Relevance Project, along with proposed PRSCs and a PRSC TA, will help the Government improve enrollment rates and education quality. The Social Investment Fund credits support rehabilitation of

school buildings, and a proposed urban heating project will help modernize heating systems in selected schools.

- In **health care** IDA is helping improve access through a Health Systems Modernization Project. Public health will also benefit from other proposed IDA-supported projects: a Yerevan Water Project, an Urban Heating project, and possibly an Infrastructure Project if it includes improvements in transport in remote areas. Programmatic Public Expenditure Reviews will identify issues relating to healthcare spending and propose solutions.
- In **rural development** on-going IDA support includes an Agricultural Reform Support Credit, a Title Registration Project, an Irrigation Dam Safety and an Irrigation Development project, as well as studies on rural productivity and on rural infrastructure. The Health and Education projects are addressing the quality of rural services, and a Trans-Caucasus Tourism Initiative is helping promote the off-farm economy in select rural areas. Other new interventions under preparation include a Rural Development Project.
- In **infrastructure** IDA is helping improve access through the Municipal Development and Armenia Water projects, which are contributing to improved drinking water services. Proposed new interventions include the Urban Heating Project, the second Yerevan Water Project, and the Infrastructure Project.
- In the **environment** IDA is supporting work on natural resource management, and will support a Country Environment Assessment. In addition IDA will support a Renewable Energy Project to reduce Armenia's dependence on imported fossil fuels: the Urban Heating project, which will reduce demand for fuelwood for heating; the Rural Development Project which will assess the options for sustainable forest and natural resource based income generation activities; and the water supply projects, which together with any additional investment in irrigation, will improve water resource management.

Areas in which IDA leads and its analysis serves as input into the IMF program

- IDA has been leading the dialogue on **structural reforms** through a series of five Structural Adjustment Credits, and will continue to provide support the proposed PRSCs. Institution building and technical assistance has been supported through a Structural Adjustment Technical Assistance Credit.
- In **private sector development** IDA is supporting improvements in the business environment through a Public Sector Reform Credit and a Judicial Reform Project. The SACs and the proposed PRSCs and PRSC TA include support for tax reform and improvements in the application of accounting standards. IDA's Analytical and Advisory program includes financial sector advisory services that will help improve corporate governance, as will IDFs on public procurement and competition policy. Regular business surveys will help monitor results.
- Improvement in the **financial system** will be assisted through advisory and analytical work (such as the Financial Sector Advisory Notes and the Country Economic Memorandum on pro-poor growth), sequenced with programmatic support to reforms through the series of PRSCs. These interventions will promote an increase of minimum capital requirements for the banking sector, establishment of a credit bureau, as well as

new legislation relating to the banking sector. In the context of the PRSCs, IDA will also provide support for anti-money laundering and combating the financing of terrorism through support for the adoption of comprehensive legislation, the establishment of a Financial Intelligence Unit, and the training of government and financial institution officials.

- **Public Sector Management.** IDA is supporting improved public sector management through the Public Sector Reform Credit that tackles civil service reform, public procurement, and e-government, as well as through a Judicial Reform Project. A planned series of PRSCs and the PRSC TA will tackle many related issues, including tax reform, increased transparency of the budget process at central and local levels, and application of accounting standards. A possible further Public Sector Project would also address problems in this area. The Analytical and Advisory program supports these interventions through the Country Financial Accountability Assessment, and through financial sector advisory services. The Programmatic Public Expenditure Reviews, and the Country Economic Memorandum, will help diagnose problems and monitor outcomes, and the regular business surveys will help monitor results.

Areas of shared responsibility

4. IDA and the Fund have been working jointly in the following main areas:

- **Poverty Reduction Strategy.** Both institutions have been working closely with the Government to provide support to the development of the PRSP, through seminars and workshops, direct staff input, and a multi-donor Trust Fund to support the work of the PRSP secretariat.
- **Budget Planning and Execution.** The annual Programmatic Public Expenditure Reviews will provide the underpinnings for systemic changes in expenditure management, with the immediate aim being improved budget formulation. The IMF has been providing technical assistance on Treasury reform within the Ministry of Finance.
- **Financial Sector Reforms.** The joint Financial Sector Assessment Program has supported: (i) strengthened banking and non-banking supervision; (ii) introduction of international accounting standards; (iii) and consolidation of banks through higher capital requirement ratios; and (iv) anti money-laundering legislation. The IMF has focused in particular on banking supervision.

Areas in which the IMF leads and its analysis serves as input into the IDA program

- **Fiscal Framework.** IMF takes the lead on annual budget negotiations and budget monitoring. The IMF's focus on prudent fiscal policy has served as a useful input into IDA's work on public expenditure management..

Areas in which the IMF leads and there is no direct IDA involvement

- **Monetary Framework.** The IMF closely collaborates with the Central Bank in the design and implementation of a monetary program that aims at remonetization of the economy, while keeping inflation low and the exchange rate of the Dram stable.

- **Economic Statistics.** IMF technical assistance has been conducive to improvements in national accounts, price, monetary and government financial statistics.

TABLE A. IDA-FUND COLLABORATION ON ARMENIA

Area	Specialized Advice from Fund	Specialized Advice from IDA	Key Instruments
Macroeconomic Framework/ Management	Monetary policy, exchange rate, fiscal, and trade policies, economic statistics, selected tax, customs, and banking sector reforms	Economic growth, PRSP-related expenditure allocations, financial sector reforms, economic statistics	<i>IMF:</i> PRGF performance criteria and benchmarks on monetary and fiscal targets and structural measures on fiscal and banking system reform. <i>IDA:</i> Macromonitoring; Trade and Transport Facilitation Project; Financial Sector Advisory Work; PRSC
Budget	Budget formulation and execution, tax policy and administration, customs, debt management, extra budgetary funds.	Public expenditure reviews and budget formulation, particularly in the areas of social and infrastructure budget allocations, Country Procurement Assessment, Country Financial Accountability Assessment	<i>IMF:</i> PRGF performance criteria on overall fiscal balance and revenue collection. Monitoring of budget execution. <i>Bank:</i> Public Expenditure Review Updates; Support for PRSP Updates; PRSC
Public Sector Reform	Public asset management, quasi-fiscal deficits, selected energy sector reforms, and tax and customs components of anti-corruption agenda.	Civil service reform, anti-corruption agenda, decentralization. Energy sector reforms.	<i>IMF:</i> PRGF structural performance criteria and benchmarks on fiscal and energy sector areas. <i>IDA:</i> Public Sector Management Project
Social/Poverty		Poverty analysis; reforms in education, health, social protection; support to community driven development	<i>IMF:</i> PRGF <i>IDA:</i> Support through IDA Credits for Education, Health and Social Investment Funds, Social Protection.
Private Sector Development		Costs of Doing Business Surveys. Support for improved legislation and regulatory framework for private sector, and support for privatization and market liberalization.	<i>IDA:</i> Business Environment Study, Labor Market Study, Private Sector Development Projects.
Infrastructure		Private sector participation in infrastructure	<i>IDA:</i> Support though ongoing and proposed IDA Credits for Water Supply, Municipal Development, Roads, Transport and Energy

Annex 10: Bank Portfolio Performance and Management

Selected Indicators* of Bank Portfolio Performance and Management

As of 04/14/2004

Indicator	2001	2002	2003	2004
Portfolio Assessment				
Number of Projects Under Implementation ^a	13	17	14	13
Average Implementation Period (years) ^b	2.5	2.8	3.3	3.8
Percent of Problem Projects by Number ^{a, c}	7.7	5.9	0.0	7.7
Percent of Problem Projects by Amount ^{a, c}	11.2	6.8	0.0	8.9
Percent of Projects at Risk by Number ^{a, d}	7.7	5.9	0.0	15.4
Percent of Projects at Risk by Amount ^{a, d}	11.2	6.8	0.0	11.1
Disbursement Ratio (%) ^e	20.1	24.1	20.2	24.7
Portfolio Management				
CPPR during the year (yes/no)				
Supervision Resources (total US\$)				
Average Supervision (US\$/project)				

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	15	9
Proj Eval by OED by Amt (US\$ millions)	466.5	231.4
% of OED Projects Rated U or HU by Number	13.3	11.1
% of OED Projects Rated U or HU by Amount	15.8	6.6

a. As shown in the Annual Report on Portfolio Performance (except for current FY).

b. Average age of projects in the Bank's country portfolio.

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex 11: Bank Group Program Summary

FY04 Lending, and Proposed IDA Base-Case Lending Program FY05-08				
<i>Fiscal year</i>	<i>Project</i>	<i>US\$(M)</i>	<i>Strategic Rewards (H/M/L)</i>	<i>Implementation Risks (H/M/L)</i>
2004	Education Quality and Relevance	19.0	H	H
	Public Sector Modernization	10.2	H	H
	Municipal Water and Wastewater	23.0	M	M
	Health Systems Modernization	19.0	H	H
	Social Protection Administration	5.2	L	L
	Ag. Reform Support Supplement	1.7	L	L
	Irrigation Dam Safety II	6.8	M	L
	Total	84.8		
2005	PRSC I /PRSC TA	25	H	H
	Rural Development I	15-25	H	M
	Yerevan Water Ii	20	M	L
	Total	60-70		
2006	PRSC II	20	H	H
	Social Investment Fund III	15-25	M	L
	Urban Heating	15	M	M
	Total	50-60		
2007	PRSC III	20	H	H
	Renewable Energy	5	M	M
	Infrastructure	10-20	M	L
	Total	35-45		
2008	Rural Development II	10-20	H	M
	Total	10-20		

IFC and MIGA Program, FY 2001-2004

	2001	2002	2003	2004
IFC approvals (US\$m)	0.00	7.27	0.00	1.25
Sector (%)				
Accommodation & Tourism				100
Collective Investment		69		
Finance & Insurance		31		
Total	0	100	0	100
Investment instrument (%)				
Loans		28		
Equity		55		50
Quasi-Equity		17		50
Other				
Total	0	100	0	100
MIGA guarantees (US\$m)	2.70	2.70	2.70	2.70

Annex 12: Summary of Non-Lending Services

As of April 20, 2004				
<i>Product</i>	<i>Completion</i>	<i>Cost (US\$000)</i>	<i>Audience^a</i>	<i>Objective^b</i>
<u>Recent completions</u>				
Poverty Assessment	FY04	183	G,D,B,P	KG,PD,PS
Country Financial Accountability Assessment	FY04	147	G,D,B,P	KG,PS,PD
Country Procurement Assessment Review	FY03	152	G,D,B,P	KG,PS,PD
Trade Facilitation Dialogue	FY03	38	G,D,B	PS
Urban Heating Strategy	FY03	156	G,D,B,P	KG,PS,PD
Banking Sector Advisory TA	FY03	185	G,B	PS
FSAP Follow-Up TA	FY03	93	G,D,B	PS
<u>Underway</u>				
Social Protection Study	FY04	50	G,D,B,P	KG,PS,PD
Financial Sector TA	FY04	82	G,B	KG,PS
Poverty Assessment Follow-Up TA	FY04	52	G,D,B	PS
Anti-corruption (IDF)	FY04	16	G,D,B,P	KG,PD,PS
CFAA Follow Up	On-going	16 pa	G,B	PS
CPAR Follow Up	On-going	16 pa	G,B	PS
Country Economic Memorandum	FY05	182	G,D,B,P	KG,PS
Rural Sector Strategy and Action Plan	FY05	150	G,D,B,P	KG,PS
Treasury Action Plan and Pilot (IDF)	FY06	56	G,B	PS
Public Procurement (IDF)	FY07	45	G,D,B	PS
Macro Monitoring	On-going	88 pa	G,B	KG,PS
<u>Planned</u>				
Private/Financial Sector Services	On-going	80-100	G,D,B	KG,PS
Labor Market Dynamics	FY06	150	G,D,B,P	KG,PS,PD
Programmatic Poverty Assessments	On-going	100 pa	G,D,B,P	KG,PS,PD
Programmatic Public Expenditure Reviews ^c	On-going	80 pa	G,D,B,P	KG,PS,PD
Country Environment Assessment	FY08	150	G,D,B,P	KG,PS,PD
Private/Financial Sector Services	On-going	100 pa	G,D,B	KG,PS
FIAS follow-up	On-going	10 pa	G,D,B,P	KG,PS
Annual Business Survey	On-going	20 pa	G,D,B,P	KG,PS
Competition Policy (IDF)	FY08	45	G,D,B	PS
Donor Coordination	On-going	50 pa	G,D,B	PS

a. Government (G), donor (D), Bank (B), public dissemination (P).

b. Knowledge Generation (KG), public debate (PD), problem-solving (PS).

c. Includes core diagnostic studies in FY08 (Poverty Assessment) and FY07 (Public Expenditure Review)

Annex 13: Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1996-2002	Europe & Central Asia	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	2.8	3.3	3.1	472.9	2,408.5
Growth rate (% annual average for period)	2.3	1.5	-1.1	0.0	0.9
Urban population (% of population)	63.0	66.6	67.4	63.6	49.4
Total fertility rate (births per woman)	2.8	2.5	1.2	1.6	2.1
POVERTY					
<i>(% of population)</i>					
National headcount index	..	..	53.7	..	..
Urban headcount index	..	..	60.4	..	..
Rural headcount index	..	..	44.8	..	..
INCOME					
GNI per capita (US\$)	..	..	790	2,160	1,400
Consumer price index (1995=100)	..	..	153	..	..
Food price index (1995=100)	..	..	126	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Share of income or consumption					
Gini index	..	..	37.9	..	..
Lowest quintile (% of income or consumption)	..	..	6.7	..	..
Highest quintile (% of income or consumption)	..	..	45.1	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	3.2	4.3	2.7
Education (% of GDP)	..	..	3.2	4.3	4.0
Social security and welfare (% of GDP)	..	..	..	..	..
Net primary school enrollment rate					
<i>(% of age group)</i>					
Total	..	..	85	..	91
Male	..	..	85	..	92
Female	..	..	84	..	92
Access to an improved water source					
<i>(% of population)</i>					
Total	..	..	..	91	81
Urban	..	..	..	96	95
Rural	..	..	..	83	70
Immunization rate					
<i>(% of children ages 12-23 months)</i>					
Measles	..	..	91	93	78
DPT	..	..	94	92	84
Child malnutrition (% under 5 years)	..	..	3	..	9
Life expectancy at birth					
<i>(years)</i>					
Total	72	73	75	69	69
Male	69	71	71	64	67
Female	75	76	79	73	72
Mortality					
Infant (per 1,000 live births)	24	22	30	31	32
Under 5 (per 1,000 live births)	..	80	35	37	40
Adult (15-59)					
Male (per 1,000 population)	187	158	223	317	212
Female (per 1,000 population)	99	85	106	137	131
Maternal (modeled, per 100,000 live births)	..	..	55	..	..
Births attended by skilled health staff (%)	..	..	97	..	..

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age.

Annex 14: Key Economic Indicators

Indicator	Actual			Prel.		Projected			
	1999	2000	2001	2002	2003	2004	2005	2006	2007
National accounts (as % of GDP)									
Gross domestic product ^a	100	100	100	100	100	100	100	100	100
Agriculture	29	26	28	26	24	24	23	23	23
Industry	32	35	33	37	41	41	41	42	43
Services	38	39	39	37	35	36	35	35	35
Total Consumption	111	109	101	97	94	94	93	92	92
Gross domestic fixed investment	16	18	18	19	24	23	23	22	22
Government investment	..	..	..	..	5	3	4	4	4
Private investment	..	..	..	..	18	19	18	18	18
Exports (GNFS) ^b	21	23	25	30	32	32	33	32	32
Imports (GNFS)	50	51	46	47	50	49	48	47	46
Gross domestic savings	-11	-9	-1	3	6	6	7	8	8
Gross national savings ^c	2	4	10	14	17	16	16	16	16
<i>Memorandum items</i>									
Gross domestic product (US\$ million at current prices)	1845	1912	2118	2367	2797	3026	3307	3590	3900
GNI per capita (US\$, Atlas method)	630	680	720	810	910	980	1050	1130	1230
Real annual growth rates (% , calculated from 1996 prices)									
Gross domestic product at market prices	3.3	6.0	9.6	12.9	13.9	6.8	5.7	5.7	5.7
Gross Domestic Income	2.4	7.6	14.0	14.6	6.3	2.0	4.5	5.1	5.8
Real annual per capita growth rates (% , calculated from 1996 prices)									
Gross domestic product at market prices	4.0	6.5	9.3	12.9	13.9	6.8	5.7	5.7	5.7
Total consumption	1.4	5.9	2.6	8.6	12.0	6.7	4.5	5.2	5.2
Private consumption	1.4	6.4	2.5	9.1	11.1	6.8	3.9	4.6	3.7
Balance of Payments (US\$)									
Exports (GNFS) ^b	383	447	540	698	894	977	1077	1161	1246
Merchandise FOB	247	310	353	514	678	740	814	878	943
Imports (GNFS) ^b	919	966	978	1107	1397	1490	1590	1687	1787
Merchandise FOB	721	773	773	883	1269	1355	1447	1536	1627
Resource balance	-536	-519	-438	-409	-503	-513	-513	-526	-541
Net current transfers	174	188	174	173	193	206	185	180	200
Current account balance	-307	-278	-201	-148	-187	-194	-217	-239	-236
Net private foreign direct investment	122	104	70	111	121	98	105	108	110
Long-term loans (net)	91	89	83	50	4	43	94	105	125
Official	69	97	59	68	2	50	74	73	65
Private	21	-7	24	-18	2	-6	20	32	60
Other capital (net incl errors&ommissions)	99	102	64	50	42	27	40	50	50
Change in reserves ^d	-4	-17	-16	-63	-49	26	-63	-64	-49
<i>Memorandum items</i>									
Resource balance (% of GDP)	-29.0	-27.2	-20.7	-17.3	-18.0	-16.9	-15.5	-14.6	-13.9
Real annual growth rates (YR96 prices)									
Merchandise exports (FOB)	6.1	0.8	2.9	3.3	34.0	7.5	8.8	6.6	6.2
Primary	6.1	0.8	2.9	3.3	34.2	7.7	9.9	6.9	6.4
Manufactures	6.1	0.8	2.9	3.3	34.2	6.9	4.7	5.4	5.3
Merchandise imports (CIF)	6.1	0.8	2.9	3.3	28.6	5.7	5.4	4.8	4.7

Armenia – Key Economic Indicators (Continued)

Indicator	1999	Actual 2000	2001	2002	Prel. 2003	2004	Projected 2005	2006	2007
Public finance (as % of GDP at market prices)^e									
Current revenues	19.3	16.7	16.3	16.7	14.7	15.8	16.1	16.5	16.8
Current expenditures	17.6	16.3	16.0	16.2	13.7	14.6	14.7	14.9	14.7
Current account surplus (+) or deficit (-)	1.7	0.4	0.3	0.5	1.0	1.2	1.4	1.6	2.1
Capital expenditure	6.9	5.3	4.7	3.3	5.6	4.0	5.1	4.8	5.0
Foreign financing	..	..	..	..	3.1	2.4	3.5	3.1	2.2
Monetary indicators									
M2/GDP	11.1	14.7	14.6	15.6	14.4	15.2	16.1	18.2	19.2
Growth of M2 (%)	14.0	38.6	13.6	23.0	10.4	16.3	15.5	23.1	15.5
Private sector credit growth / total credit growth (%)	..	..	96.7	15.1	-38.7	93.4	89.3	88.1	89.3
Price indices(YR96 =100)									
Merchandise export price index	61.7	79.4	87.8	125.6	136.1	138.2	141.9	147.3	154.7
Merchandise import price index	73.3	79.3	76.5	83.3	87.9	88.7	90.8	94.1	98.7
Merchandise terms of trade index	84.2	100.1	114.8	150.9	154.9	155.8	156.3	156.6	156.7
Real exchange rate (US\$/LCU) ^f	116.0	109.0	99.0	88.8	72.0	70.9	69.8	69.1	68.8
Real interest rates									
Consumer price index (% change)	0.6	-0.8	3.1	1.1	4.6	3.0	3.0	3.0	3.0
GDP deflator (% change)	0.1	-1.5	4.1	2.3	4.7	3.0	3.0	3.0	3.0

a. GDP at factor cost

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

f. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

Annex 15: Key Exposure Indicators

Indicator	Actual			Prel.		Projected			
	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total debt outstanding and disbursed (TDO) (US\$m) ^a	902	961	989	1051	1090	1133	1173	1214	1181
Net disbursements (US\$m) ^a	..	..	..	..	..	..	..	..	..
Total debt service (TDS) (US\$m) ^a	..	..	..	..	..	..	..	..	..
Debt and debt service indicators (%)									
TDO/XGS ^b	183.4	171.6	151.4	124.5	106.6	102.3	96.9	93.6	85.2
TDO/GDP	..	..	..	..	39.0	37.5	35.5	33.8	30.3
TDS/XGS	..	..	..	..	..	..	..	..	..
Concessional/TDO	50.8	55.9	..	..	..	..	..	..	..
IBRD exposure indicators (%)									
IBRD DS/public DS	1.7	2.0	1.6	1.3	0.7	1.4	1.6	1.6	1.8
Preferred creditor DS/public DS (%) ^c	64.0	78.8	52.1	69.3	28.8	90.1	83.4	82.6	80.3
IBRD DS/XGS	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
IBRD TDO (US\$m) ^d	9	8	7	9	8	7	7	6	6
Of which present value of guarantees (US\$m)									
Share of IBRD portfolio (%)	..	..	..	..	..	..	..	..	..
IDA TDO (US\$m) ^d	352	388	428	533	666	716	790	839	844
IFC Committed Portfolio (US\$m)									
Loans	0.0	0.0	0.0	0.0	2.0	2.0	4.0	6.0	8.0
Equity and quasi-equity /e	0.0	0.0	3.6	3.6	3.8	5.1	5.6	5.6	5.6
MIGA									
MIGA guarantees (US\$m)	0.0	2.7	2.7	2.7	2.7				

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

Annex 16: Operations Portfolio

Active Projects

Project ID	Project Name	<u>Last PSR</u>		Fiscal Year
		Supervision Rating		
		<u>Development Objectives</u>	<u>Implementation Progress</u>	
P035806	AGR REF SUPPORT	S	S	1998
P074503	EDUC QUAL & RELEVANCE (APL #1)	Not yet rated	Not yet rated	2004
P008276	ELEC TRANSM & DISTR	S	U	1999
P044852	ENT INCUBATOR LIL	S	S	2002
P076543	FIEF LIL	S	S	2002
P064879	IRRIG DAM SAFETY	S	HS	1999
P055022	IRRIG DEVT	S	S	2002
P057838	JUDICIAL REFORM	S	S	2001
P035805	MUN DEVT	S	S	1998
P057847	NAT RES MGMT	S	S	2002
P069917	NAT RES MGT (GEF)	S	#	2002
P057952	SIF 2	S	S	2000
P057560	TITLE REG	S	S	1999
P044829	TRANSPORT	S	S	2000

Closed Projects 17

IBRD/IDA *

Total Disbursed (Active)	123
of which has been repaid	0
Total Disbursed (Closed)	519
of which has been repaid	3
Total Disbursed (Active + Closed)	641
of which has been repaid	3
Total Undisbursed (Active)	117
Total Undisbursed (Closed)	0
Total Undisbursed (Active + Closed)	117