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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

COUNTRY PARTNERSHIP STRATEGY

FOR

THE REPUBLIC OF ARMENIA

For the Period of FY09-FY12

May 12, 2009

South Caucasus Country Department
Europe and Central Asia Region

CURRENCY EQUIVALENTS
(Exchange Rate Effective May 11, 2009)

Currency Unit = Dram
US$1 = 372.47

GOVERNMENT FISCAL YEAR
January 1 to December 31

WEIGHTS AND MEASURES
Metric System

ABBREVATIONS AND ACRONYMS

AAA	Analytical & Advisory Services
ABA	Armenian Development Agency
ADA	Armenian Development Agency
ADB	Asian Development Bank
APL	Adaptable Program Loan
ARCS	Administrative and Regulatory Costs Survey
ASIF	Armenian Social Investment Fund
AWSC	Armenian Water Sewage Company
BEEPS	Business Environment & Enterprise Performance Survey
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CASCR	Country Assistance Strategy Progress Report
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
CIS	Commonwealth of Independent States
USAID	United States Agency for International Development
CPIA	Country Policy and Institutional Assessment
CPPR	Country Portfolio Performance Review
CPS	Country Partnership Strategy
DB	Doing Business
DBRA	Doing Business Reform Advisory
DPO	Development Policy Operations
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
EU	European Commission
FSAP	Financial Sector Assessment Program
FTA	Federal Transit Administration
GDP	Gross Domestic Product
GEF	Global Environment Facility
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IDA	International Development Agency
IEG	Impact Evaluation Group
IFC	International Financial Corporation
IMF	International Monetary Fund
MIGA	Multilateral Investment Guarantee Agency
MCC	Millennium Challenge Corporation
MDG	Millennium Development Goals
MTEF	Medium Term Development Framework
NCD	Non-Communicable Diseases
NGO	Non-Governmental Organization
NSS	National Statistics Service
PCF	Per-Capita Financing
PEFA	Public Expenditure and Financial Assessment
PEM	Public Expenditure Management
PFM	Public Financial Management
PHC	Primary Heath Care
PIU	Project Implementation Unit
PPP	Public-Private Partnership
PPIAF	Public Private Infrastructure Advisory Facility
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Support Program
QAG	Quality Assurance Group
RESCAD	Rural Enterprise and Small-Scale Commercial Agriculture Development Project
ROSC	Report on Observance of Standards and Codes
SDP	Sustainable Development Program
SIF	Social Investment Fund
SME	Small & Medium Enterprise
TAIEX	Technical Assistance Information Exchange Unit of the EU
UNDP	United Nations Development Program
UNFPA	United Nations Populations Fund
UNICEF	United Nations Children's Fund
UNISDR	United Nations, secretariat of the International Strategy for Disaster Reduction
USAID	United States Agency for International Development
VAT	Value Added Tax
WBI	World Bank Institute
WUA	Water User Association
YWSC	Yerevan Water and Sewage Company

The World Bank Group Team

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Table of Contents

Table of Figures

Boxes

Annexes

MAP OF THE REPUBLIC OF ARMENIA No. 33364

Executive Summary

i. The Country Partnership Strategy (CPS) for Armenia for FY09-12 has been prepared against the background of a severe global economic crisis. The strategy focuses on the near term needs of addressing vulnerability and mitigating the adverse economic and social effects of the crisis as well as strengthening the foundations for medium term competitiveness and growth.

ii. Over the past dozen years, Armenia experienced double-digit rates of growth in GDP, amidst low inflation. Macroeconomic policies were supportive, with fiscal deficits being small, and monetary and exchange rate policies were prudent. The authorities pursued a steady program of structural reforms which has led to Armenia being ranked consistently as a top IDA performer. The reforms were centered on sharpening competition, improving governance, and mitigating social and environmental risks. The economy today is market-oriented and highly open to trade, capital, and technological innovation.

iii. Even as Armenia benefited from greater openness, those same channels have now transmitted the global crisis to its economy. A loss of export demand, a collapse of commodity export prices, and a sharp decline in remittances and private capital flows have occurred. GDP is projected to contract by 8 percent in 2009 with significant downside risks.

iv. The authorities have responded swiftly to the economic crisis. First, in order to restore external balance, the central bank returned to a flexible exchange rate regime in March 2009. Second, the government has re-prioritized its expenditures towards those that protect or create jobs in the short term and towards social programs, especially the well targeted safety net. Third, the authorities have sought external donor flows to offset lower private capital inflows and budget revenues and to target them into projects and programs that will complement the anti-crisis measures.

v. The framework for medium tern structural reforms is provided by the *Sustainable Development Program* (2008) -- Armenia's second Poverty Reduction Strategy Paper. The *Program* has three key goals: reducing poverty, including the elimination of extreme poverty; ensuring human development; and deepening economic growth.

vi. The CPS is directly aligned with this *Program.* It is anchored on the two strategic objectives of mitigating vulnerability and strengthening medium-term competitiveness. It also exercises selectivity and progressively disengages from areas where reform or investment needs have been substantially satisfied or where other donors can lead, or where the country has adequate internal knowledge and capacity. The CPS envisages increasing reliance upon leveraging other development partners. It responds to the government's request to front-load IDA and IBRD resources over FY09-10, consistent with existing rules, in order to respond promptly to the effects of the international crisis.

vii. The CPS presents an integrated strategy for the World Bank Group. It reflects Armenia's transition to IDA/IBRD blend status from fiscal year 2009, as well as the full integration of the IFC program for the country. The strategy envisages full use of the IDA-15 envelope (projected at $150 million), the IBRD lending limit of $395 million over this four fiscal year period, as well as projected IFC commitments in the range of $120-160 million. This assistance effort is supported by a far-reaching program of advisory services and trust fund support.

viii. A lending program averaging five operations per year is proposed with a strong implementation focus, and supported by a rich AAA program. Over the CPS period, a series of three development policy operations will provide an anchor for policy and institutional reforms. The AAA program contains core diagnostic studies and economic and sector work to design and implement the crisis response, strengthen the capacity for improved governance as well as provide detailed advice on the next generation of reforms. Moreover, the CPS is embedded in a results framework, utilizes outcome indicators and will, in turn, endeavor to deepen the results-orientation culture within the country.

ix. The Bank's work on governance and anti-corruption will be cross-cutting in nature, with dialogue focused on the key, critical pre-conditions for success with an overall governance strategy that will address political economy factors. IFC will support transparency in the business climate through its advisory work on the business enabling environment and possible engagements on corporate governance issues.

x. The IFC and IDA/IBRD find that joint approaches and programs would have a particularly high pay-off over the CPS period in the finance, business enabling environment, and infrastructure sectors. The Bank Group is strongly committed to harmonizing its assistance with country systems and coordinating its activities with other development partners. On the former, the Bank will build capacity; on the latter, close discussions with key multilateral and bilateral partners as well as the government lead to a structured allocation across partners of advisory and investment tasks in support of long term development.

Staff would appreciate guidance from Executive Directors on

- Are the critical development challenges appropriately discussed in the CPS and does the twin pillar structure of support provide the best response?
- Are the key CPS principles of selectivity, flexibility, leveraging partners and front-loading of resources appropriate?
- Is the proposed program of Bank Group support responsive to the needs arising from the crisis as well as medium term investment needs?
- Is the results framework realistic and does it provide for sufficient accountability?

ARMENIA: COUNTRY PARTNERSHIP STRATEGY

I. The Country Context

A. Introduction

1. **This Country Partnership Strategy (CPS) for Armenia has been prepared in the context of the global economic crisis and its impact on the country.** It focuses on the near term needs of addressing vulnerability and mitigating the adverse poverty effects of the crisis as well as laying the foundation for promoting medium term competitiveness and growth.

2. **The CPS for FY09-12 presents an integrated strategy for the World Bank Group.** It reflects Armenia's transition to IDA/IBRD blend status from fiscal year 2009, as well as the full integration of the IFC program for the country. With income per head that averaged $3,200 over 2006-08, Armenia ranks as a lower middle-income country. This Country Partnership Strategy envisages full use of the IDA-15 envelope (projected at $150 million), the IBRD lending limit of $395 million over this four fiscal year period, as well as projected IFC commitments in the range of $120-160 million. This assistance effort is supported by a far-reaching program of advisory services and trust fund support.

3. **The country's economic transformation since the collapse of the Soviet Union has been profound.** The economy today is market-oriented, highly open to trade, capital, and technological innovation, and is based on services (particularly construction), light industry, and metals, although a significant share of the population is still dependent on agriculture. GDP expanded by double-digit rates annually over the past dozen years, with growth led by non-tradables and fuelled by high remittances and capital inflows. Macroeconomic policies were supportive, with fiscal deficits being small and monetary and exchange rate policies being prudent. Inflation was kept low, the overall size of the government was restrained as private initiative was permitted to drive the economy, and public external debt was also extremely low. Rising budget revenues were directed at raising real spending on public provision of public goods and services.

4. **The authorities pursued a steady program of structural reforms which has led to Armenia being ranked consistently as a top IDA performer over the last several years.** The reforms were centered on sharpening competition, improving governance, and mitigating social and environmental risks. The scope of the market economy was greatly extended, regulatory reforms in banking and in public utilities yielded efficiency gains, public financial management was strengthened, far-reaching reforms to improve efficiency and quality of social services were pursued, and the rural economy and environment institutions reformed. As a result of growth, reforms and external inflows (remittances and capital), poverty plunged over the past decade.

5. **Even as Armenia benefited from greater openness to global trade and investment, those same channels have now transmitted the current global economic crisis to its economy.** The country has been struck by three simultaneous shocks—loss of export demand, a collapse of commodity export prices, and a sharp decline in remittances and private capital flows. Exports and economic growth began to contract from the final quarter of 2008. GDP is projected to contract by 8 percent in 2009 with significant downside risks. As a result, budgetary revenues have begun to fall sharply and poverty and social vulnerability is expected to rise sharply in 2009.

6. **The central challenge for the authorities is to mitigate the economic and social impacts of the current economic crisis, which are likely to persist for several years, while also laying the foundations for rapid post-crisis recovery and growth.** With limited domestic resources, the primary short-term focus has to be to address current crisis needs and seek to leverage donor funding to support a modest fiscal stimulus, boost domestic investments, especially for job creation, and scale up targeted social safety net programs. At the same time, being a small open economy, Armenia's future is inextricably linked to that of the global economy and its best strategy is to be prepared to take full advantage of the eventual global recovery.

7. **This severe exogenous economic shock has abruptly broken the momentum of over a decade of double-digit growth and social progress.** Despite low internal and external debt burdens, the capacity of a small open economy such as that of Armenia to use fiscal space to substitute public sector demand for the private sector contraction and support output is constrained. Thus, in addition to the own-efforts of the country to mitigate the impact of the international crisis, stepped-up donor support will be required, importantly for filling fiscal and external financing gaps as well as supporting the public investment program.

8. **The proposed Country Partnership Strategy for FY09-12 is therefore anchored in the two strategic objectives of mitigating vulnerability and strengthening medium-term competitiveness.** A variety of Bank instruments will be used to support the strategy. This strategy is strongly supported by the client who values the Bank group as a valued development partner for addressing its complex development needs. Recognizing that the country's development strategy and the Bank's support to it are challenged by the uncertainties surrounding the depth and duration of the global economic crisis, and the international policy response, frontloading of resources, flexibility in the design, timing, and sequencing of lending interventions, and enhanced implementation support will be essential.

9. **Several principles will consequently guide the proposed CPS.** First, there is direct **alignment** with Armenia's national *Sustainable Development Program which is* being revised to take account of the current international conditions. In particular, Bank strategy will seek to address the urgent while staying focused on the important medium-term issues. Second, the Bank Group must exercise **selectivity** and progressively disengage from areas where reform or investment needs have been substantially satisfied or where other donors can lead, or where the country has adequate internal knowledge and capacity. Third, the Bank Group will increasingly rely upon **leveraging** other development partners given competing demands on IBRD resources and the Region's administrative budget. Fourth, the CPS responds to the government's request to **front-load** IDA and IBRD resources over FY09-10, consistent with existing rules, in order to respond promptly to the effects of the international crisis.

B. The Political Context

10. **The last CAS period (FY05-08) was characterized by relative political stability, but the situation is evolving**. This stability was reflected in the continuity in office of the President of the Republic and of a stable coalition in parliament that provided strong backing for the reformist agenda laid out in the first Poverty Reduction Strategy Paper of 2004. In contrast, the presidential elections in 2008 were controversial and unresolved tensions with the opposition exist. There has occurred an erosion of external support from some of Armenia's longstanding international partners, who would like to see decisive action to improve credibility of the electoral process, strengthen mechanisms of voice and accountability, and improved governance.

11. **The current economic crisis presents difficult choices and places a premium on the importance of fostering broad political consensus.** The new government's socioeconomic program is presented in the second Poverty Reduction Strategy Paper, entitled the *Sustainable Development Program*

(SDP, October 2008), which was developed with extensive social participation, but before the impacts of the global economic slowdown began to unfold fully in Armenia. The SDP set ambitious targets for further reductions in poverty, deepening human capital and modernizing the economy, in a context of continued GDP growth. The re-formulation of the program now, under conditions of much weaker international growth and financial inflows, will require hard choices in public expenditures and external debt strategies; and thus there will be significant demands on the government to develop a broad consensus on these choices.

12. **However, the regional political context offers new opportunities.** The recent agreement on a road map towards normalization of relations with Turkey[1] and intensified efforts to end the frozen conflict over Nagorno-Karabakh with Azerbaijan are encouraging developments. Resolution of differences with these two neighbors would allow Armenia to reap the potential of eased transport and transit links, lower costs to trade, and enable possible participation in regional transit and energy corridor developments. The geo-political stability of the South Caucasus would also be greatly improved and the perception of investment risks reduced.

13. **Armenia is also pursuing a deepening of relations with the European Union and its member states, while continuing to maintain strong links with other traditional bilateral partners.** Through instruments such as the EU's Eastern Partnership and steps towards negotiating a free trade agreement with the EU (a notable agreement on civil aviation services with the EU was negotiated in 2008), the country will be able to raise standards and modernize across a wide range of activities, strengthen competition, and obtain a political anchor, thereby countervailing its current isolation.

C. Recent Economic Developments

14. **Armenia's macroeconomic performance during the past CAS period was robust (Table 1).** Economic growth has been sustained at double-digit level over the past dozen years, and averaged over 12 percent annually over the last CAS period (2004-2008). Growth was supported by a highly favorable external environment, macroeconomic stability, and some strengthening in economic governance. The construction and service sectors became the largest contributor to growth, and exports played a diminished role. Inflation remained in the single digits despite fuel and food price shocks, assisted by a prudent fiscal stance (deficits averaged 1½ percent of GDP over the CAS period), but the underlying structural fiscal position did not improve because of continued weaknesses in tax administration. Fiscal deficits have been financed overwhelmingly through external concessional borrowing; thus, domestic debt is small. The monetary stance was disciplined and the dram appreciated substantially both in nominal terms and real terms. This real appreciation in combination with strong rise in domestic absorption led to widening trade and current account deficits.

[1] The key elements of the road map are mutual recognition of present frontiers, diplomatic recognition and re-opening of borders, agreements to foster trade and transport links, and establishment of a joint commission to examine historical events.

Table 1: Economic Developments over the last CAS period

	2004	2005	2006	2007	2008 preliminary
Growth (percent change)	10.5	13.9	13.2	13.8	6.8
Inflation, eop (percent change)	2.0	-0.2	5.2	6.6	5.2
Investment/GDP	24.9	30.5	35.9	37.2	39.9
Fiscal balance/GDP	-1.7	-1.9	-1.5	-1.5	-1.2
External current account/GDP	-0.5	-1.1	-1.8	-6.4	-11.3
External public debt/GDP	33.1	22.4	18.9	15.7	13.2
Short term debt/reserves (percent)	16.1	16.8	15.0	13.0	24.0
Real exchange rate (percent change; += appreciation)	6.5	7.4	8.8	15.3	19.8

Source: NSS.

15. **Rapid economic growth was driven by foreign savings, reflected in a widening of the current account deficit, but domestic savings also rose significantly.** The current account deficit in relation to GDP exceeded 11 percent in 2008 compared to less than 2 percent in 2006. A decline in export volumes began in 2006, but growing prices for non-ferrous metals, a main export for Armenia, helped to mask poor export performance. In contrast, import growth both in volume and value terms was very strong in recent years driven by strong remittances, FDI, commercial bank external borrowing and a large real exchange rate appreciation. The strength of the capital account led to the maintenance of a comfortable level of gross international reserves throughout the CAS period. The authorities pursued a prudent external debt management strategy with no public sector borrowing on commercial terms; as a result, the external debt level was maintained at modest levels. Moreover, the sharp and sustained real appreciation of the currency together with strong economic growth led to a marked decline in the external public debt to GDP ratio.

D. Macroeconomic Prospects and Debt Sustainability

16. **Strong economic fundamentals – low debt, rising savings and a cautious fiscal stance -- shielded the economy from the initial effects of the global output slowdown and the financial crisis, but the effects of falling external demand began to be felt from the final quarter of 2008.** A marked slowdown in remittances and capital inflows is occurring (Table 2), especially in light of the close economic and investment linkages with Russia. The contraction in real output and the *ruble* devaluation is leading to a large fall in dollar GDP in Russia. Armenia is highly dependent on remittances ($2 billion or 17 percent of GDP) and FDI ($940 million)[2]. These total almost $3 billion, with about three-quarters of these amounts originating in Russia. Exports have weakened because of sharply declining prices of non-ferrous metals and plummeting external demand. Domestic profitability in mining has been severely squeezed.

[2] Data for 2008.

Table 2: Medium-Term Projections, 2007-2012

(In percent of GDP, unless otherwise specified)

	Actual	Estimate	Projections			
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Real GDP growth (percent change)	13.8	6.8	-8.0	-2.0	1.5	3.0
Inflation, end-of-period (percent change)	6.6	5.2	6.5	4.5	4.0	4.0
Investment	37.2	39.9	33.6	32.3	32.9	33.7
Overall fiscal balance (including grants)	-1.7	-1.2	-5.0	-3.0	-2.0	-2.0
Current account	-6.4	-11.4	-12.2	-12.4	-11.2	-9.5
Gross international reserves (in months of Imports)	4.2	4.7	3.0	2.9	3.3	3.4
External public debt	15.7	13.2	23.4	28.7	30.9	31.8
Memorandum items:						
Income per head (in US dollars)	3,067	3,987	2,983	2,932	2,980	3,069
Remittances and private transfers (in millions of US dollars)	1,671	2,063	1,547	1,509	1,576	1,709
Real effective exchange rate (change in per cent; +=appreciation)	15.3	19.8	…	…	…	…
Short term external debt/reserves (in percent)	13.0	24.0	…	….	….	…

Source: Bank projections based on official data

17. **As a result, economic contraction is now projected to be 8 percent in 2009 and a further 2 percent in 2010 (Table 2).** An even sharper contraction in 2009 cannot be ruled out, depending on the severity of external developments. In recent years, growth has been heavily based on an expanding construction and domestic services sectors fuelled by remittances and FDI. The real estate sector has already begun to contract, as has metallurgy, and signals are emerging that other sectors (e.g. Armenia's small but growing IT industry) are also under stress. The recent depreciation of the currency in real terms will encourage a shift of resources to the tradables sector. **Unemployment** has risen sharply in recent months, as numerous mines have been closed, construction industry activity has dropped sharply, and migrants working abroad have returned home for lack of employment opportunities outside the country, putting further pressure on the rural economy, social safety net and tax receipts alike. The budget for 2009 is being revised in light of changing conditions. Revenues are projected to fall by 6 percent in 2009 in relation to 2008; thus, the revenue shortfall compared to the original 2009 budget passed by parliament may amount to 4 percent of GDP. **Income per head** is projected to fall sharply in 2009-10[3] (returning to the 2007 level) before picking up again. The low level of economic activity is expected to moderate inflation and to lead to a stable (if still large) external current account deficit.

18. **Due to significant reforms in earlier years, the banking system is sound, although financial intermediation is still shallow and there has been a rapid growth in external borrowing in recent**

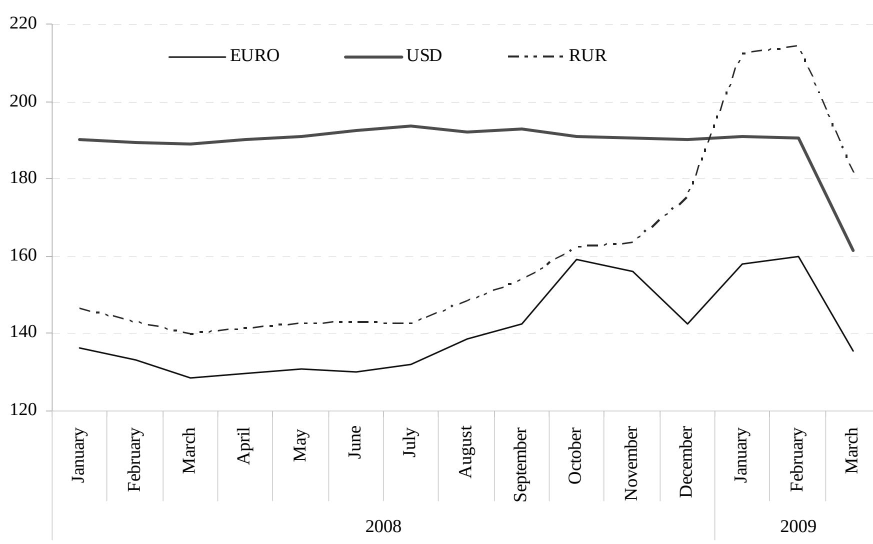
[3] This sharp fall (see table 2) reflects not only the economic contraction but also the substantial depreciation of the currency – in PPP terms the decline would be moderate.

years. In a bid to support strong lending growth, banks' external borrowings increased ten-fold from end-2005 to end-2008. During the same period, the loan-to-deposit ratio increased from 105 percent to 184 percent, with bank lending being funded through external sources, largely through international organizations or foreign parent banks – a less volatile source than commercial sources. Looking forward, Armenian banks will need to develop new, domestic funding sources to supplement their liquidity and support further loan growth in the face of a less favorable external environment. Re-dollarization has been rapid in the four months to March 2009, and as a result of weakness in *dram* deposits, *dram* credit has become scarce. The banking system is, however, well capitalized (on average capital to asset ratio is 27 percent), the open foreign exchange position is small, end-borrowers are not exposed to currency risk, and stress tests show that the system is robust.

19. **The authorities have responded swiftly to the economic crisis.** First, in order to restore external balance, the central bank returned to a flexible exchange rate regime in March 2009. This followed a *de facto* fixed exchange rate policy relative to the dollar during the previous four months with the intent of providing support to the banking sector, but with consequent losses in net international reserves amounting to half a billion dollars. With the floating of the *dram*, the currency rapidly stabilized at a rate that represented a depreciation of about 20 percent vis-à-vis the dollar. With respect to currencies of other major trading partners, the *dram* appreciated versus the *ruble* over this four month period and modestly depreciated versus the *euro* (Figure 1).

20. Second, the government has re-prioritized its expenditures towards those that protect or create jobs in the short term (such as public investment program) and towards social programs, especially the well targeted safety net. It has deferred non-priority current expenditures. Measures to improve the efficiency of public expenditures and tax collections continue to be pursued. Third, the authorities have sought external donor flows to offset lower private capital inflows and budgetary receipts, and to target them into projects and programs that will complement the authorities' anti-crisis measures. In March 2009, Armenia obtained a standby arrangement with the IMF in the amount of $540 million of which $350 million is projected to be disbursed this year to support international reserves. The projected *ex ante* budget support needs of around $200 million annually over 2009-10 are projected to be met through budget support operations from IDA/IBRD, ADB and Russia. These initiatives have been undertaken within a sound policy regime, including open trade policies.

Figure 1: Nominal Exchange Rates, Indices
(January 2003=100; units of foreign currency per dram)



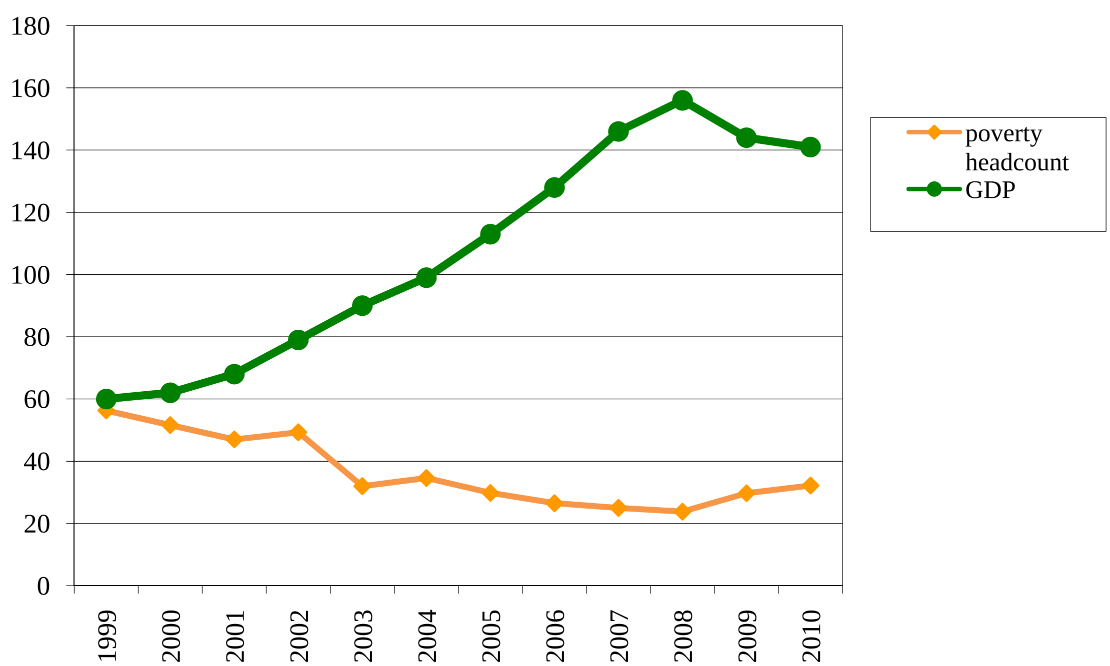
Source: Bank calculations, based on data from the Central Bank.

21. **Despite the external shocks and larger external borrowing than originally anticipated, the debt outlook continues to be favorable with a low risk of debt distress**. External public and publicly-guaranteed debt in relation to GDP fell from 33 percent in 2004 to 13 percent at the end of 2008. With a growth in the share of debt on commercial terms as well as the projected volume of borrowing, the ratio of external public debt to GDP may reach 30 percent by 2012. This level is projected to be prudent. Debt service will remain modest in relation to both external earnings and fiscal revenues.

E. The Poverty Profile

22. **Economic growth has resulted in falling poverty: the incidence of poverty fell from around 56 percent in 1998 to about 35 percent in 2004 and further declined to 25 percent in 2007** (Figure 1).[3] These developments are attributable to strong reform efforts in transition, steps taken to create an improved business climate, as well as a sharp increase in real wages, private transfers from abroad, and rising social transfers made possible because of an increasingly strong fiscal position.

Figure 2: Changes in GDP (1989=100) and poverty incidence



Source: World Economic Outlook database, 2008 and Integrated Living Conditions Surveys for 1989/99 through 2007.

23. **Extreme poverty declined even faster, from about 6.4 percent in 2004 to less than 4 percent in 2007.** Moreover, poverty has become shallower and less severe as the poverty gap and the severity of poverty have declined considerably faster. But, significant pockets of poverty still remain. However, a recently completed poverty mapping report highlighted the striking disparity in poverty rates across the

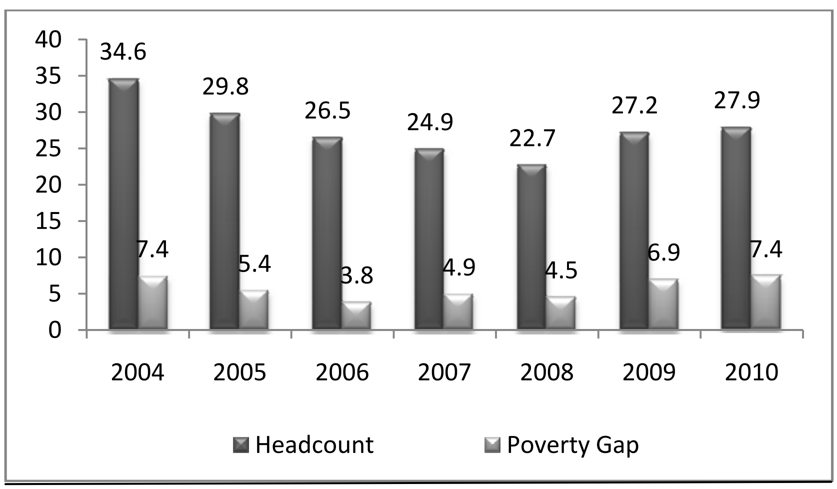
[3] Social Snapshot and Poverty in Armenia 2008, the National Statistical Service of the Republic of Armenia, February, 2008. The national poverty line corresponds to AMD 23,168 *per adult equivalent per month* (about US$75) in 2007 prices

regions. The **spatial disparities** in poverty incidence and the pace of poverty reduction suggest that the benefits of recent economic growth have not been evenly distributed across the country.

24. **Rising unemployment and falling remittances as a result of the crisis are likely to reverse some of the gains in poverty**. The increase is exacerbated by the disproportionately higher impact of the crisis on the construction and mining sectors. The main ways through which the crisis could be transmitted to households are: (a) exchange rate adjustment (devaluation of the local currency, consumer price inflation); (b) labor markets (via decreased employment and wages); (c) remittances (stemming from economic slowdown in source countries) and (d) government (and non-governmental) spending on social services such as education, health and social protection. The impact through the financial markets (e.g., reduced access to credit, erosion of savings and asset values) and product markets (via lower growth and production, relative prices changes) can also be substantial.

25. **Simulations of the impact of the crisis suggest that Armenia could see an increase in poverty rates in 2009 and 2010.** The overall poverty incidence could increase by about 5.2 percentage points between 2008 and 2010 (Figure 3). That means 147,000 people could fall below the poverty line in 2009 and another 25,000 in 2010. The projected poverty incidence in 2010 of about 28 percent is higher than the 2006 level of 26.5, implying that the poverty reduction recorded between 2006 and 2008 would be more than fully offset by poverty increases due to the crisis. The increase in the poverty gap would be more pronounced as the already poor become poorer. The projected poverty gap in 2010 is as large as the level in 2004.

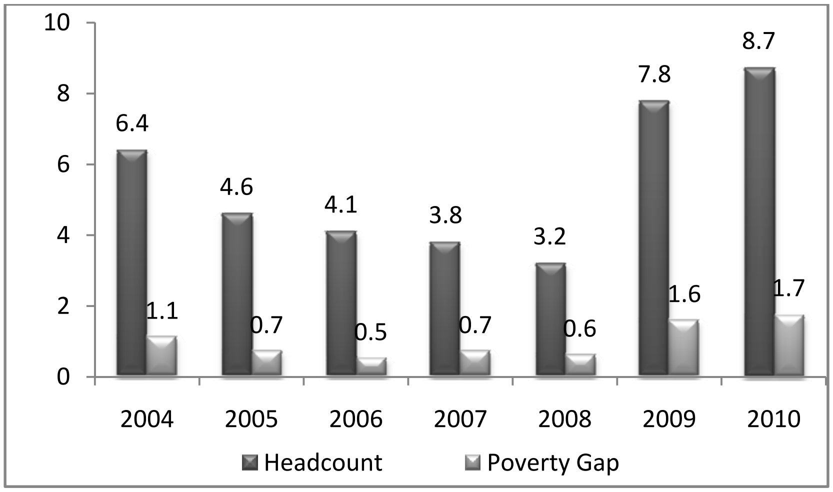
Figure 3: Poverty Trends and Projections of Overall Poverty, 2004—2010



Sources: National Statistical Services of the RA; World Bank staff estimates based on ILCS 2007 and growth and employment, remittances, and exchange rate adjustment projections.

26. **The extreme poverty incidence and poverty gap could increase by a substantially larger margin**. The levels of extreme poverty in 2009 and 2010 could easily surpass their corresponding levels in 2004 (Figure 4). An estimated 149,000 people could fall below the extreme poverty threshold in 2009 and another 31,000 would be added in 2010. The number of extreme poor in 2010 could outnumber that in 2004 by about 77,000 people.

Figure 4: Poverty Trends and Projections of Extreme Poverty, 2004—2010



Sources: National Statistical Services of the RA; World Bank staff estimates based on ILCS 2007 and growth and employment, remittances, and exchange rate adjustment projections.

F. Progress towards Millennium Development Goals

27. **Armenia has been on track to achieve most, if not all, of its Millennium Development Goals (MDGs) by 2015 and hopes to protect these gains from the crisis.** In 2005, the government published a first progress report on meeting the MDGs[4]; this document also sets out more ambitious goals than the global targets. Rates of poverty, infant mortality and maternal mortality have fallen rapidly over the past few years, there is virtually full enrolment in basic schools, and the country is in the midst of education reforms that are increasing years of schooling and will further strengthen teachers' salaries, training and curricula. However, strong efforts will be necessary in promoting gender equality, combating communicable diseases, and ensuring environmental sustainability.

28. **Armenia adopted a more ambitious goal for the first priority of the Millennium Development Goals (MDGs)** -- a reduction by half of the share of people living in **extreme poverty and suffering from hunger** by 2015. As noted, the country has already made significant progress in eradicating poverty. Using the MDG level of $4.30, poverty has fallen from 73% in 2000 to 39.2% in 2007. Nevertheless, it has set a target to bring this below 20 percent, which may prove difficult in the current global economic environment.

[4] Government of Armenia, 2005, *Millennium Development Goals: Nationalization and Progress.*

Table 3: Progress toward the Millennium Development Goals as adapted by Armenia
Selected targets and indicators

	Baseline	Progress	Target 2015
Goal 1: Eradicate extreme poverty and hunger			
• Proportion of Population below $4.30 (2005 PPP) per day	73.4 (2004)	39.2(2007)	<20
Goal 2: Achieve universal primary education			
• Gross enrollment ratio in primary education	87.8 (2000)	93.2 (2007)	>99
Goal 3: Promote gender equality and empower women			
• Share of women in employment in non-agricultural sector	47 (2000)	46 (2006)	50
• Eliminate disparity in primary and secondary education[6]			
Goal 4: Reduce child mortality			
• Under-five mortality rate per 1000 live birth	19.3 (2000)	12.3(2007)	<10
Goal 5: Improve maternal health			
• Maternal mortality ratio	52 (2000)	15 (2007)	<10
Goal 5: Combat HIV/AIDS, malaria, and other diseases			
• HIV/AIDS among pregnant women	<1(2000)	<1 (2007)	<0.5
Goal 7: Ensure environmental sustainability			
• Proportion of population with sustainable access to improved water (urban and rural)	87.6 (2000)	94.1 (2007)	>95
• Proportion of population with access to improved sanitation facilities (urban and rural)	63.3 (2000)	67 (2007)	>95

Source: Armenia National Statistics Agency, MDG, Bank staff.

29. **Armenia has similarly established national targets for the other millennium development goals** (Table 4). Good progress has been made toward implementation of measures seeking to reduce **child and maternal mortality** rates. The under-5 mortality rate (per 1000 live born) fell from 19.3 in 2000 to 12.3 in 2007, and the maternal mortality rate (per 100,000 live born) dropped was at 15.0 in 2007, compared to 52 in 2000. The proportion of population with access to improved **water and sanitation** has also improved since 2000. The attainment of the self-imposed and ambitious targets by 2015 will require unremitting effort, and some of the targets may need to be adjusted in light of the global economic downturn.

G. Governance and Anti-Corruption

30. **Over the last CAS period, the authorities pursued a governance strategy that provided for key public sector management reforms, measures to address political and public accountability, and efforts to increase civil society voice and participation.** Specifically steps were taken on legislative changes to increase the penalties for corruption, higher public financial audit standards with parliamentary oversight, reforms in revenue collection and the judiciary. There was heightened attention to **judicial reform** and improving judicial governance with a view to strengthening the independence of the judiciary and improving its effectiveness.

31. **Some steps were taken to improve the public administration system** *inter alia* by restructuring central government institutions, developing a professional civil service, and reforming local

[6] Armenia continues to exceed these goals as the girl/boy ratio in primary and secondary education was 104 and 105, respectively, in 2007.

government. The authorities also implemented reforms in **customs and tax** administrations with the aim of reducing the direct interaction between clients and officers, adopting rules based approach with less discretion for officials, and the use of risk management systems as opposed to universal examinations. Armenia joined the Group of Corruption Fighting Countries (GRECO) in 2004 and adopted OECD principles on eliminating corruption.

32. **However, the record is one of mixed progress**. The main advances are evident in **capacity building** in selected public institutions such as the ministry of finance, which pioneered public finance management changes and is among the most advanced in the CIS country grouping, the multi-sector public regulatory commission, and the Central Bank. In other areas, however, changes have been to a degree formal, with enforcement weak or absent. Fundamental political economy difficulties such as the enforcement of **conflict of interest** legislation on public officials, ministers and parliamentarians, checks to the power of powerful business interests in evading customs and tax payments, exercising *de facto* monopolies in imports and internal distribution and distorting competition conditions, remain to be seriously addressed. Progress with customs and tax has been fitful and lacking in full commitment. The rule of law is put under challenge.

33. **Various international indices confirm this mixed progress.** On the one hand, Armenia continues to perform reasonably well in the Doing Business indicators with a rank of 44. However, Transparency International currently ranks Armenia as 109 out of 180 countries in its 2008 Corruption Perception Index, falling from 99 in 2007. Surveys of public and business opinion have repeatedly shown tax and customs, education, and governance reform/anti-corruption policy as the three main concerns.

34. **The 2009 Anti-Corruption Strategy is expected to centre on conflict of interest management and rules of conduct for public officials**. Business processes in various areas (e.g. central government, tax and customs services) and improved accountability both on performance and resource management aspects will be other elements of the strategy. Whilst these are important, the strategy will also need to pay attention to the fundamental weaknesses identified above in para 30.

II. The Country's Development Agenda and Priorities

A. The Country Development Program

35. **The *Sustainable Development Program* (SDP), approved by the government in October 2008, is Armenia's second Poverty Reduction Strategy Paper (PRSP-2).**[7] The SDP has three key goals covering the period 2009–2021 (with specific medium term targets indicated in 2009–2015): reducing poverty, including the elimination of extreme poverty; ensuring human development; and deepening economic growth and accelerating development of lagging regions.

36. **The specific quantitative targets of the SDP were rapidly overtaken by the impact of the global economic crisis and the medium term outlook for the economy is now radically different.** The SDP is therefore being revised by the authorities within a participatory and consultative framework and a new document will be published in the autumn of 2009. Nevertheless, the central reformist thrust of the SDP is expected to be re-affirmed. Thus, the document provides valuable guidance on the medium term reform needs of the country.

[7] PRSP-1 met its key economic and social goals, reform measures were broadly taken as planned, and this effort was supported by a series of four poverty reduction support credits from IDA.

37. **The SDP puts forth a second generation economic growth and diversification strategy aimed at deepening competition and fostering private sector development**. It envisages greater fairness in economic competition which will require stronger political will as well as legal and regulatory measures. These include: (a) strengthening the law on competition, and improving conflict of interest laws and implementing them more forcefully; (b) upgrading regulatory frameworks for public-private partnerships; and (c) liberalizing the civil aviation sector and further improving the pro-competition regulatory framework in the telecommunications sector. Efforts will be made to ease administrative and legal barriers, including those related to weaknesses in corporate governance, for small businesses and firms as well as to reduce costly tax and customs administration barriers.

38. **The SDP explains that reforms in infrastructure, particularly transportation, telecommunications, and energy, within a framework of enhanced private participation, are critical to ensuring growth.** Road and rail links will have to be substantially upgraded to realize the potential of a transit country. Moreover, recent liberalization in telecommunications and in civil aviation will have to be extended. The authorities envisage renewed efforts at diversifying sources of energy and increasing the utilization of indigenous energy resources.

39. **The SDP also proposes ambitious reforms in public administration and the judiciary.** In public administration the SDP focuses on the following areas: (a) raising governance standards and efficiency in the unified revenue-raising institution through deep customs and tax administration reforms; (b) increasing the competitiveness of public service pay while improving performance management; (c) further developing and rolling out e-government systems; (d) introducing conflict of interest rules for public servants; and (e) strengthening public expenditure management (PEM) through development of a comprehensive strategy.

40. **In all these areas, the authorities see the development of a knowledge economy to be critical.** Improvements in competition, backbone infrastructure and communication services, and in public administration will require investments in information and communication technologies (e.g., to permit e-government services or to promote efficient information availability and innovation within the private sector) and the adoption of new methods of doing business.

41. **Over the medium-term the further development of the social sectors remains among the key priorities.** Further reforms of the primary health care system are needed in order to complete the transformation to a more efficient, family medicine-based system. The SDP focus on improving the quality and accessibility of preschool **education** is highly important, as it responds to the serious deterioration and increasing inequity of the preschool sector over the last ten years. In higher education, the political will to align Armenia with the Bologna process goals is a critical first step in reforming the governance and financing of the system, increasing transparency and accountability, and eventually improving quality.

42. **Finally, the SDP pays significant attention to the social protection system and lays out ambitious objectives on benefit levels, targeting, and moving toward middle income country standards.** Perhaps the most significant new expenditure commitment in the SDP is the considerable real increase in state pensions**.** This reflects the objective of providing minimum income security against poverty in old age, and the introduction of a mandatory funded pension pillar in 2010.

B. Key Economic and Social Priorities

43. **In view of the global economic crisis, the two strategic objectives of the authorities are to mitigate Armenia's vulnerability to the current shocks and strengthen competitiveness for post-crisis recovery and growth over the medium term.** Over the rest of 2009 and 2010, the economy will

continue to be buffeted by the external shock from the contraction in global output and tight conditions in private financial markets. The first challenge for the authorities is to devise and sustain policies that would safeguard **economic stability and protect social wellbeing.** Such policies are rooted in an expansionary counter-cyclical fiscal stance with donors providing the requisite financing. This task is currently dominating the policy agenda. The second challenge will be to position the economy to resume high rates of growth when international conditions turn more benign. For a small open economy like Armenia, this can be achieved only by strengthening **international competitiveness**. This, in turn, entails protecting past structural reform achievements and completing the unfinished agenda as identified in the SDP.

Addressing vulnerability

44. **As noted, the economy faces severe adjustment pressures from the fallout of the global economic crisis.** These arise from the sharp fall off in external transfers (principally remittances) and private capital inflows (principally foreign direct investment), the contraction in global demand for exports, particularly metals, and the deterioration in terms of trade. The exposure of the economy and the banking system to rollover risks from external borrowing, in contrast, is small and not a source of concern. Addressing these impacts over the next couple of years is critically important in order to protect the economic and social fabric of the country. This requires action along three broad fronts.

45. ***First, the authorities are implementing counter-cyclical macroeconomic policies within prudent limits.*** The external shocks have led to a contraction in output and a consequent rise in unemployment and poverty. The authorities have already taken a big step with the exchange rate depreciation which will help ease the external adjustment and improve export profitability. Some relaxation of monetary and fiscal policy has also taken place even though the revenue and financing constraints are binding. The budget for 2009 is being revised to reflect the depressed revenue base, and commensurate changes will have to be made in expenditures consistent with the aim of limiting the fiscal deficit to around 6 percent of GDP. The challenge for the government is to alter the composition of public spending and to shift it in towards rapid infrastructure operations in rural areas and elsewhere to yield quick results with respect to safeguarding or creating short-term employment.

46. **At the same time, social protection spending also needs to be protected and targeting of some programs improved.** The distributional impact of the crisis is likely to be adverse, with higher poverty and inequality, given the sharp downturn in more labor intensive and low skilled sectors. As unemployment rises and returning migrants put further pressure on the labor market, demands on the social protection system will grow. The rise in nominal **basic pensions** by a total of 75 percent over 2008-09 will also help to fight poverty.

47. **As part of countercyclical policy, the government is also easing credit constraints by public provision of credit through the banking system.** Support for output and employment from the private sector is being fostered through the provision of lines of credit to the **banking system**, intermediated by the Central Bank, for on-lending to small and medium enterprises. Such operations will serve to bolster liquidity in banks, improve their balance sheet, lower their costs of funding, and thereby stimulate lending for commercial purposes. The authorities continue to maintain a highly open and liberal regime for **trade, investment and capital flows,** and have avoided resorting to protectionist measures.

48. ***Second, bolstering financial stability is a key objective.*** The liquidity and solvency of the banking system were strong at the start of the crisis, and the authorities are intent on maintaining this strength. At the same time, financial intermediation is still low. Following the depreciation of the dram, it is expected that the incentives for dollarization and disintermediation would diminish, and the authorities are committed to a flexible **monetary and exchange rate policy** stance to help restore

liquidity in the banking markets. Liquidity will be bolstered by the addition to reserves from the drawings on a standby arrangement with the Fund, which could be used to address shifts in currency preferences in the banking system. The Central Bank is widening its temporary liquidity support to banks and has broadened the range of acceptable collateral. To address possible solvency and restructuring needs should pressures on the economy intensify, the Central Bank will facilitate restructuring plans, consider providing longer term funding or equity to banks, and, if needed, enlarge the deposit insurance fund. Banking supervision will also be enhanced through robust monitoring of compliance with prudential norms. To support the real sector during the crisis, broadening the reach of financial intermediation remains important. At the end of 2008, the ratio of total assets to GDP was 28.1 percent and of this loans represented 16.9 percent of GDP.

49. ***Third, economic and social risks have to be managed***. These cut across agricultural, irrigation, and the social sectors.

- In ***agriculture*** slow productivity growth has been the main factor for below average growth rates over the CAS period (7% compared to 13% for overall GDP), despite steady reforms in extension services, provision of higher quality seeds and improved access to credit. Persistent livestock diseases, such as brucellosis and African swine fever led to a decline in the livestock share in gross agricultural output. Poor compliance with food safety standards at processing enterprises inhibits agri-food exports. The near-term reform agenda will address control of major livestock diseases, improving food safety and competitiveness of agri-food products, through knowledge and technology transfer as well as investments.

- In ***irrigation and drainage***, the government has begun to reverse the deterioration of the **system** and established an improved policy and financial framework. Water Users Associations now cover all irrigated land. Nevertheless, revenues remain at only 42 percent of cost-recovery levels and only 70 percent of irrigable land is irrigated. There is a need to complete priority irrigation works to minimize water losses and strengthen the capacity of less experienced WUAs and creating unions of WUAs, and this will be increasingly important if Armenia is to successfully address climate change impacts in the future.

- In ***social protection***, the institutional reforms focus on sharpening the targeting of the family poverty benefit scheme and improving the delivery mechanism. The recent changes in the governance structure of social protection should be built on to improve quality of service delivery through a strengthened information base and improved accountability and transparency. This would require completing the development of the social protection MIS as well as completing the physical and/or virtual transformation of all local social protection offices into a "one-stop-shops".

- The authorities regard reforms in ***pensions*** to be a key element of their development strategy. The institution of a multi-pillar pensions system, with a prominent role for mandatory private individual accounts, is seen as essential for raising savings, providing for retirement income with individual responsibility, and spurring the development of domestic capital markets. The reformed pension system will provide the incentives for building up sophisticated ICT and backbone services – a key component of a knowledge-based economy. Under rapidly changing economic and fiscal conditions, it will be necessary to re-examine the fiscal costs and the phased introduction of this reform. Moreover, such a reform spanning administrative aspects (such as the maintenance and reconciliation of records, the transition to the new system) as well as the investment aspects (the opening of individual accounts, the establishment of the central depository, capital market reforms) necessitate careful design work accompanied by an equally careful evaluation of implementation capacity.

- ***In health care,*** important reform themes are a further development of primary care and related financing reforms (such as the introduction of co-payments for hospital services included in the revised basic benefits package in order to decrease informal, out-of-pocket payments), continued hospital optimization *inter alia* to incorporate the narrow specialist care at the hospital level and strengthening of delivery of non-communicable disease interventions, especially at the primary care level. Over the past years, rationalization of the hospital system has yielded an efficiency dividend. It will be necessary to exploit these achievements to obtain the resources for the next stages of reform given the reduced budgetary resources that will be available in 2009-2010.

50. An important new agenda concerns **natural disasters and climate change adaptation**. While Armenia is a high risk country for potential economic and human losses, with earthquakes being the principal risk, the country lacks a comprehensive national disaster risk management strategy and the institutional framework is still weak, with a duplication of responsibilities between different government agencies. To counter seismic risk, enforcement of construction code/standards both at design and construction stages will be necessary. The authorities would also need to consider ways of reducing financial exposure through catastrophic insurance facilities. The South Caucasus is also highly exposed to increased climate extremes, and Armenia is concerned about the impacts from recent climate variability as well as longer term slow-onset change impacts.

Strengthening Competitiveness for Sustained Post-Crisis Growth

51. **Addressing the short-term crisis vulnerabilities needs to be accompanied by measures to boost competitiveness for medium-term growth.** A critical core of **structural reforms**, identified in the SDP, will be pursued over 2009-2010. Given the fiscal difficulties, reforms will necessarily focus on areas that do not involve large budget outlays or which yield higher budget revenues. There are five specific areas where government action can help unlock key constraints to growth.

52. **First, improvements in the public sector efficiency can bring significant fiscal, economic and governance gains.** Issues in public governance were discussed earlier and they clearly undermine economic efficiency. There are five areas where public action is needed:

- *In* ***tax and customs administration***, the recent merger of these administrations offers the opportunity to design a strategic business plan with the aim of ending parallelism between the services and ensuring genuine data sharing, joint intelligence and risk management pooling. Two fundamental principles that have guided reform over the recent past need to be pursued with greater vigour: (i) the need to minimize interaction between the public and officials so as to reduce corruption; and (ii) to shift to risk management-based operating procedures in place of excessive direct controls and interventions. Moreover, early actions to address certain gaps in the tax regime, such as reform of taxation of fuels and tobacco to a system of VAT and excise taxes, the move away from presumptive taxes and limited use of the simplified tax regime would raise tax yields and promote neutrality.

- *In* ***public expenditure management***, fragmented initiatives need to give way to moves towards an integrated program. Strengthening the PEM system's basic processes suggests deepening the budget's performance orientation while strengthening fiduciary accountability with a focus on financial control and integrity. Deepening the budget's performance orientation will entail strengthening the MTEF and planning processes and consolidating the program budgeting reform. Strengthening fiduciary accountability and transparency would entail focusing on reporting and monitoring (including for non-commercial organizations), internal audit and controls, external audit, and parliamentary oversight.

- *In* ***civil service reform***, attention will be paid to performance management, improved regulation, and strengthened link to pay incentives. The broader public sector agenda relates to decentralization, regional and local government reform.

- The next phase of ***judicial*** reforms will focus on the implementation of the Judicial Code which introduced the use of precedent in order to provide consistency to court judgments and measures to improve the efficiency of court operations. This phase of reforms is designed to improve the accountability of the judiciary while continuing to strengthen judicial governance institutions.

- *In* ***conflict of interest,*** rules and regulation for ministers, parliamentarians and the public service are highly fragmented, sometimes overlapping and inconsistent. The law also is incomplete in its coverage and enforcement is sporadic and not rules-based. The linkages between public and private business interests are often close and clearly conflictive. Moreover, the system of asset disclosures has important shortcomings and is rarely effective. Implementation of assets disclosures may have begun in earnest, but has become ineffective. Reforms in these areas will have to be designed with the realization that they need to be embedded in a larger agenda of public administration reform and fighting corruption.

53. **Second, much can be done to improve the business environment further**. Public governance reforms will surely help to draw in private investment. But more needs to be done to provide a friendlier environment to draw in scare private investment. These include:

- **In *addressing gaps in the Doing Business issues***: While Armenia's ranking in the Doing Business report series is fairly strong (44^{th} in 2009), progress in recent years has been mixed, and the government has defined further improvements as a priority. In 2008, the government prepared an Action Plan, which is based on the Reform Memorandum prepared with the Doing Business Reform Advisory (DBRA) team in December 2007 but goes beyond the initial Memorandum recommendations and has ambitious targets. The Government has agreed on a specific program with the IFC's advisory services (including DBRA and FIAS) to work on improvements in starting a business, dealing with construction permits, paying taxes, trading across borders, and inspections reform.

- In reforming the ***regulatory and competition*** regimes for the knowledge and communication economy. This would require the creation of facilitating frameworks, *inter alia*, to provide for public-private partnership (PPP) mechanisms. Other measures in this area could include facilitating measures in telecom regulations for open access and sharing of communications infrastructure and assisting interoperability and information use interface with e-government. It will also be important to ensure that more commercially attractive spectrum is available for private use and radio spectrum allocation policies promote maximum contribution of the telecom sector to economic growth. As current aviation policy remains restrictive, measures to ensure competition and fair allocation in a market-based manner of aviation rights to operate services following the ending of the current monopoly of a privately-owned airline will have to be developed.

- Increased ***access to finance,*** in particular for SMEs in both Yerevan and the regions, will support the development of a diverse and vibrant private sector that can sustain growth in the longer term. While SMEs and micro-enterprises account for about 42 percent of Armenia's GDP, SME and microfinance lending accounted for only 27 percent of total bank lending at the end of 2008, which is down from 33 percent in mid-year 2006. However, a sustained increase in the availability of finance will require deposit growth and Armenian banks' access to external sources of financing more diverse that the IFI and foreign-parent-bank sources, which currently account for most of the cross-border financing to Armenian banks.

- *In* ***corporate governance*** issues relate to poor standards in securities markets and in corporate practices. Basic shareholder rights are provided for by law, but weak in practice. There are no requirements for public disclosure of ultimate beneficial owners. Company boards often lack independence from controlling owners and from management. There are no rules on full director independence. Reform efforts, in compliance with the OECD Principles will have to centre on the company registry to provide for public access to documents and shareholder list. The legal framework to assure properly functioning boards should be developed. Major weaknesses in corporate accounting and auditing exist. The authorities are committed to raising standards in corporate financial reporting and auditing through the implementation of international standards.

54. **Third, the infrastructure deficit has to be addressed over time as part of a comprehensive strategy for the country.** In meeting the infrastructure deficit, focus will need to be placed on the creation of an environment for greater private sector participation and improved efficiency. Infrastructure investment needs are heavy and all sources of financing, foreign and domestic, will need to be tapped within a liberal, market-oriented framework. In addition, across the different sectors, there arises a need to develop a capacity for analysis of sector policy to ensure the best informed decisions for sector investments, pricing, regulations and management of assets.

- In ***transport***, the road network is of particular importance for a landlocked country with partly closed borders. Investment and operating costs are high, and strategic interests indicate investments in both transit transport corridors as well as in rural or lifeline roads. There is a need to develop a coherent strategy for roads based on sound asset management principles, with a balance between capital and recurrent expenditures and funding mechanisms that ensure the sustainability of ongoing and planned investments at the national and local levels as well as to tackle problems with road safety. Finally, there is a need to put in place workable monitoring and regulatory frameworks for the recently concessioned railways to secure the efficiency and safety of the operations.

- In ***energy*,** the agenda is dominated by the necessity to decommission the nuclear power plant at the fast approaching end of its operational life and to develop a strategy for the mix of energy generating sources. The country has substantial renewable energy potential, but the investment needs are heavy. It is vulnerable to energy price shocks as it imports natural gas for heating and part of electricity generation and all of its petroleum needs. Significant improvements can be made in the efficiency of energy use as part of a strategy to reduce energy vulnerability. While Armenia is one of the less energy intensive economies in the region, probably due to adjustments relatively high and rising energy costs, potential remains for further efficiency improvements that would enhance Armenia's competitiveness and reduce energy vulnerability A recent IFC survey of private companies showed that a majority of companies see energy efficiency as an important issue for their business, and on average these companies plan to increase their investments in energy efficiency improvements over the next three years by eight times as compared to 2006-08.

- In ***water and sanitation***, investments and institutional reforms have resulted in much greater private sector engagement, particularly in water supply, with the city of Yerevan now under a lease operator arrangement and most of the rest of the country under private management contract. Despite these achievements, which have been accompanied by increases in both utility rates and revenue collection, revenues remain below cost-recovery levels and leakages are high because of the need for significant new investment.

- In ***municipal solid waste management***, where serious institutional and strategic deficiencies exist, the government intends to expand the role of the private sector in management in line with international best practices.

55. And finally**, *skills development*** has to be central for Armenia's vision of a knowledge economy. With the introduction of a 12-year general secondary education system, focus is shifting to the polar points of the education experience: (i) improving and expanding pre-school education; and (ii) reforming tertiary education, particularly its governance and financing mechanisms and promoting institutional and programme innovation. Specifically, reforms will have to address improvements in the school readiness of children entering primary education in the rural area, and in the integration of the Armenian tertiary education into the European Higher Education Area in line with the Bologna Process.

III. The Bank Group Partnership Strategy

A. Implementation of the last CAS[8]

56. **The 2004-08 CAS was one of the first pilot results-based country assistance strategies in the Bank**. Its design supported the PRSP objectives and focused interventions on three areas according to the World Bank's comparative advantage: (i) promoting private sector growth by improving public sector management, strengthening the financial sector, and reducing infrastructure bottlenecks; (ii) making growth more pro-poor by promoting a more dynamic rural economy, improving social assistance and the workings of the labor market; and (iii) reducing non-income poverty through improvements in the delivery of health, education and social services.

57. The CAS relied on a mix of adjustment and targeted investment credits, as well as related analytic work, to strengthen development effectiveness. It also used the Armenia's own PRSP goals in the CAS results matrix, thus ensuring alignment with the PRSP and national ownership, and developed monitorable indicators. The country team subsequently worked with the Government to develop interim indicators to serve as inputs to the mid-term progress report and annual CAS progress discussions with the government.

58. The 2004-08 CAS focused mainly on IDA, given IFC's still limited engagement in Armenia at the time the CAS was written. IFC, however, significantly increased its activities during 2004-08 and committed about $40 million to ten different projects with six clients. Toward the end of the CAS period, IFC also launched advisory work in energy efficiency finance, housing finance, and business enabling environment. Due to IFC's increased focus on Armenia, the FY09-12 CPS is a joint strategy.

Results achieved

59. **With respect to the first pillar – promote private sector led growth -- the Bank program led to good results.** Economic growth accelerated driven by a solid macroeconomic foundation and deep structural reforms consolidating market economy institutions, but also helped by external factors (remittances, foreign direct investment). The Bank program has contributed to the achievement of results primarily through the PRSC series but also though targeted operations on the judicial sector, public administration, transport, energy and the environment, etc. Telecom reforms are improving the linkages between the country and the rest of the world. Improved institutions (laws, regulatory bodies, private

[8] See Annex II for details

sector participation) are in place for the delivery of better public services. The work on the financial sector has strengthened regulation and competition, and deposits and credit have grown rapidly. The growth of financial intermediation has been further supported by IFC's investments in three banks and one leasing company. At end-2007, these four financial institutions reported portfolios that hold more than 3600 SME and microfinance loans with a total volume of $155 million. IFC has been able to promote growth in the mining, tourism, and retail sectors through direct investments in enterprises in these sectors. The performances of the public sector and the judiciary have improved. Nevertheless, technical improvements have not yet translated into improved public perceptions of service delivery in some areas, notably tax and customs.

60. **Income poverty, the key objective of the second pillar, was also reduced.** The design of this pillar was tightly aligned to the poverty diagnosis. Emphasis on economic growth as a driver of poverty reduction was complemented by (a) in-depth work on agriculture and rural development where many of the poor lived; and (b) policies (through the PRSC) and targeted programs that supported the vulnerable. As a result, poverty decreased sharply, including poverty in rural areas where increases in rural productivity and incomes practically eliminated absolute poverty as was the original intent.

61. **With respect to the third pillar – reduction of non-income poverty -- the results foreseen from Bank assistance have been delivered.** The public/private approach piloted and then expanded on water and sanitation has been innovative and has delivered results. Key achievements in education include increased allocation of public resources, attention to inputs that go into quality (curriculum modernization, teacher training), and expansion of the general education system to a 12 year cycle. Still, substantive challenges remain commensurate with the objective of turning Armenia into an knowedge-based economy able to assure access to quality education to all. In health, larger budgetary allocations have contributed to achievement of results most notably in access to health service by the poor and availability of family trained doctors. Health expenditures, improved water supply, rising incomes and better health practices all contributed to a rise in the life expectancy of the population.

62. The policy and technical work underlying the design and content of the reforms and interventions discussed under the three pillars was assisted by an ambitious range of **advisory and knowledge products** developed by the Bank, often in close partnership with country institutions. Three are notable: the book, *The Caucasian Tiger: Policies to Sustain Growth in Armenia (2007)*, which conducted an in-depth investigation of the effects of transition reforms and developed the agenda for second generation reforms; a series of annual *Poverty Assessments*, that provided not only assessments but were an important vehicle for transferring skills to national institutions; and a series of programmatic *Public Expenditure Reviews*, focusing on the social sectors and on infrastructure that provided a resource base for policy formation.

Box 1: Lessons from the 2004-08 CAS

- *The Armenian experience shows that reform works well when there is steady commitment to reform across a long time period.* Moreover, the strength of the Bank's engagement can be traced not just to its activities during the CAS period but a long and deep relationship of trust built over more than a decade.

- *A key element in making the Bank's program effective has been the complementary re-enforcing package of annual policy support, related investments, and selected analytic work.* For example, health investments were combined with health policy targets in the PRSC as well as Public Expenditure analysis focusing on the health sector.

- *The use of programmatic instruments, focusing work in areas that the Bank has built up expertise over a long time period, has enabled it to provide quick and expert support.* On the policy side, each annual program has built on the achievements of the previous one.

- *Public/private partnerships work in Armenia*.

- *Results indicators need to be chosen which are both relevant and easily measured.* Where results indicators relied on those measured by the government in the PRSP or the annual Poverty Assessment, they have proven robust and useful.

- *The vulnerability of growth continues to be a concern.* This makes policies to integrate the economy even more important.

- *Further progress on governance is likely to depend on clear high level commitment rather than technical fixes.*

- *The shift to IBRD lending implies* more strategic choices. A likely greater emphasis on infrastructure should not come at the expense of capacity building and social sector investments. It will also be important to strengthen collaboration across the Bank group, including IDA, IBRD, IFC and MIGA.

- *There is an opportunity to build and gradually rely more on country systems.*

B. Bank Group Country Partnership Program

The Results-Based Framework

63. **As one of the first countries to pilot a results-based approach under the last CAS, the culture of results-orientation is becoming increasingly well established in Armenia.** The focus on results was a major feature of the last CAS and Armenia was successful with respect to the targets then set. At program and project levels, incentives to deliver results have grown, and the wide dissemination of successful outcomes (e.g., in poverty, social service delivery, utility quality standards, quality of seeds supplied) has had demonstration effects.

64. **The CPS will deepen the results-orientation built thus far.** The results framework identifies the outcomes to which the CPS is expected to contribute and provides measurable indicators to assess the achievement of each outcome (see Annex II). Through dialogue and specific interventions, the Bank will endeavor to encourage amongst counterparts the measurement and evaluation of results and the creation of business processes, incentives and managerial behavior towards results orientation. The move towards greater attention to results in the country has benefitted from the increasing rigor of results frameworks for recent projects and the increased capacity of country systems as supported by the Bank. Adjustments to the matrix will be made at the *CPS Progress Report* stage to incorporate new activities planned in the

outer years of the CPS, recognizing that in most instances implementation will not progress fast enough to contribute to long-term development outcomes during the planning horizon of this strategy.

65. **Plans for monitoring and evaluation under this CPS will capitalize on opportunities for increased harmonization.** To this end, indicators from the SDP have been incorporated into the results framework where appropriate and the Bank will rely on country data systems and unified reporting systems where feasible. The Bank will actively monitor implementation progress of the CPS with the government and key partners through regular CPS implementation reviews, and through the DPO series process.

Principles of Engagement

66. The proposed CPS is based upon the following principles of engagement:

- ***Alignment with national strategy*--** There is direct alignment with the Armenia's *Sustainable Development Program*, taking account of the adjustments being made to reflect current international conditions.

- ***Selectivity* --** The Bank Group will progressively disengage from areas where reform or investment needs have been substantially satisfied or where other donors have comparative advantage, or where the country has the knowledge and the capacity to handle for itself;

- ***Leveraging* --** The Bank Group will increasingly rely upon leveraging other development partners given competing demands on IDA and IBRD resources and on the internal administrative budget;

- ***Flexibility***. The CPS is cast as a highly flexible strategy, given the uncertainties on the depth and duration of the international crisis. While the principal objectives and strategic directions of the assistance strategy are unlikely to change, flexibility is necessary in the balance between pillars and the mix of instruments that will be most appropriate, particularly in the outer years of the CPS period.

- ***Frontloading.*** The allocation of Armenia's IDA and IBRD envelopes has been significantly frontloaded in the initial fiscal years of the CPS. Therefore, the capacity of the Bank to respond to Armenia's growing and complex requirements beyond 2010 will critically depend on whether additional lending resources are allocated to the country.

Proposed Program of Support

67. **In line with the results-based framework, the CPS envisages a two pillar strategy of addressing vulnerability and strengthening medium-term competitiveness.** It proposes a lending program of about five operations per year, strong implementation focus, and a rich AAA program (see Table 4). Subject to the considerations of flexibility indicated above, IDA/IBRD commitments will total approximately $150 million per annum over FY09-10 and $120 million over FY11-12, with the front-loading reflecting the crisis needs. The overall IDA-15 envelope is projected at $150 million, assuming continued high performance with respect to the IDA performance-based allocation system.[9] It is expected that Armenia will fully utilize the IDA-15 lending envelope. The IBRD planned lending is $395 million over this four fiscal year period. Subject to finding appropriate projects in the market, IFC intends to finance four or five projects per year in FY10-12, with average project size of about $10 million. This would represent a significant increase over recent years; in FY08 IFC supported two projects and in FY09, it will support three or four.

Table 4: Proposed Lending Program, 2009-12
(*in millions of US Dollars)*

FY09				**FY10**				**FY11-12**			
PROJECTS	**IBRD**	**IDA**	**IFC**	**PROJECTS**	**IBRD**	**IDA**	**IFC**	**PROJECTS**	**IBRD**	**IDA**	**IFC**
PILLAR 1: ADDRESSING VULNERABILITY											
ASIF AF*		8		ASIF AF	7						
RESCAD AF*		2		Social Assistance AF	5			Agriculture*	14		
SME Line of Credit*	50										
Financing to Private Sector			8	Financing to Private Sector			20				
Water AF*		20		Irrigation*	30						
Lifeline Roads*		25		Rural Roads*	36						
PILLAR II: STRENGTHENING COMPETITIVENESS FOR POST-CRISIS GROWTH											
				DPC-1*		60		DPC-2 & 3*	25	10	
				Roads 1	43			Roads 2	68		
Education Quality & Relevance*		25		E-Armenia	24						
				Public Sector Management	9			Public Financial Management	8		
Financing to Private Sector			4	Financing to private sector			10	Energy	76		
								Financing to private sector			100
Total	50	80	12		154	60	30		191	10	100

Note: * Denotes applicability to both pillars

9 Armenia has the potential for graduation from IDA by the end of the IDA-15 period, depending on continuing per capita performance and growth. Therefore, no assumptions are made for FY12 as this is part of IDA16 and will be decided in that context.

Box 2: Analytic and Advisory Services

I. Addressing Vulnerability

Macroeconomic, fiscal and financial
- crisis response and management, including use of appropriate macroeconomic tools
- choices in public expenditure allocations
- portfolio and non-performing loan workouts for banks and risk management tools and strategies.
- financial sector monitoring
- post-crisis strategy

Fighting poverty
- poverty monitoring and distributional analysis of policy implications

Combating social and environmental risks
- health financing
- social protection strategy/management issues
- natural disaster risk
- pensions – design and implementation of reforms
- climate change vulnerability issues

II. Strengthening Competitiveness for Post-Crisis Growth

Competition and Governance
- trade expansion strategy/preparedness for FTA with the EU
- financial sector update or FSAP update
- PEFA follow-up/PSM agenda
- improvements in the business climate
- higher education reforms

Knowledge economy, regulation and infrastructure
- regulatory development
- telecoms reforms/ICT
- energy sector strategy
- advisory assistance to banks on energy efficiency and housing financing
- structural reforms supported by DPOs (tax/royalty regime in mining, telecom, spectrum, civil aviation forms, regulation of railways, health policy)

68. **The design of the CPS strongly reflects the context of the global economic crisis.** In FY09, Armenia was the first country to benefit from the IDA Fast Track Facility which permitted the use of expedited preparation and implementation procedures. This permitted a frontloading of IDA resources of 50 percent of the annual envelope in response to the crisis needs to support output and employment. Thus, additional financing (totaling $35 million) was rapidly provided, under emergency procedures, for rural road rehabilitation, community development and the rural economy, for projects with strong implementation performance and where designs for investments existed but could not be implemented because of financing limitations. As a result, these activities started rapidly in spring 2009 and are expected to be completed by the end of the construction season at end-2009. Earlier in the fiscal year, IDA also approved additional financing for water ($20 million). An APL project for enhancing quality and relevance in education ($25 million) is also scheduled for FY09. This will support of continued reforms, notably the extension of the school year to the 12th grade. Thus, IDA credits committed will total $80 million in FY 09.

69. **Given the economic uncertainties, the program laid out here has been more fully elaborated for FY09 and FY10.** The program details for the latter two fiscal years will be presented in the *CPS Progress Report* to be distributed to the Board within 18 months. The scheduling of this report will ensure that adjustments to the country partnership strategy are timely and effective.

70. **This fiscal year also saw the first IBRD loan to Armenia** after its attaining blend status, approved by the Board in February 2009, in the amount of $50 million for a domestic commercial bank intermediated line of credit to the small and medium enterprise sector. This loan is part of the crisis response as it will bolster output, investment and employment at a time of credit drought and is expected to disburse rapidly.

71. **Over the CPS period, the series of three development policy operations will provide an anchor for policy and institutional reforms that cut across both pillars.** The first operation being presented to the Board in early FY10 will provide fiscal and balance of payments support of $50 million and undergird the revised budget and public expenditure choices in a recession environment as well as reforms in governance and competition. The subsequent two operations are still to be defined fully, but will cover the critical reform priorities under each of the themes described above.

72. **The proposed program of new AAA follows the principles outlined above and also links systematically to the Bank's ongoing portfolio and new lending.** At the beginning of fiscal 2009, the Bank provided the new government with a comprehensive set of policy notes covering the reform agenda that was being developed under the SPD. In-depth discussions were held with the prime minister and all key line ministers, government agencies, and with academics and the public. The Bank's work continues to be guided by the analysis of this report. The further AAA program supported by the CPS contains core diagnostic studies and ESW to design and implement the crisis response, strengthen the capacity for improved governance as well as provide detailed advice on the design of the next generation of reforms. These will be provided as formal reports, just-in-time advisory notes as well as technical assistance.

73. The CPS program of support is organized along the following results-based framework.

<u>Strategic Objective 1: Addressing Vulnerabilities</u>

Results area 1: A post-crisis Armenia that regains macro-stability and is poised for high growth

Outcome 1: Macro stability maintained through appropriate external and domestic fiscal adjustment

Outcome 2: Tax regime and administration reformed:

Outcome 3: Financial intermediation rises, with growth in SME credit lines to rise as a share of total credit.

74. ***Macro-stability and positioning for high growth***. The AAA work will be directed at providing rapid analysis on the evolving macro-economic stresses, particularly on fiscal adjustment and choices in public expenditures so as to safeguard the anti-poverty thrust of policies. Fiscal policy advice would focus on both expenditure efficiency and equity gains and on strengthening the revenue base through improvements in tax policy and administration. Bank advice would build on Armenia's solid track record of improving the efficiency and transparency of public finances. The DPOs would be central to this objective. The recently completed series of PRSCs has established a strong framework and the new *DPO* series will build upon it. A full economic report in FY10-11 will provide comprehensive advice on post-

crisis re-attainment of rapid growth, with a shift towards tradables. Advice on trade expansion and policy reform in view of the interest in a deep free trade agreement with the EU will be provided. Key infrastructure support through current and new road, energy, and water projects (noted below) will also generate employment, support output during the downturn and help position Armenia for growth after the current period.

75. ***Tax reforms.*** The DPOs will be central to this objective. The recently completed series of PRSCs has established a strong framework and the new *DPO* series will continue to have a central focus on this objective. The economic report will provide the analytical framework.

76. ***The financial sector.*** A banking sector diagnostic or an update of the FSAP will be on the agenda for the latter period of the CPS. The Bank will continue with policy advice to the Central Bank, in close coordination with the IMF, to advise on financial sector policy and institutional changes needed to respond to the crisis. Bank AAA will focus on banking sector risks and vulnerabilities. The *SME line of credit* (FY09) is strengthening the investment base for growth during the current difficult credit period (and may attract additional financing from other sources to extend gains in the medium term).

77. IFC's current focus on the financial sector will continue, as this is the best way for IFC to support the availability of finance to a broad number of companies. To support its client banks during the current financial turmoil, IFC will provide short-term liquidity (such as trade finance) and possible support on recapitalization with equity or quasi-equity. During this period, SME finance and microfinance will remain key priorities to help ensure that small businesses still have access to capital. IFC will also provide advisory services to support the management of portfolios and NPLs. This will include work directly with client banks, as well as with Government to improve the necessary regulatory environment. IFC will also seek to support clients in the real sector with financing where prudent and is considering an advisory services program for SMEs on crisis management, including topics such as cost reduction and cash flow management, risk management, and options for companies unable to meet current debt obligations.

Results area 2: Adverse poverty impact limited amidst assured health and social protection

Outcome 1: Income poverty impacts are limited through employment generation from job-creating programs and through improved poverty targeting.

Outcome 2: Increased utilization of basic health services by the poor, with a decline in out-of-pocket payments.

Outcome 3: Urban households employ safe gas-based heating; solid waste management follows international good practice.

78. ***Poverty, social protection and job creation.*** The strong gains in poverty reduction are jeopardized by the current economic crisis, and thus generating immediate employment opportunities is critical. The Bank will continue to work jointly with the authorities on increasing sophistication in poverty monitoring and on drawing the policy implications of the changing profile of poverty. Clearly, policies to reverse rapidly the expected worsening in poverty over FY09-10 shall have high priority.

79. The set of three emergency interventions in lifeline roads, community development and the rural economy will generate employment as well as create new sustainable capacity in infrastructure. The IDA fast track operations in FY09-- The Social Investment Fund (ASIF-3) and the Rural Development Fund

(RESCAD) as well as the Lifeline Roads project-- were targeted for their short-term job creation potential. Further additional financing for ASIF-3 is planned for FY10. The subsequent roads projects over FY11-12 will create further job opportunities through direct employment as well as creating opportunities for improved market access and economic growth. In FY10 additional financing for social assistance to support institutional changes is being planned. The roads projects over FY11-12 will further assist link poor villages to markets. The DPO will provide for changes in social protection design and support for the development of the multi-pillar pensions system. The ongoing *Social Projection Project* has already put into place a well functioning safety net, but this will be augmented by further technical strengthening through additional financing in FY10. Bank work under the DPOs will support the policy and institutional reforms to further enhance the poverty targeting of selected government programs.

80. ***Health.*** The financing of health reforms and support for the design of the multi-pillar pension system will be a part of the AAA agenda. The ongoing *Health APL I and II projects* aim at scaling up family based medicine and the further optimizing hospital administration in the regions, to extend health care quality nation-wide. Design of reforms to the basic benefits package, adequate costing and reimbursement for services will help reduce informal payments and will likely be supported through the DPO series.

81. ***Heating.*** The ongoing *Urban Heating Project* continues to provide heating services in key public services, including schools and hospitals.

Results area 3: Rural and environmental risks decrease

Outcome 1: Irrigated acreage rises as institutions for water management develop.

Outcome 2: Rural output and employment is supported.

Outcome 3: Environmentally-safe mining code under implementation.

Outcome 4: Preparedness for handling natural disasters is developed.

82. ***Irrigation.*** A number of projects supporting irrigation sector and rural development (Irrigation, Dam Safety, and Dam Safety II) have recently closed or are closing. These projects have been instrumental in restoring irrigation systems and establishing principles of participatory irrigation management through formation of water user associations. A *new irrigation loan in FY10* would enable the Bank to continue rehabilitation of irrigation systems and facilitate the next institutional step in creating federations of Water User Associations.

83. ***The rural economy.*** The crisis-impact work will pay close attention to the impact on the rural economy and to enhancing export and growth prospects. The Bank has long been a supporter of local and rural development. The IDA fast track projects discussed above support rural development. Those projects have strong beneficial impacts on the rural economy not only through their short-term employment-generation but also through the development of community infrastructure and by connecting rural areas to agricultural markets. *The Social Investment Fund (ASIF-3)* and the *Rural Development Fund (RESCAD)* support priority community infrastructure needs while creating immediate employment opportunities. A follow-up *Agriculture project in FY11-12* will enable the Bank to continue to deepen rural competitiveness. Continued government investment in upgrading extension services and implementing food safety standards are important to ensure growth and the opening of new export markets.

84. ***Environmental risks.*** The DPO is supporting the development of a mining code that pays particular attention to environmental aspects and during the CPS period the code will be brought under implementation. Fiscal and regulatory incentives to ensuring environmental protection will be central to the code. The reformed environment will ease the re-start of the mining sector after the current downturn and the attraction of foreign direct investment.

85. ***Natural disasters.*** The management of natural disasters, particular the use of insurance products and public preparedness, as well as measures to adapt to climate change will feature in the latter part of the CPS period. Support in the form of policy advice and the transplantation of international best practice will be important in this regard. The Bank will consider assisting the country to conduct pilot vulnerability assessments in the energy and agriculture sectors and to develop adaptation plans for water sector investments. This work can help build in better climate resilience to Bank-supported investments as well as assist Armenia in adaptation planning. There is also the possibility to use facilities not currently included in the lending program for disaster insurance and the environment, such as the Carbon Fund.

Strategic Objective 2: Strengthening Competitiveness for Post-Crisis Growth

Results area 4: Governance is strengthened; as a result, public sector efficiency rises

Outcome 1: Conflict of interest among public officials is substantially diminished; and fair competition in commerce is established. At least 60 percent of firms agree that implementation of laws is consistent and predictable.

Outcome 2: Business surveys show near-elimination of complaints of revenue agency behavior.

Outcome 3: Program budgeting leads to efficient expenditure allocations; and civil service performance appraisal is introduced. Judicial decisions are rule-bound. Strengthened accountability, transparency and efficiency in the use of public funds.

86. ***Competition and conflict of interest.*** The advisory work will cover conflict of interest policy within the umbrella of a coherent strategy on governance and anti-corruption reforms. Measures are being designed to add to the powers and the reach of the Competition Commission and to enhance its technical skills. Policy steps taken in these areas will be a part of the DPO-supported reform agenda.

87. ***Revenue agency reforms.*** Technical advice to the revenue raising agency in both the areas of customs and tax will be provided under the DPO. The DPO-supported program envisages the implementation of the medium-term reform strategy in the agency that provides for rules-based behavior, the full extension of risk-based revenue management, reduced interaction between officials and the public, and the adoption of modern business practices to these ends. Customs reforms will provide full behind-the-border support to the operation of a free trade agreement with the EU.

88. ***Public service reforms.*** The PEFA prepared by the authorities and the CFAA will be followed up with further analysis and technical assistance. Loans in public sector and financial management (FY11-12) will finance e-infrastructure, equipment in agencies and technical assistance. Improved governance has been supported through the recently completed series of *PRSCs,* and the ongoing *Judicial Reform II* and *Public Sector Management* projects. New follow-on loans in *public sector management* and *financial management* (FY11-12) will finance further improvement in civil service reform, building modern accounting, internal controls and auditing systems, and further strengthening electronic feedback

on service delivery.

Results area 5: Foundations for knowledge economy and competitiveness strengthened

Outcome 1:	In support of a knowledge-based economy with the necessary infrastructure, strategy being implemented for increased internet penetration, amidst the laying of a national ICT broadband backbone network.
Outcome 2:	PPP framework in operation. Commercially valuable spectrum available for private sector use; and aviation fully liberalized.
Outcome 3:	In transport management, road network is improved and analysis and regulatory capacities strengthened.
Outcome 4:	In energy, investment financing for new generation capacity; and transmission losses reduction.
Outcome 5:	In water, share of consumers with continuous water supply rises, cost recovery improves, budget support for current operations phased out by 2012.
Outcome 6:	A growing private sector faces more open competition and access to finance.
Outcome 7:	In education, increase of net preschool (5 years old) enrollment rate. Increase in the share of public funding in the total revenues of public higher education institutions.

89. ***Knowledge and competitiveness.*** A major effort will lie in developing a comprehensive strategy towards a knowledge-based economy and the design of the supporting infrastructure. An ICT/e-governance project (FY10) will provide technical support and financing for key infrastructure. It also will provide technical support and financing for building critical "backbone" telecommunications infrastructure, facilitate technology transfer and also augment the education projects (noted below) by establishing an innovation fund for higher education centers of excellence. The *DPO* will supplement this through regulatory and competition reforms as a key theme, and reforms in governance and financing of universities to create the conditions and provide the incentives for their increased involvement in research, development and innovation.

90. ***PPP framework.*** Regulatory reforms on private sector participation in infrastructure and utility services, and policy reforms in telecommunications, civil aviation liberalization will be analyzed in the context of the lending being prepared. The DPO will play the central role in these areas. The Bank will provide advice on the management of PPPs. Outcomes will provide for the auctioning of commercially valuable radio spectrum and the full liberalization of civil aviation once the existing monopolistic commercial agreement comes to an end in 2013. IFC may also support the development of particular PPPs either through advisory or investment work.

91. ***Transport.*** Studies will cover management of transport assets and associated regulatory reforms. The *roads sector operation* (FY10) will improve quality. IFC will seek opportunities to catalyze private sector participation in transport and logistics projects, facilitating improved access to markets.

92. ***Energy.*** AAA will support the authorities in the development of an energy strategy in light of the need to decommission the existing nuclear power plant. The current *renewable energy project* and *Geothermal GEF project* are supporting the development of alternative energy sources. New *Energy Supply Reliability and Energy Efficiency Project* (FY11-12) will enhance electricity supply reliability, reduce transmission losses and energy intensity of the economy, and contribute to the export of electricity. A new hydro/renewable energy project (FY11-12) could be pursued and IFC is seeking opportunities to finance private small renewable energy projects. IFC is completing an energy efficiency survey to identify opportunities and will build on this work through advisory and financing to banks to encourage the provision of energy efficiency financing.

93. ***Water.*** The Bank has been very active in building a new public-private partnership in the delivery of water supply to businesses and the public through two ongoing projects -- *Yerevan Water* and *Municipal Water* projects. *Additional Finance for the Municipal Water Project* was provided in FY09 to help extend the management contract and set further quality benchmarks.

94. ***Private sector.*** IFC has launched an advisory initiative to support improvements in the business enabling environment, which will decrease the costs of doing business in Armenia and increase the competitiveness of its private sector. To support growth of the private sector, IFC will also provide and mobilize financing. In the banking sector, after the crisis-related needs for short-term liquidity and recapitalization have passed, IFC will resume longer term lending to facilitate access to finance to a broad number of private companies. IFC will target reaching 4800 SMEs through its partner banks by FY12, with a total SME loan volume of at least $200million. IFC will also remain engaged in the development of housing finance, a government priority, through advisory and investment services. IFC will also directly finance private companies of sufficient size and transparency. In addition to the possible PPPs, transport and logistics, and energy investments mentioned above, IFC will seek to make direct investments in sectors where Armenia has a comparative advantage, such as mining, or where the investment project has a positive impact on businesses in its value-chain, such as retail, warehousing or food production.

95. ***Education.*** Higher education reforms will focus on innovation, and on governance and financing aspects. The *education APL-II project* (FY09) will enhance school learning by supporting the completion of the 12-year general education system while improving the school readiness of children entering primary education. The project will also help improve quality assurance in higher education institutions so as to support their integration into the European Higher Education Area. It will build on the ongoing *education APL I project* and extend gains to both the pre-school and tertiary level which have largely depended on private fees which lock out the poor. The project will help improve the school readiness of children entering the primary system. It will also help develop the quality assurance framework. IFC will support the development of student loans through its client banks.

Use of Bank Group Instruments

96. **Investment operations will contribute most heavily to the Bank's implementation program**. Their share in total lending will likely be about 80 percent. The bulk of the investment operations are likely to be in the infrastructure sectors. IFC will invest primarily through financial intermediaries, with a focus on short-term liquidity and equity or quasi-equity during current financial turmoil. IFC will also selectively invest directly in companies with the full range of products as appropriate.

97. **Development policy operations will remain the main policy-based lending instrument** of the Bank directed at providing support for the implementation of the SDP. While the overall share of DPOs will likely be about 20 percent, the cross-sectoral content of the DPOs and their leveraging of budget support operations from other partners, such as the ADB or the EC give them higher prominence.

Moreover, the complementarity of efforts between programmatic support under the DPOs and investment lending will be key to supporting reforms, institutional change and essential supporting investment and, hence, to making efficient use of Bank resources – as was done under the previous CAS.

98. **IFC intends to significantly increase its investment activities in the country.** Its focus on the financial sector will continue, as this is the most effective way for IFC to reach a large number of smaller businesses in the economy. To support its client banks during current financial turmoil, IFC will provide short-term liquidity (such as trade finance) and possible support on recapitalization with equity or quasi-equity, possibly leveraging financing from the Bank Capitalization Facility and the Global Trade Facility. IFC is also seeking to develop instruments that would allow for the provision of local currency financing to Armenian banks.

99. **Analytic and advisory work will continue to be a core element of the program.** The Bank will continue as a leading external source of economic, poverty and sector analysis. The AAA work done over the 2004-08 CAS period has deeply informed the CPS program now being proposed. Work on macroeconomic and reform policy choices presented to the new government in mid-2008 as well as a programmatic series of public expenditure reviews was used to shape the government's economic program across a broad swath of activities: taxation regime, raising governance standards and efficiency in revenue collection, public management, institutional reforms in regulation and infrastructure, and expenditure choices in the social sectors. Poverty assessments have influenced the design of social transfers. Technical assistance on pension schemes has been used to make strategic choices in the institution of a multi-pillar system.

100. **AAA will be used to illustrate policy choices that are particularly important in macroeconomic and anti-poverty policies, public expenditure options and core structural reforms.** Analytical work will maintain its focus on sophisticated structural reforms and on those issues most critical to reducing the risks to the population posed by transition and external shocks. As noted, the advisory work program will be responsive to opportunities at the regional south Caucasus level and to global public goods. IFC will provide advisory services related to business enabling environment, access to finance, energy efficiency, and possibly on PPPs for infrastructure and social services.

101. **The Bank will also build on its experience with programmatic approaches in selected sectors across various instruments.** For instance, Bank engagement over time in the energy sector would be continued with new investment projects to support transmission rehabilitation and energy efficiency measures, but would be informed by analytical work on an appropriate energy sector strategy for the country. IFC will complement the Bank's role through advisory services to banks on energy efficiency lending and possibly financing (either direct or through partner banks) to support renewable energy and energy efficiency.

102. **The Bank's work on governance and anti-corruption will be consistent with the Bank's recently approved corporate strategy.**[10] It will be cross-cutting in nature, with dialogue focused on the key, critical pre-conditions for success with an overall governance strategy that will address political economy factors. It will also provide advice on selected interventions in public governance, the judiciary, the revenue-collection agencies, social services (addressing corruption in tertiary education as well as out of pocket spending in the health sector); and this technical work will be backed up by lending. IFC will support transparency in the business climate through its advisory work on the business enabling environment and possible engagements on corporate governance issues. As with other key reform areas, country ownership and leadership are critical in this area together with the coordinated roles of other donors. This is the only way that the Bank's program can make a decisive difference in the period of the

[10] See *Strengthening World Bank Group Engagement on Governance and Anti-Corruption,* March 2007

proposed engagement strategy and improve the country's standing on various governance measures.

Box 3: One Bank – IFC and IDA/IBRD Integrated Programs

The IFC and IDA/IBRD find that joint approaches and programs in the following sectors would have a particularly high pay-off over the CPS period:

- **In the financial sector,** the objectives of the Bank Group program are to deepen financial intermediation, raise the share of lending to SMEs, and ensure the continued strong health of banks. IDA/IBRD will provide advice on strengthening supervision, developing contingent liquidity support schemes, providing finance to the banking system for on-lending to SMEs. IFC will focus on liquidity provision through trade credits and possibly assist banks in re-capitalization using its new facilities as well as provide SME and micro-financing. It will also provide advisory services related to NPL and risk management. This joint framework will provide comprehensive technical and financial assistance at a time of stress, keeping the vision of long term development always in mind.
- In the **business enabling environment**, IFC and World Bank teams are jointly developing targets related to the business climate for an upcoming IDA DPO and will continue to work together to ensure consistent messaging and coordinated actions with the Government. On issues related to revenues, IFC and the Bank will also involve the IMF as appropriate.
- **In energy,** IDA/IBRD will assist the authorities build on their strategy to consider long-term generation and exports as well as renewed emphasis on renewables and efficiency. Lending support will be directed at transmission improvements and developing renewables. IFC will seek to support private companies in developing renewable energy, either directly or through banks, and will support the development of energy efficiency financing by its client banks.
- **In infrastructure and PPPs,** all parts of the Bank Group will be heavily engaged in supporting this new priority. IDA/IBRD will focus on the regulatory framework and the infrastructure requirements of the knowledge-based economy. It will finance infrastructure and e-development. Besides its focus on the business environment, IFC will look to providing advice on specific PPP deals and possibly financing them.
- **In mining,** IDA/IBRD is providing advice on a reform of the mining code, with focus on the fiscal and environmental aspects, to create a sustainable and transparent framework for activities and foreign investment. IFC has one mining investment in Armenia currently and if the regulatory and licensing regime improves, it may anticipate additional opportunities in the CPS period.

Portfolio management and performance

103. **Total Bank exposure to Armenia amounts to the equivalent of $1.1 billion**, (including three Global Environment Fund operations), with disbursements amounting to $1 billion. The active portfolio[11] consists of seventeen IDA credits, one IBRD loan and two GEF projects, for a total commitment of $385 million, of which $186 million undisbursed. The Bank Group also actively manages a portfolio of about 35 trust fund grants.

104. **Portfolio performance has been highly satisfactory.** The disbursement ratio[12] of the portfolio -- a key indicator of overall portfolio performance -- was 34 percent by end-FY 2008, well above the ECA average of 18 percent for the same period. All investment projects are rated in the satisfactory range both for Implementation Progress and achievement of Development Objectives. Over the CPS period, it is expected that the total number of projects in the portfolio will decline. The 2005 Country Financial Accountability Assessment (CFAA) report concluded that the overall fiduciary risk is significant. The key reasons are: (i) inadequate capacity of core control and supervisory agencies performing the audits within

[11] Data as of March 1, 2009.
[12] Disbursements during the fiscal year as a percentage of undisbursed balances at the beginning of the fiscal year (investment operations only)

the public sector; and (ii) although most of the basic laws are in place with respect to various entities' (private sector and public enterprises, including state non-commercial organizations) financial reporting, compliance remains a problem and authorities need to improve the quality of auditing, reporting, monitoring and supervision. The PEFA assessment report published in October 2008 also demonstrates that several critical Public Financial Management (PFM) elements including internal controls, internal and external audit, and financial reporting are still weak.

105. **While the country financial management inherent risk is significant, the control risk at the entities level implementing Bank projects is moderate.** The Bank projects financial management systems have been adequate to ensure that funds have been used for intended purpose. All the projects in the portfolio have been audited by private sector auditors acceptable to the Bank. There are no overdue audits regarding the projects (credits and grants) or continuing entities. Some delays have been observed in the past particularly regarding to audit of companies operating in the water sector. The project implementing agencies have satisfactory financial management arrangements in place and sound internal control systems. The FM staff involved in Bank projects is experienced and skilled. An issue of concern was the high turnover of FM staff, mainly caused by the attractive remuneration packages offered in the private sector. However, recent increase in salaries and slow down in private sector recruitment indicate that this issues does not pose a significant risk. All projects have moderately satisfactory or higher FM rating.

106. **Nevertheless, continued strong attention to portfolio and enhanced implementation support will be required**. Infrastructure investments will likely represent a higher share of portfolio, requiring more focused supervision to address quality issues and corruption risks. Implementation support could be enhanced through (i) introduction of risk-based approaches; (ii) more resources for risky projects; (iii) better physical verification of works; and (iv) a greater reliance on civil society organizations in implementation. Results will be monitored through a series of Portfolio Performance Reviews, to be conducted every two years jointly with the government. In line with the Bank's overall strategic direction, it would be important to move towards the use of country systems in Armenia. There are no major fiduciary risks likely to affect the implementation of the CPS programme.

107. **IFC has a committed portfolio of $43 million**, of which $40 million is disbursed. The portfolio includes seven clients, in banking leasing, tourism, mining, and retail-related infrastructure. Portfolio performance overall has been satisfactory. About two thirds of this portfolio is debt with the remainder in equity, quasi-equity, and a guarantee (through IFC's global trade facility).

Box 4: Bank Office Strengthens its Public Outreach

In March, 2009 the WB Yerevan Office, launched its long-awaited Public Information Center, in partnership with the Papazian Library of the American University of Armenia (AUA). The Papazian library serves over 9,000 regular patrons and is open for general public. The rationale behind the name "Knowledge for Development Center" is the belief that knowledge-sharing is essential for people's full participation in society and is an important step to support reform and development. By situating the center in a local institution, the Bank's role as a 'knowledge bank' will be enhanced.

The Knowledge for Development Center houses around 1000 Bank publications of the past five years, a dedicated shelf with files on each on-going and active project in Armenia, and provides access to the Bank's e-resources, with full-text publications and up-to-date development indicators via a well-equipped computer corner.

The center will go beyond one-way 'information dissemination' to a more two-way communication and sharing of knowledge with and among users. To this end, the Center will expand its role as a hub for facilitating dialogue, consultations, and knowledge-sharing among the academia, media, Government, Civil Society, as well as the private sector.

C. Partnerships

108. The update of the PRSP through the preparation of the Sustainable Development Program has served as a vehicle for strengthening the government's role in donor coordination. Donors are active in a number of key areas (as described below) and Armenia has made efforts to obtain stepped-up donor assistance in the light of the financing needs that arose from the international economic crisis. In addition to coordination in the field, many donors including Japan, UK, Netherlands, Sweden and the EU have provided grant resources through Trust Funds managed through the World Bank.

109. The **IMF** approved a standby arrangement in the amount of $540 million in March 2009 for a period of 28 months that is heavily front-loaded (disbursements in 2009 will amount to $350 million) to deal with the crisis effects. The key elements of the program provide support for (i) a return to a flexible exchange rate regime; (ii) a strengthening of the financial sector to maintain stability and confidence, including through Central Bank liquidity support operations, as needed, and (iii) a revision of fiscal priorities to maintain macroeconomic stability, while protecting social outlays and public investment, in light of the expected revenue shortfall. This new agreement has replaced the PRGF that was approved in November 2008. World Bank, IMF and Government of Armenia jointly work on Armenia's short- and medium-term macroeconomic and fiscal projections, and Debt Sustainability Analysis. Another area of cooperation is tax administration and tax policy reforms. The IMF and the Bank have provided technical assistance to the State Revenue Committee to introduce change management system, including for reforming the Large Taxpayer Unit.

110. The **Asian Development Bank** supports rural development, private sector development, and promotion of regional cooperation. Armenia joined ADB in 2005. The first investment lending operations supported rehabilitation of rural roads and rural water supply. ADB water project covers small towns and villages in five *marzes* included in AWSC service area, where the Bank-assisted project is being implemented. Hence, the Bank works closely with ADB to coordinate investments in the area. ADB is also considering financing of the North-South road transport corridor, assistance in financial reforms for enhancing business environment, as well as budget support in close consultation with the World Bank.

111. The **EBRD** provides finance to SME's, primarily through credit lines to local partner banks, but also directly through its Direct Investment Facility, Direct Lending Facility, as well as co-financing and risk sharing with local banks under the Medium-Sized Co-financing Facility. To reinforce the local banks' capacity for meeting the private sector's financing needs, EBRD selectively pursues equity participation in Armenia's best banks. It has financed three financial institutions that are also clients of IFC, one with equity and two with debt. EBRD also supports creditworthy renewable energy and energy efficiency projects, and finances the country's leading privately-owned power generation and distribution companies. It is co-financing the Bank's on-going Renewable Energy Project that supports investments for the development of renewable energy projects, mostly small-hydro power plants. EBRD is also planning to provide financing to private operators and concessionaires of public utilities and transport infrastructure companies. Where justified by the potential transition impact, EBRD would pursue sovereign-backed projects, particularly those with a significant component of grant co-financing. In addition, EBRD is providing financing for rehabilitation of five of Armenia's wastewater treatment system in Sevan region within AWSC service area. The project is implemented and supervised by the management operator of AWSC. The Bank coordinates with EBRD the exchange of information on mutual efforts in Armenia's water sector.

112. The **European Union** is supporting the development of an increasingly close relationship between the EU and Armenia in the context of the European Neighborhood Policy (ENP) and the Eastern Partnership. Consultations have been initiated for the possible establishment of a Free Trade Agreement, implying an even closer alignment with the body of regulations on the EU single market. The EU's

assistance strategy focuses on strengthening democratic structures and good governance, on further support for regulatory reform and administrative capacity building and on poverty reduction. Assistance is provided via Twinning, TAIEX and EU Advisory Group, and through budget support grants. Budget support has focused on vocational education training and judicial sector reform. The EU and the Bank coordinate closely with regular exchange of information on judicial sector reform, as part of the Judicial Reform Project supported by the Bank.

113. The **UNDP** country program for Armenia supports economic and social governance, with the aim of expanding and strengthening the national social monitoring system; introducing innovative income generation schemes; strengthening disaster risk management; and multi-sectoral responses to HIV/AIDS. Another area of focus is democratic governance where the UNDP program helps strengthen governing institutions with policy, oversight and electoral functions; promote participatory policy-making among targeted groups; and increase awareness of human rights. In the area of environmental governance it helps strengthen the conservation and sustainable use of natural resources and increase access to sustainable energy. There has been close cooperation between UNDP and the World Bank in supporting the preparation of SDP, where UNDP's assistance was in the area of facilitating participatory process and reflecting the voice of vulnerable groups in the poverty reduction strategy. Moreover, the Bank supports a program on institutional arrangements in disaster risk management financed by the Global Facility for Disaster Reduction and Recovery (a partnership of the WB, UNISDR and others), thus cooperating and sharing information with UNDP in the area of disaster risk management. The UNDP and the Bank also cooperate to support community-based activities to manage communal services, particularly heating.

114. **Other UN agencies** support areas related to Bank activities—in environmental management; renewable energy development; primary and public health programs; and in preschool education. UNFPA supports reproductive health, while FAO assists in the areas of food safety, brucellosis control, re-forestation, capacity building in agricultural biotechnologies and bio-safety, as well as pesticide quality control. UNICEF supports the development of pre-school education as well as health and nutrition, and child protection. Under the Education Quality and Relevance Project, UNICEF supported the establishment of preschool classrooms in 22 most vulnerable communities contributing to the training of preschool teachers. It is envisaged to further expand the existing partnership between the Bank and UNICEF into the agenda of the new education project and establish preschool classrooms in 150 vulnerable communities. The WFP is continuing its food security assistance to vulnerable groups, while UNHCR has ongoing projects in health and vocational training.

115. **German Financial Cooperation** with Armenia started in 1995. KfW finances investments and consulting services in the financial sector and economic infrastructure. The Sustainable Economic Development Program promotes micro, small and medium-sized enterprises, the Credit Guarantee Fund for Armenian commercial banks, and development of a sustainable housing finance market. KfW has also financed energy projects, including rehabilitation of high-voltage sub-stations, hydro power plants, and construction of high voltage lines. The Municipal infrastructure program supports water supply and wastewater systems rehabilitation, housing for refugees and a management contract in water sector. KfW has also supported nature protection through the establishment and management of protected areas. The Bank built on the KfW experience in developing the SME line of credit operation.

116. The **Russian Federation** is expected to extend a loan to Armenian in the amount of $500 million to help mitigate the impact of the global economic crisis. The timing and the purposes of the loan are still to be settled, but it is expected that the proceeds will be used for anti-crisis needs as well as for residential housing spending in the northern city of Gyumri to benefit populations displaced from the 1988 earthquake.

117. The **USAID** program helps to improve governmental functions—especially tax and customs administration, social protection, the judiciary, public sector accounting, management of healthcare, and ensuring secure and sustained access to energy and water resources. It also helps private sector development by improving access to finance and capacity of small and medium sized enterprises. The Economic Growth program supports financial sector deepening, provision of business advisory services, and promotion of advanced education and technology. The Democracy and Governance program supports youth and community action, civic advocacy, local government, rule of law development programs, as well as access to information for community involvement. The Health and Social Development program supports primary healthcare reform, reproductive health, as well as strengthening of social protection systems. The Bank and USAID are cooperating in assisting the tax administration to implement risk based audit practices, and improve VAT refunds and taxpayer services. Close cooperation has also been engaged in supporting pension reform. The Bank and USAID are cooperating in providing training to commercial banks participating in the Access to Finance for SMEs credit line.

118. The **Millennium Challenge Corporation** is focused on the reduction of rural poverty through a sustainable increase in the economic performance of the agricultural sector. The program mainly supports rural road rehabilitation and construction of irrigation canals. Another component of the program, the Water-to-Market Activity, provides training to farmers in which there is close collaboration between MCC and the Bank in the use of new and improved farming technologies. The Program was developed in close collaboration with the Bank teams working on irrigation, agriculture and transport sectors. Because the "good governance" criterion included in the compact with MCC has not been met, the roads component has been suspended and the program will be under quarterly review by the MCC Executive Board.

IV. Managing Risks

119. **The key risks to the implementation of the CPS arise from the external environment, the geopolitical situation, and the political economy factors**. These risks and measures to mitigate them are discussed below.

- *The global economic environment.* Economic shocks are clearly predominant today and will quite possibly remain so throughout the CPS period. These could result in a further drop in the demand for Armenia's exports, additional weakening in export prices, and/or a continued reduction in remittance and foreign investment inflows. Developments in the Russian economy are of particular importance given the deep trade links, the large population of migrant workers in Russia as well as Russian investment in Armenia. Armenia's integration into the world economy has also rendered it vulnerable to external adverse developments, but its cautious attitude to foreign borrowing has lowered risks of banking capital cut-offs.

- *Regional geopolitical factors*. A further risk arises from geo-political factors: continued stand-off or a worsening in relations with Azerbaijan over the Nagorno Karabakh conflict and continued closed borders with Turkey. Moreover, political and investment risk in the south Caucasus has risen as a result of the Georgia-Russia conflict of August 2008. Conversely, a settlement of regional conflicts and a lessening of international tensions throughout the south Caucasus would reduce the perception of risk and stimulate investment.

- *Political economy factors* are dominant in the second generation reform dialogue. As discussed, reforms are entering a difficult and sensitive terrain in governance and competition. The power of vested business interests and their influence over parliament and the government is evident in links between public service and businesses that raise conflict of interest concerns. A credible and effective governance strategy can no longer be developed without tackling such weaknesses. A fair playing field for the private sector becomes even more important during times of economic volatility.

120. **The economic risks are mitigated in part by strong economic fundamentals**: low debt (internal and external) that permit fiscal and debt space for counter-cyclical and social support policies, and the strong record of structural reforms that have placed the economy well to seize opportunities for growth as the international cycle turns. Nevertheless, a small open economy like Armenia will be unable to avoid the fallout from the global economic crisis and would have to go through significant economic and social adjustment**.**

121. **The willingness of the Bank Group and the Fund as well as other partners to offer extraordinary financial support and employment-supporting measures is an important mitigating factor.** As stabilizing factors for both economic and geopolitical risks, both the EU and Russia are reaching out in offering balance of payments support, but also long term trade access possibilities (the free trade agreement with the EU and similar arrangements with the EurSec). The CPS will also retain flexibility to adjust Bank lending as needed to respond to shifting needs. Nevertheless, the extent of the global economic downturn and the ability of the government to mitigate its economic and social impacts may affect targeted CPS results and these will need to be revisited at mid-course.

122. **Attempts at resolving differences with the two neighboring states, Azerbaijan and Turkey, continue.** Should the situation either deteriorate or improve significantly, we would need to revisit the CPS framework.

123. **Domestic political tensions remain a factor.** Pressures on the current government by sections of the public and claims that the electoral process is flawed and voice and public participation face restrictions can undercut action towards addressing the more important economic development needs of the country. The CPS will be implemented in a manner that widens dialogue and knowledge dissemination, and so works to build broad support for institutional and policy reforms.

ARMENIA

Annex 1: CAS Completion Report: FY05-FY08

1. The Country Assistance Strategy Completion Report (CASCR) provides an evaluation of Bank Group assistance to Armenia for FY05-FY08. The CAS (report number 28991-AM) was discussed by the Board in June 2004 and was among the first set of pilot results based CASs. Results targets were based on achieving the goals in Armenia's Poverty Reduction Support Program (PRSP). The CAS Progress Report (report number 38585-AM) discussed by the Board in February 2007 reported on interim results and also indicated where revisions of the program were needed. This Completion Report examines the relevance of the CAS to Armenia's longer term goals, the achievements of CAS outcomes, and Bank Group performance in furthering CAS outcomes. It draws on project completion and supervision reports, IEG and QAG reports, the Government's evaluation of the PRSP, the IMF PRGF program and other documentation, various national and international surveys, as well as inputs from former and current Government officials, other stakeholders in Armenia, and the Bank country team.

I. Relevance of the CAS

Background

2. *From 1995 to 2000, Armenia staged an impressive and sustained economic recovery.* Soon after independence (1991), Armenia like all other FSU countries, went through a severe economic contraction, accentuated by the aftermath of a major earthquake and the conflict with Azerbaijan. After the cease-fire (1994), the authorities introduced a comprehensive package of first generation economic reforms that focused on (a) achieving a sound macroeconomic environment, (b) relying on the private sector to carry out productive economic activities and (c) improving the capacity of the state in the provision of basic public services. A process of economic recovery and transformation ensued.

3. *From 2000 to 2004 Armenia completed most first generation reforms and began several second generation reforms, within a continuing sound macroeconomic framework.* The authorities prioritized the consolidation of fiscal accounts, the elimination of budget arrears and the reduction of quasi-fiscal deficits through realignments of utility tariffs and increased collection rates. In addition, in an effort to improve performance and sustainability, the government began to involve the private sector in the delivery of public services. Concurrently, reforms were launched in a wide range of areas covering (a) justice, (b) finance, (c) taxation and public expenditures, (d) competition and regulation and (e) social services and assistance. By 2004 Armenia had had been growing by about 10 percent per year on average and had reached and surpassed the level of income per capita at independence. Armenia also posted the highest policy (CPIA) rating of all IDA countries.

4. *Nevertheless important challenges remained in the 2005-08 period, with respect to full implementation of second generation reforms, governance and poverty reduction.* First, while growth was high, it was concentrated in a few sectors which made it vulnerable to shocks[13] . This underlined the importance of improving the business environment and reducing barriers to entry of new firms and

[13] The 2004 IEG Country Assessment Evaluation rated the Bank's assistance as *satisfactory* and its contribution to institutional development as *substantial* but underlined that "high growth rates may be difficult to sustain: growth has been focused in a few capital intensive sectors and not yet supported by large-scale entry of new firms."

businesses. Second, high growth rates had yet to translate into significant poverty reduction. Poverty remained at 49% in 2002, especially in rural areas and secondary cities, and a gini coefficient of .45 signaled high inequality. This underlined the need to diversify sources of growth, strengthen the social safety net, improve budget allocations to the social sectors and improve the delivery of services. Third, the modest pace of modernization, accountability and transparency of state institutions had the potential to constrain economic growth, poverty alleviation, and economic diversification. Specific concerns included the low level of revenue mobilization and a lack of judicial independence.

The Government Strategy: 2003 PRSP

5. *The Government engaged in an intensive consultative process that resulted in setting a series of national goals in its first Poverty Reduction Strategy Paper (PRSP), issued in October 2003.* The PRSP focused on the challenges of (i) reducing poverty and inequality, and (ii) improving human development. To achieve these, the PRSP emphasized private-sector-led growth and macroeconomic stability and committed to strengthen the core functions of the state, including those contributing to poverty reduction. The Joint Staff Assessment (JSA) of the IMF and the Bank endorsed this analysis and noted the participatory process supporting its design. The JSA stressed the importance of monitoring and evaluation, prioritization of interventions and linking the PRSP to the Medium-term expenditure framework and annual budgets.

The 2005-08 CAS Design

6. *The CAS design supported the PRSP objectives and focused interventions in three areas where the World Bank considered it had a comparative advantage:* (i) promoting private sector growth by improving public sector management, strengthening the financial sector, and reducing infrastructure bottlenecks; (ii) making growth more pro-poor by promoting a more dynamic rural economy, improving social assistance and the workings of the labor market; and (iii) reducing non-income poverty through the delivery of better health, education and other basic services.

7. *Besides supporting the PRSP, the CAS design addressed the recommendations identified by IEG's March 2004 Country Assistance Evaluation (CAE).* The CAE found that Bank assistance over the previous 10 years had been well used and achieved substantial impact, but also recommended that the Bank focus more forcefully on improving the business climate and public sector management. Management agreed with these recommendations and incorporated them into the CAS. The economic growth agenda emphasized the removal of infrastructure bottlenecks with an emphasis on improving competitiveness through reducing the costs of linking the country to external markets, creating a strong financial sector, and increasing the capacity of the authorities to develop and implement policy.

8. *The CAS relied on a mix of adjustment and targeted investment loans, supported by related analytic work.* This was consistent with the CAE finding that the mutually supportive investment and adjustment operations had helped increase development effectiveness. At the beginning of the CAS, fourteen investment projects were under implementation. None of them would be cancelled or reprogrammed during the life of the CAS. These projects, jointly with the PRSC series, were intended to contribute the bulk of results targeted under CAS. In some areas (rural development, water, education, health, social assistance) the agendas and roadmaps were already quite developed based on the on-going projects and the analytical work. In other areas, the PRSC served as the basis for policy dialogue with government. The CAS set out both a base and indicated that with continued policy improvements and growth, a high case would be possible, as would the potential to move from IDA to blend status (both of which have occurred).

Identified Risks

9. *The CAS identified four possible sources of risk. First*, the CAS saw political change in the Caucasus Region as a downside risk in case of conflict and an upside potential should relations with neighbors be normalized. While neither was considered very likely, it was appropriate to include this geopolitical issue. *Second*, the CAS indicated that reform momentum could slow as the political consensus in Armenia became more complex, and correctly put an emphasis on active knowledge dissemination and involvement of civil society. *Third*, several economic risks such as lower remittances, or higher prices of energy could destabilize the economy. The CAS Progress Report elaborated further on the emerging economic risk associated with high exchange rate appreciation. While these economic risks did not undermine growth during the CAS period, the current global crisis underscores Armenia's vulnerability to such shocks. *Fourth*, the CAS recognized that Armenia was vulnerable to unexpected natural resource shocks (earthquakes, major drought, floods, landslides, or frost. Although there were no major natural disasters during the CAS period, there was a need to add to assistance program an operation to address an unexpected Avian Influenza threat.

Overall Assessment of CAS Relevance

10. *The CASCR rates the relevance of the CAS design and the identification of risks to be Satisfactory*. The CAS built on both the PRSP and the CAE in its design. The CAS notably used PRSP goals for which there was high government ownership in the results matrix, thus ensuring alignment with national objectives and uses a range of monitorable indicators. The approach also used a proven mix of adjustment and investment operations in a mutually supportive manner to achieve these goals. It is noteworthy that virtually all of the operations in the CAS high case were implemented as envisaged with only minor modifications, and the majority of strategic objectives were achieved. Risks were also correctly identified and although none emerged in such a manner as to undermine achievement of CAS objectives, they were – and continue to be – among the main development risk factors for Armenia.

II. Results Assessment

Long Term Development Outcomes

11. *Overall, the rate of economic growth exceeded expectations.* Economic growth accelerated to an average of 13 percent per annum between 2003 and 2007, while the target in the PRSP and CAS was 6 percent. Rapid growth was fueled by a favorable external environment that generated increasing remittances and capital; but also sound economic policies including keeping inflationary pressures moderate. Investment as a share of GDP jumped to 34.8 percent in 2007 from 24.3 percent in 2003; the increase was financed with savings, which rose from 17.5 to 28.6 percent of GDP. External debt was also kept low. As an independent corroboration of these results, in July 2008 Fitch raised Armenia's rating to BB, similar at that time to other Middle Income Countries. On the downside, Armenia export performance and rural sector development continued to lag behind overall growth.

12. *The decline in poverty incidence and inequality also exceeded expectations.* The PRSP and the CAS had projected a substantial fall in poverty from a base-line of 49 percent in 2002 to 41 percent by 2006. In fact, poverty fell even sharper than anticipated, reaching 34 percent in 2005, 26.5% in 2006 and further declined to 25% in 2007. Just as impressive, the percent of extreme poor fell from the PRSP target of 15% to below 4%. Also, income inequality narrowed as the Gini coefficient dropped from 0.45 in 2002 to .37 in 2006 and 2007. These results have been spurred by a strong rise in remittances, real wages, and social transfers. Unemployment appears to have fallen, though the statistics are unreliable. In addition, low labor force participation rate (56 percent) possibly masks significant underemployment. There are also many who are clustered just above the poverty line, underlining their vulnerability to an

economic downturn. While poverty has declined significantly throughout Armenia, it remains higher outside of Yerevan, particularly in the secondary towns.

13. *Human development indicators have improved.* The PRSP targeted a substantial increase in social expenditures, and this was exceeded in absolute terms (although the target of raising social spending to 10.8% of GDP was not met, given the rapid GDP increase). As a result of this increase as well as institutional improvements, prospects to meet the MDG targets have all improved: While the CAS indicated that most MDGs would likely be met, prospects in the health area were considered unclear or unlikely. According to the demographic handbook of Armenia, infant mortality (per 1000 live births) fell from 15.6 in 2000 to 10.9 in 2007. Reforms have continued in general secondary education, including increased teacher salaries, refurbished curricula, and the addition of a 12th grade. Nevertheless, access to pre-school education, which is the responsibility of local governments, remains low and fees in higher education are relatively high. The contribution of social assistance expenditures to reducing poverty has been significant.

14. *The quality of economic governance has improved but has done so unevenly.* Armenia remains the country with the highest policy (CPIA) rating across IDA countries. The shift from public to private sector continued and with a strengthened regulatory regime in both the financial sector and utilities. Technical improvements were made in the budget and revenue areas. Nevertheless, a significant unfinished agenda remains. While Armenia continues to rank relatively well in Doing Business (#44 in 2009 DB), these ratings have remained roughly stagnant during the CAS period, and point to more work needed particularly in customs and taxation. Considerable work is needed in strengthening public transparency and accountability, building a more level and transparent corporate playing field, with strengthened corporate financial reporting framework and moving towards a higher level on innovation/technology The WBI "Governance Matters" framework indicates improvements in regulatory oversight but stable on rule of law. The WBI ratings on Voice and Corruption have worsened. Nevertheless, in comparison to other CIS countries, Armenia remains a leader using the WBI methodology, coming first in regulatory quality, and second in control of corruption and in the rule of law.

Overview of Results Delivered by the CAS program

15. The CAS program has three pillars: (i) promoting private sector led growth, (ii) making growth more pro-poor, and (iii) reducing non-income poverty. This CAS Completion Report finds that the results were *satisfactory* for all three pillars, with particularly strong results for the second and third ones.

Pillar I: Promote private sector led growth

16. Within Pillar I, the CAS focused on four specific areas: (i) weak public sector services; (ii) an underdeveloped financial sector; (iii) unreliable and costly telecommunications and transportation; and (iv) the need for improved natural resource management. The 2002 BEEPS indicates that while Armenia outperformed ECA averages on many indicators, they were lower on telecommunications, electricity, finance and transportation. Entrepreneurs perceived the financial sector, tax administration, and uncertainty in regulatory policies as constraints. Hence the priorities selected by the CAS, particularly on public services, telecommunications, transportation and finance, were relevant.

17. The operational instruments to deliver the assistance included the Programmatic Reform Support Credit (PRSC) series, complementary investment operations and analytic work. The analytical work provided under the 2005 CEM (which was later published as a book: *The Caucasian Tiger*), focused on reform sustainability and competition policy, and has played a vital role in providing rigorous analysis and designing the reforms. This was then followed up by a programmatic public expenditure review

series and just-in-time notes. The PRSCs covered finance, taxation, public expenditure, transportation, regulation, tariff policy, etc. Complementary investment operations focused on modernizing public administration and the judiciary.

A: Improving Public Sector Services, Governance, and Judicial Sector

18. The CAS highlights that performance of the state agencies was limiting private economic activity due to obsolete public administrative practices, lagging mobilization of public resources, and limited transparency in using these expenditures. In addition, the judiciary was seen as lacking independence and having poor administrative practices that introduced uncertainty in the rule of law and property rights. This chapter is organized around two sub-themes: (a) improving the capacity of the public sector; and (b) enhancing the judiciary. The CAS results matrix makes primary use of two surveys carried out under our projects – the Administrative and Regulatory Costs Survey (ARCS) and the Enforcement Survey prepared by the Ministry of Justice (ESD). These are then checked against various international surveys including the Bank's CPIA rating, EBRD transition index, credit rating agencies, BEEPS, Doing Business (DB), the WBI Composite Index, and the Judicial Reform Index (JRI) by the American Bar Association

Public Sector Performance

Table 1: CAS Goals: Public Sector Agencies Serve Population efficiently; Governance Improves

Targeted Results	Status	Additional Achievements
Gradual improvement in business perceptions of government policies (on 4 point scale where 1 = no obstacle)	Some Progress Achieved - Complexity/ Transparency measure improves from 1.9 (ARCS04) to 1.4 (ARCS07) - Standards and Certification measure improves from 1.3 (ARCS04) to 1.1 (ARCS07) - DB shows mixed trends; BEEPS2008 not issued yet.	• Public resource availability improves (small rise in revenues to GDP ratio) • PRSP objectives and budget allocations more aligned; • Criteria for evaluating the performance of civil servants being piloted in selected entities. • Technical improvement in customs and tax administration but still not even playing field for businesses.
Gradual improvement in citizens' perceptions of quality of local services delivery	Unclear -ARCS shows general improvement in quality of regulations and bureaucratic behavior but does not differentiate at local level.	• Responsibilities of local government clarified and improved o Land and property registry given to local governments o Law on municipal civil service applied • Increased autonomy for schools • Increased community investment
Gradual improvement in business perception of crime and corruption as obstacles to company growth	Unclear - ARCS rating for Corruption as obstacle drops from 2.98 (ARCS04) to 1.7 (RACS07) - WBI index on corruption perception increases.	• Framework for Corporate governance improved: procedures introduced on manager's and owners' responsibility
Instruments: PRSC series, Public Sector Management Project, CEM, Policy Notes		

19. *Although the evidence is mixed, on balance the performance of the public sector has improved.* Better macroeconomic management is reflected in improved national and international ratings (prior to the current global economic crisis) including ratings from the Bank, EBRD, and Fitch. Advances in the delivery of public services (health, education, social assistance, telecommunications, electricity, water and

transportation), as will be reported later, point to a greater capacity of the state to deliver results. Public officials are better remunerated and merit is increasingly the criterion for hiring and promotion. The budget is comprehensive and has become more aligned with the PRSP and national objectives. At the same time, improvement in taxes and customs has been more tentative and recent, and these remain areas of concern. Work on reducing corruption and the use of political power for economic benefit has also been lagging. The participation of the population in public decision making is limited. Recent measures (ARCS, DB, WBI) provide mixed evidence and BEEPS08 is not yet available to gauge impact.

20. *The resources available to the public sector have increased rapidly.* Rapid income growth and a modest increase in the ratio of taxes collected to GDP from 14.0 percent in 2003 to 16.1 in 2007 provided the government with enough resources to dispel concerns about the state being unable to supply basic services. Still, the playing field is not yet level for businesses in paying government revenues and the limited buoyancy of tax collection (the IMF estimates the yield could be up to 6 points higher with better administration), remains a concern.

21. *The Government is moving to reduce the cost of compliance with tax and customs legislation but the results are not yet clear.* With the PRSC and analytic support from the Bank, IMF and other donors, Armenia is working on improving tax and customs practices, which BEEPS and Doing Business surveys have identified as major constraints to doing businesses. Preliminary efforts to overhaul tax and customs administrations have centered on facilitating compliance with the tax law, the establishment of a Large Taxpayers Unit (LTU), reducing opportunities for corruption through piloting self-declarations in customs, and establishing a higher threshold for VAT registration. However, as these technical improvements have largely come towards the end of the CAS, surveys have not yet corroborated whether they have led to improved perceptions towards tax and customs. The 2009 Doing Business report which ranked Armenia's business environment 44th overall, still places taxation in Armenia at 150th place.

22. *Progress in public expenditure management has improved the alignment of budgetary allocations with national priorities.* To better align the budget to the national objectives, the Government, with Bank and IMF support, brought budget classification and public sector accounting and reporting standards in line with GFS classification and chart of account; in addition, it rigorously follows a rolling Medium Term Expenditure Framework (MTEF) and is piloting program budgeting, which is ready for broader implementation. As a result, today Armenia has a more clearly articulated budget process which lends discipline in determining funding priorities. In addition, budget monitoring and control systems are in place and will be strengthened with the implementation of a new Law on Internal Audit has been submitted to parliament for approval, and is in line best international practices. Oversight (financial reporting and supervision) over state non-commercial enterprises has tightened to mitigate risks, which loomed large at the beginning of the CAS and remain substantial. With Bank support, the government has completed a Public Expenditure and Financial Accountability (PEFA) analysis in 2008. The PEFA confirms progress in budget transparency and accounting and establishes benchmarks to gauge progress in the future.

23. *Civil Service Reform:* The size of the Government has shrunk, though there may be room for further pull backs. At the same time, the government has increased salaries, which still are below private sector counterparts. A new Public Service Law will help to strengthen the merit basis for appointments, and the Government is introducing a performance management system. The Bank's Public Sector Modernization Project is helping the Government to improve and track the application of merit principles in Civil Service Management; to ensure equal opportunity in procurement contracts; and to improve local government services. Work is on-going in all of these areas, but full results will come at project completion in 2010.

24. *Local governments have a stronger fiscal base*. Local governments now manage all land and property tax databases and receive all the revenues collected. At the same time, local governments have

greater responsibilities, for example in the area of basic education, and it is not clear whether funds are yet adequate for their service responsibilities. The Bank has been supporting decentralization through the Public Sector Management Project and the Social Investment Fund which is helping to build the capacity of communities and local governments. The CAS proposed to measure increases in the capacity of local government and perception of local service quality through surveys undertaken under the PSM project, but these questions were regrettably discontinued.

25. *Technical efforts to fighting corruption seem to lack traction.* In 2006 the government completed implementation of a 2003 Anti-corruption strategy, which focused on greater transparency in government (dissemination of budgetary information, aggressive use of web portals to provide information, information of legal rights, etc.). At the same time, public perception is of limited progress — Armenia has remained at roughly the same low level in Transparency International's Corruption Index from 2004 to 2008; the World Competitiveness Survey (2008) ranks corruption as a major constraint on business. And the WBI governance indicators show a worsening of public perception in this area. Preparation of a new anti-corruption strategy is underway and expected to focus on conflict of interest management. While important, the effectiveness of any such strategy would benefit from a close look at the symptoms of corruption rather than only on technical issues. The 2008 BEEPS may throw light on which specific aspects of corruption are of concern.

<u>Modernizing the Judiciary</u>

Table 2: CAS Goals: Judicial Sector Enforces Laws and Contracts Fairly

Targeted Results	Status	Additional Achievements
Court users more satisfied with judicial performance and services Share of judicial decisions fully or partially enforced increases from 68% in 2003	<u>Achieved</u> - Functioning of judiciary measure improves from 2.32 (ARCS04) to 1.48 (ARCS07) - Public satisfaction with courts improves under JRP survey. <u>Achieved</u> -Improved to 71% under ESD survey (also improvements in number and amount of enforced decisions).	Autonomy & capacity of Judiciary enhanced: • Constitutional reform establishes the autonomy of the judiciary and judicial precedent to ensure consistency in law; • Courts and Enforcement services using automated case management system ; • Public awareness programs on citizens' rights and programs implemented. *Note: These accomplishments notwithstanding, ABA's JRI index of Judicial oversight and administrative practices remained unchanged as "neutral" from 2004 to 2008*
Instruments: Judicial Sector Reform Project (JRP) I and II		

26. *The Bank support for the judiciary has produced some tangible results.* According to the 2002 BEEPS, only between 25% and 35% of firms using the courts found services affordable, quick, and able to enforce fair decisions. To assist in the development of an independent, accessible and efficient judiciary in FY01 the Bank approved a Judicial Sector Reform Project. The ICR for this project rated the results as satisfactory; but IEG, downgraded the rating to moderately satisfactory because infrastructure rehabilitation absorbed most resources and, in their opinion, de-emphasized broader institution building. With hindsight, however, the project did make a major contribution to the design of the 2006 Constitutional amendments and the drafting of the new Judicial Code, both of which set the institutional basis for a more independent Judiciary. The Code introduces practices that should facilitate prompt and fair judicial rulings. To support deeper reform of the judiciary, the Bank approved a second Judicial

Sector Reform Project. What has been done thus far under JRP II combined with JRP I has produced the following results:

- A modern electronic case management system has been piloted and rolled out to all courthouses;
- Development of a comprehensive legal information system (ARLIS) launched in 2005 now contains about 37,500 laws and averages half a million pages visited per month;
- Improved recording of court proceedings through the use of audio technology;
- Widespread information diffusion of rights and judicial procedures;
- A court design that reduces opportunities for private interface between the judges and parties.

27. *Available indicators show that the Judiciary has improved*. A Survey under JRP I found that, between 2000 and 2006, satisfaction of court users increased across a variety of services (courts, enforcement, prosecutor, police and legal support.) At the same time, even the performance of the courts and legal support which ranked the highest, are still relatively low at slightly over 4 on a 10 point scale. The ARCS Survey also found an improvement from 2004 to 2007 in whether the judiciary was an obstacle for business. The Enforcement Survey under the Ministry of Justice (EDS) also shows a slight improvement in the share of judicial decisions enforced. At the same time, ABA's JRI index of Judicial oversight and administrative practices remained unchanged as "neutral" from 2004 to 2008 The 2008 BEEPS (not yet issued) and a follow-up survey under the second JRP will update the measurement of progress.

B. Increasing Financial Sector Intermediation

Table 3: CAS Goal: Increasing Financial Sector Intermediation

Targeted Results	Status	Additional Achievements
Loans/GDP ratio increases from 5.9% in 2003 to 8 % in 2007. Number of accounts held in private banks increases from 407,000 to 500,000 in 2008.	Achieved (13.6% in 2007) Achieved (over 1 mill accts)	-- Improve financial institutional framework: • New regulatory agency in place; • Unified supervision and use of risk based criteria • New facility to register movable property pledges; • Bank Reporting follows international standards; • Consolidation and entry of foreign banks. • Pension reform designed • Stock market improved through foreign ownership
Instruments: PRSC series, 2005 FSAP, Financial Sector TA, IFC lending and advisory services		

28. The financial sector loomed as a major constraint to growth in the CAS: the 2002 BEEPS reported that around 50 percent of the respondents found access to finance and the quality of financial services a constraint to growth. Weak corporate governance, poor mechanisms to enforce secured transactions, including a difficult debt recovery process, and lacking financial services such as credit bureaus and mortgages were additional concerns.

29. *The quality of financial sector institutions has improved and several key concerns present at the beginning of the CAS have been addressed*. First, building on the recommendations of the 2005 FSAP and the PRSC, a unified supervisory regime for the financial sector, including banking and non-banking institutions, under the authority of the Central Bank, is now in place and has contributed to a tighter enforcement of Basle principles. Second, legislative changes have strengthened creditor rights, improved civil procedures for debt recovery, and simplified procedures for certification of property sales and registration of secured credit. Third, these legislative changes jointly with a new facility for registering pledges of movable property in the central cadastre registry provide an adequate legal framework for most secure transactions in Armenia. The IFC made important contributions during this period by adding two

more banks to its pre-existing portfolio that included only one bank and a leasing company. At the end of 2007, these four financial institutions supported by the IFC reported portfolios including more than 3,600 SME and microfinance loans with a total volume of about $155 million. IFC has also provided advisory services on mortgage lending and corporate governance for banks.

30. *Better institutions contributed to a deeper and more stable banking sector.* Domestic credit expanded faster than GDP---the ratio of bank loans to GDP ratio rose from 5.68 percent in 2003 to 13.58 percent in 2007. Banking corporate practices have improved, consolidation has reduced the number of banks and foreign bank entry has increased competitive pressure. Despite their growth, banks are currently well capitalized and supervised, and this has enabled them to fare better than many other developing country banks in the current global financial crisis.

31. *Today the financial sector is sturdier, although it still is dominated by banking.* Access to and cost of financing remain larger issues in Armenia than the ECA or CIS average (2005 BEEPS.) A recent analysis of interest rate spreads suggests the need for further bank efforts to improve operating efficiency. The share of investment activity which is intermediated through the banking system is also still comparatively low, in part related to significant direct investment activity by the Armenian Diaspora. Lastly, expansion of the non-banking financial agenda is tied to improvements in the corporate governance of the real sector and gains in the informal economy, both areas where rapid improvements are needed.

C. Improved Communications Infrastructure

Table 4: CAS Goal: Improved Communications Infrastructure

Targeted Results	Status	Additional Achievements
Increase the number of telecom licenses from 1 in 2004;	Achieved	Policy emphasis on breaking isolation from markets through greater competition in delivering services: • Regulatory Reform to eliminate monopoly rights of incumbent operator and allow entry of new mobile operators • In civil aviation, open sky policy negotiated with US and horizontal air agreements negotiated with EU.
Indicators relating to road transport to be developed under FY08 Infrastructure Project.	N/A	A new transport project was delayed until FY09, but results were achieved under the earlier Transport Project (closed in FY05) which rehabilitated 227 km of roads. A PPIAF grant facilitated the railway concession. Bank facilitated other donors (MCC) activities in this area.
Instruments: PRSC series, PPIAF Grant, existing Transport Project (closed in FY05)		

32. The CAS found the situation in telecommunications to be the "largest comparative disadvantage" for Armenia; a long-term monopoly was in place, tariffs were high and the quality of the service poor. The PRSC provided a platform for policy dialogue on opening up the telecommunication sector that was fed by the findings of the 2005 CEM (which evolved into the publication *The Caucasian Tiger*) and several just-in-time policy notes. This dialogue, combined with a negotiated end of the exclusivity period for ArmenTel, which had been established at the time of privatization, has resulted in the telecom sector opening to competition. The 2005 BEEPS reported improvements in electricity and telecommunications over 2002, but this will need to be verified against the BEEPS 2008 (not yet issued). The gains in transportation while positive were less significant.

33. *A framework for the regulation of utilities is in place and the private sector is engaged in service delivery for all utilities.* The Public Services Regulatory Commission (PSRC) was consolidated as the

umbrella regulatory agency for telecommunications, energy, railways, and water. The Bank was in fact the main player through both its adjustment operations and its infrastructure investments in getting the PSRC to be a reasonably well functioning multi-sector regulatory body.

34. *Telecommunications has undergone a substantial transformation.* A poorly structured privatization occurred in 1998 which granted a 15 year monopoly to ArmenTel. With policy advice from the Bank, this was partly re-negotiated in 2004-05 and a new telecommunications law passed, but it is only beginning in 2007-08 that Armenia has been able to set out a full plan for modernization of its telecommunications sector. The positive results achieved include (a) an increase in the number of mobile service operators' licenses from 1 in 2004 to 3 now; (b) more than doubling of the number of mobile telephone service subscribers within the last two years; and (c) 30 private operators have received licenses for the operation of internet services, including high-speed broadband services. Nevertheless, the modernization agenda in telecommunications is major and needs to be addressed rapidly to avoid constraining the country's economic growth prospects; key issues include: (a) the government ownership of some economically valuable spectrum and the institutional framework for spectrum management, (b) limited range of telecommunication services outside of the Yerevan area, (c) telecommunication services' quality, and (d) sub-optimal development of the national IT industry, an area in which Armenia could have a significant comparative advantage.

35. *In addition to telecom reform, the Bank supported the development of Information Technology (IT) as a key driver of development.* Currently IT is about a $100 million business, significant in Armenia's small economy. An Enterprise Incubator LIL (closed in FY07) piloted innovative private-public mechanisms that are providing (a) services to nascent industries and (b) continuous education and training to professionals in the field of information technology (IT). The project exceeded the key quantitative indicators and IEG confirmed a satisfactory rating on outcomes and Bank performance. An Export Facility LIL (jointly implemented with MIGA) helped create the Armenian Development Agency (ADA), ranked by MIGA's 2006 Investment Agencies Promotion Review as one of the most effective investment promotion agencies, has attracted several IT companies and is helping Armenia move up the technology ladder.

36. *As part of an effort to enhance connectivity, the Bank also supported introducing competition in aviation.* The CAS did not originally include a focus on aviation, but this issue was subsequently emphasized in both the PRSC and analytic work as critical, particularly given Armenia's closed borders with two of its neighbors. The government has announced a policy of expanding participation in international aviation services to raise efficiency and reduce costs. Implementing the policy is cumbersome given that exclusive rights were issued to the local airline company. Still, despite this handicap, an *open skies* aviation agreement with the United States was signed and a liberalized aviation agreement was negotiated with the EU.

37. *Progress in roads and railways has helped interconnectivity, but much remains to be accomplished.* An existing Transport Project at the start of the CAS period was concluded successfully in FY05 and rehabilitated 227 km of roads, 11 bridges, and 72 km of railway track. New legislation was supported under the PRSC providing for the corporatization of railways. During this CAS period, the Bank provided PPIAF assistance to develop a framework for a railway concession, which was completed in June 2008. Nevertheless, to ensure railway service quality the government needs to establish an effective oversight of the operator. When Armenia became eligible for MCC financing, the Bank made the results of its 2005 rural infrastructure study available and helped Armenia design a program in transport and irrigation for MCC financing, and shifted out of new financing of these sectors (subsequently, the Bank re-entered rural roads in mid-FY09, complementing MCC activities, because of the need to provide rapid employment generation as a crisis response).

D. More Sustainable use of Natural Resources

Table 5: CAS Goal: More Sustainable use of Natural Resources

Targeted Results	Status	Additional Achievements
Government enforcing its national environmental safeguard policies better Appropriate watershed management practices adopted in target areas.	Partially Achieved Achieved	-- New Forest Code adopted, weak enforcement -- Institutions in place to monitor illegal logging; -- Forest Management Plans for 128,000 hectares -- Risk for half a million people from Dams removed. -- Strategy to use mini-hydro to generate electricity
Instruments: Natural Resource Project; PRSC series; Dam Safety Projects; Renewable Energy Project, IFC advisory work		

38. Work on environment centered on three challenges: (a) to reverse deterioration of forested areas, (b) to remove risks posed by an aging dam infrastructure, and (c) to use renewable resources to meet the growing demand for energy. Progress has been made on all three fronts.

39. *A new institutional framework in place is helping rationalize logging.* The preparation and approval of a Forest Code, with PRSC support, provides the legal basis for combating uncontrolled and illegal logging. An autonomous State Forest Monitoring Center has been established to help implement the code and monitor illegal logging, though this was done at the end of the CAS period and it is too soon to judge its effectiveness. In addition, the ongoing Natural Resource Management Project (FY02) has helped adopt sustainable Forest Management Plans covering over 128,000 ha---more than one third of the forest area in the country, when no Forest Management Plans existed at the beginning of the CAS. After some initial delay, the latest project ISR seems to confirm that the introduction of appropriate watershed practices is now track. As to the impact at the national level, the percentage of the population using solid fuels decreased from 57.8 percent in 2003 to 25.6% in 2007.

40. *Armenia is expanding the use of renewable energy sources.* Today electricity generation capacity is sufficient to meet demand; but aging assets and growing demands indicate the need for new capacity. Armenia has an estimated 740 MWs of small hydro, wind and geothermal energy potential. The Renewable Energy Project is supporting development of privately owned and operated renewable energy (FY06, including GEF grant). As of mid-2008, 60 operating licenses have been issued to small hydro power plants contributing 270 GWh. However, attractive tariffs for renewable energy are needed to further development of renewable resources. The Bank has financed an energy efficiency study in 2008 which identifies economically viable opportunities in this area, and IFC has in parallel prepared an energy efficiency survey to identify impediments and facilitate business opportunities though its private bank partners. Already, the energy intensity of use has dropped from 97.7 kg oil equivalent per 1,000 PPP GDP in 2003 to 70.4 in 2007

41. *However, concerns loom on enforcement and the larger environment agenda.* Armenia has an Environment Action Plan (updated in 2008), but civil society have raised concerns on issues such as compliance with Environment Impact Assessment (EIA) regulations and the climate change agenda. Further work is needed to help revise the agenda forward and address some the broader concerns that have been raised.

Rating of the First Pillar: Satisfactory.

42. *The CASCR rates outcomes under the first pillar as satisfactory. Economic growth accelerated driven in part by external stimuli (remittances, etc.), but also a solid macro foundation and timely removal of key public sector constraints. The Bank program has contributed to the achievement of results primarily through the PRSC series but also though targeted operations on the judicial sector, public administration, transport, energy and the environment. Telecom reforms are beginning to improve linkages between the country and the rest of the world. Improved institutions (laws, regulatory bodies, private sector participation) are in place for the delivery of better public services. The work on the financial sector has strengthened regulation and competition, and the banking system has become stronger and well capitalized. The performance of the public sector and of the judicial sector have improved. Nevertheless, technical improvements have not yet translated into improved performance or public perceptions of service delivery in some areas, notably tax and customs, and broader governance concerns in both the public and private sector remain.*

Pillar II: Make growth more pro-poor

43. The CAS supported the following PRSP objective: "a larger share of the population benefits from economic growth and the vulnerable are more adequately protected." The assistance was organized around the concept of shared growth with attention to agriculture and rural development, reducing the informal economy and improving the effectiveness of social transfers. The Bank agenda benefited from a robust program under implementation (on rural development, social assistance) and solid analytic work. A cornerstone of the Bank's analytic work in this area has been the Programmatic Poverty Assessment, which has become owned by the Government which publishes it annually on web as a "Social Snapshot". The significant achievements under this pillar deliver on the dual objective to reduce poverty and spread widely the benefits of growth.

A. More people benefit from economic growth

Table 6: CAS Goal: More people benefit from economic growth

Targeted Results	**Status**	**Additional Achievements**
Share of the informal sector falls from approximately 45% of the formal economy;	Achieved (35% estimate)	-- Programmatic Poverty Assessment has helped the Government manage annual House-hold survey and publish its own annual social snapshot.
Extreme poverty declines from 17% in 2002.	Achieved (under 4% in 07)	-- 2007 labor market study provided recommendations to improve employment markets. Findings were used to draft a National Employment Strategy. The Social Protection Project supports improvements in employment services and a 2008 survey showed a 77% satisfaction rate among users.
Efficiency of employment agencies increases (measured in Social Protection Project.)	Achieved	
Instruments: Programmatic Poverty Assessment, Labor Sector study, PRSC series, Social Dev Project		

44. *More people benefitted from economic growth as the sharp drop in poverty incidence indicates.* The Bank has worked very closely with the Government to prepare and analyze annual Household Surveys and poverty reports. In 2007, 25 percent of households were classified as poor, down from 49.3 percent in 2002. In Yerevan the drop in poverty was dramatic—to 21% in 2006. The rapid rate of economic growth that generated incomes nationwide has been the main driver behind the reduction in

poverty, supported by rising remittances and a well targeted family benefit program. Inequality is also on the decrease---in 2006 and 2007 the Gini coefficient is reported at .37 down from .45 in 2002.

45. *The relative size of the informal economy is shrinking.* Government statistics put the size of the informal economy at 35 percent of the formal economy, lower than 45 percent at the beginning of the CAS. Given the range of estimates of the size of the informal economy, it is likely that the government estimate lies at the lower end; therefore, it is prudent to be vigilant and continue implementing policies that foster formalization of economic activity, such as reducing costs of complying with tax rules and regulation overall. Implementation of these policies serves as well to improve the access to financial services by small companies.

46. *Analytic work has begun on how to address unemployment and underemployment.* Unemployment appears to be declining (though statistics are unreliable) but underemployment remains a concern: a low percentage of labor force participation, excess labor in agriculture and informal activity mask underemployed resources. Labor flexibility does not appear to be a major issue as the reforms under the 2004 Labor Code (2004) place Armenia 6th in ECA in labor market flexibility (2009 Doing Business.) To better understand the underlying issues Government and the Bank jointly undertook a Labor Market Dynamics Study (FY07) to assess the capacity of employment services and provide recommendations on improving the labor market. Findings were used to draft a National Employment Strategy. Recent surveys show improved satisfaction among users of employment services, but further efforts are needed to better match education, training and job opportunities.

B. Rural areas do not have entrenched poverty

Table 7: CAS Goal: Rural areas do not have entrenched poverty

Targeted Results	Status	Additional Achievements
▪ Value added per hectare increases from US$1,371 in 2003; ▪ Share of agriculture production processed in Armenia increases (baseline tbd by Rural Development Project.)	Achieved. Achieved.	-- More hectares returned to irrigation; -- Institutions for participatory irrigation management are more efficient; -- Institutions for technological support cover all country; -- Credit to agriculture has increased; -- Extension services developed -- Seeds law passed -- Infrastructure in rural areas improved.
Instruments: Irrigation Dam Safety (FY99); Irrigation Development (FY02); Title Registration (FY99); Irrigation Dam Safety 2 (FY05), Rural Enterprise and Small-Scale Commercial Agriculture Development (FY06); SIF 3.		

47. *Strategic focus on rural development was highly relevant to poverty reduction.* In the early 1990s, people migrated to rural areas in search of ways for coping with the economic difficulties; this migration pressured productivity and incomes and put a sizeable portion of the rural population at risk of poverty. Early on the Bank initiated support for agriculture through a series of self-standing operations focused on property rights, irrigation, infrastructure, technology, and credit. The FY05-08 CAS continued to build on this agenda.

48. *Poverty in rural areas has decreased; absolute poverty has been practically eliminated.* Rural poverty fell sharply from 48.2 percent in 1999 to 23.2 in 2006 but slightly worsened to 25.5% in 2007. During the same period, the percentage of the very poor in the rural areas dropped from 14.1 percent to

2.3 percent. Poverty declined even in areas of difficult access: poverty amongst those living above 1,700 meters fell from 53.7 percent in 1999 to 27.1 percent in 2007.

49. *Increases in agricultural productivity and incomes helped reduced poverty.* After 2001, growth in agriculture picked up along with the overall the economy; between 2001 and 2006 agriculture grew at 7.6% p.a. on average driven by productivity gains, which jointly with improved terms of trade, helped raise rural incomes. Still, the fact that agriculture has grown at rates lower than the overall economy (7% compared to 13% for overall GDP) suggests the scope for further improvements. In addition, employment in rural areas has remained relatively stagnant suggesting that the sector still holds an important labor reserve.

50. *Increases in productivity in the rural areas are the result of sustained efforts to ease the key constraints to production and investment.*

- Property rights. Early efforts (completed before this CAS) registered and titled land in rural areas. A Title Registration Project closed FY05 helped survey 2.5 million properties and put in place a reliable registration system that is foundation of a working land and credit market. Outcomes include: (a) significant reduction in the time it takes to register a transaction; (b) significant increase in real estate transactions; (c) increase in the level of mortgages; (d) better property rights infrastructure. These achievements have been maintained.

- Irrigation. The attention of the authorities has centered on; (a) introducing participatory irrigation management practices; and (b) returning a larger amount of land to irrigation. Water User Associations (WUAs) - cover all irrigated land in Armenia and there is anecdotal evidence of crop yield improving. The on-going challenge is to make WUAs sustainable and continue the reform process by establishing Federations of Water Users Associations. The area under irrigation has returned to132, 000 hectares after dropping down to 112,000 (from over 200,000 hectares in Soviet times). The current arrangements of transferring managing responsibility for irrigation water supply services to WUAs has resulted in major savings in energy and increased economic self-sufficiency (the cost recovery rate is at around 42 percent, it was 8% in 2000). About 80 percent of farmers are satisfied with the current arrangements. Two Dam Safety projects and an Irrigation Development project (FY99, FY02 and FY05) have supported implementation of this agenda during this CAS period. They also contributed to reduce risks for around half a million persons living in the vicinity of the dams.

- Technology. The refurbishing of the research and transfer of technology institutions, a key pivot for increasing productivity to rural areas, had progressed with the creation of ten regional and one national agency, financed from grants and fees. The Bank's Agricultural Reform Support Project (closed at the end of FY05) and the follow-up Agricultural Reform and the Rural Development Project (FY05) has supported this agenda through improving farming services, agro-processing, bank lending in rural areas and channeling grants in support of innovative projects. In addition, under the PRSC, the government has introduced OECD certification procedures to reduce the need for seed imports.

51. The interventions in agriculture illustrate that harmonized and properly sequenced operations (property rights, technology, irrigation, finance, and infrastructure), with the support of good macroeconomic policy, can be very effective in helping raise income in the rural sectors. Most notable has been the early emphasis on property rights, prior to the CAS, which set the stage for achieving CAS targets; the certainty of property rights has had important spillovers such as active real estate markets, mortgages, creation of water user associations, etc.

C. The vulnerable are adequately and efficiently protected

Table 8: CAS Goal: The Vulnerable are adequately and efficiently Protected

Targeted Results	Status	Additional Achievements
Social Transfers are more effective;	Achieved.	Resources allocated to social security increased beyond PRSP forecasts.
Satisfaction of users with social protection system increases (baseline tbd in Social Protection Project.)	Achieved.	Social benefits as a percentage of the minimum wage increase.
Instruments: FY04 Social Protection Project; PRSC		

52. *A well targeted and easy to access system of social assistance contributed further to reduce poverty*. Although Armenia started working on the reform of its social assistance early-on, the CAS document expressed concerns about its ability to target the poor and contribute to poverty reduction. Therefore the CAS emphasized consolidating previous efforts to deliver a well-targeted, easy to access and effective system of social assistance built around two main components: pensions and family benefits (FB). The Bank provided its assistance through the FY04 Social Protection project and the PRSC series.

53. *More funds for social security and a smaller population of poor households facilitated targeting*. Pension, family benefits and other social assistance programs received 4.8 percent of GDP in 2007, up from 3.2 percent in 2005 (and representing a significant increase in absolute terms, given the very high GDP growth rate). This created favorable conditions for a more effective social security system. Pensions, capturing 66 percent of social protection funds, although not targeted, are still slightly concentrated on the poor. The Family Benefit (FB) is highly targeted on the poor as intended: 76.7% of the FB resources go to persons in the lower two quintiles and 77.3% of the recipients are in the lower two quintiles. All benefits combined as percentage of the poverty line went from 52.3 percent in 2004 to 78.5 percent in 2006. The rate of satisfaction of the beneficiaries with the system (access, timelines, etc,) as measured under the Social Protection Project is higher.

54. *Additional successful efforts have been made to reach the poor.* The Social Investment Funds series has financed demand-driven small investments in basic infrastructure and has supported community development. SIF-2, completed in 2006, financed investments in clean drinking water and schools. Short-term employment and income increased in the targeted communities. The team rated outcomes as satisfactory, but IEG founded them moderately satisfactory out of concern about the adequacy of baseline and monitoring data. A follow-up Social Investment Fund-III (FY06) has prioritized collecting the information to evaluate effectiveness ex-ante and ex-post.

55. *Additional resources and better targeting have made social transfers more effective in helping to reduce poverty.* Household survey information shows that social security expenditure is helping reduce poverty. The 2008 Public Expenditure Review estimates that, in the absence of social transfers, poverty would have risen from 26.5 to 32.8 percent in 2006. The incidence among the very poor would have almost tripled from 4.1 to 12.2 percent. Pensions have had the greatest impact. In 2008, nominal pensions increased by 62 percent, placing them above 20% of the average wage, meeting the CAS target.

Rating of Pillar II: Satisfactory.

56. *The CASCR rates as Satisfactory the results achieved under this pillar. The design of the pillar was tightly aligned to the poverty diagnosis, supported by a Programmatic Poverty Assessment. Emphasis*

on economic growth as a driver of poverty reduction was complemented by (a) in-depth work on agriculture and rural development where many of the poor lived; and (b) policies (through the PRSC) and targeted programs that supported the vulnerable. While there were other factors at work besides Bank supported interventions (such as increased remittances), Bank efforts made a clear contribution to the analysis and the sharp decline in poverty. Notably, poverty in rural areas also declined with increases in rural productivity and incomes (though many people remain clustered just above the poverty line and so are vulnerable to fall back below it during economic downturns).

Pillar III: Reduce Non-Income Poverty

57. The CAS addressed three non-income constraints to increasing the welfare of the population, especially of the poor: (i) poor quality of education: obsolete curriculum, high inefficiency, and inadequate budgetary allocations; (ii) unaffordable health care: low and poorly targeted public expenditures, with high out-of-pocket payments particularly affecting the poor; and (iii) low investment in infrastructure particularly in water and sanitation. The supporting program relied on both existing and new projects covering education, health and water supply, complemented by the PRSC series. Analytical work on health and education was done as part of the multi-year programmatic PER program. The 2008 just-in-time policy options notes prepared for the new government also covered health and education challenges.

A. Education

Table 9: CAS Goal: Maintain well educated Population with Increase Share of People Completing Appropriate Skills Training and Finding Employment in Changing Economy

Targeted Results	Status	Additional Achievements
More children are staying in the educational system Net secondary enrollment rates increase from 61% in 2001, based on survey data.	Achieved Achieved	Resources: budgetary allocations for education have increased; Efficiency: Increase in the pupils teacher ratio Quality: Curriculum revised and teachers retrained to new curriculum; Access: Expansion of secondary education from 10 to 12 years;
Instruments: Education APL (FY03); PRSC		

58. After independence, the quality and coverage of education deteriorated as resources shrank and curricula and teaching practices turned obsolete. Early on (1995) the Bank supported government in rebuilding the quality of education, but despite gradual progress, the perception of the CAS was of an education system still far from meeting the needs of the country. Limited resources, inefficiencies (high teacher/pupil ratios), obsolete curricula, and lack of adequate teacher training were the main concerns. Bank support to meet these challenges came through an Education Quality and Relevance APL (FY03) and the PRSC. The main focus of these interventions was on general secondary education, whose reform had commenced with the introduction of the Per Capita Financing (PCF) and school autonomy.

59. *Real resources available for education are increasing as a result of a greater share in a rising public budget.* The share of the total budget going to education increased from 13.2% in 2004 to 15.53% in 2007 and its share in GDP reached an estimated 3% of GDP in 2007, when it was 2.2% in 1997. Still, the public allocation to education remains relatively low even if private contributions (1.9 percent of GDP) are added up. The government allocated most of the additional resources to improve access and

quality in general secondary education (grades 1-10) according to the national priorities. The availability of resources has made it possible to increase the average annual salary of teachers, which in 2003 stood at 43% of GDP per capita and is expected to reach 100 percent of GDP in 2008—latest information 85% in 2006.

60. *Efforts to improve the efficiency of the education system have centered on adjusting general secondary education to the declining population.* The introduction of per capita financing as a pilot in 1999 helped rationalize education expenditure and address the risk of an over dimensioned educational system---since 2001 the average number of students in general secondary education declined by 20 percent. The optimization program developed and implemented during this CAS helped increase the pupil teacher ratio from 11 in 2003 to an estimated 14.5 in 2008 through an aggressive teacher reduction and re-training program, which the Bank supported.

61. *Access to general secondary education has improved and is equitable.* Until recently the general secondary education system in Armenia consisted of eight years of compulsory basic education and two years of upper secondary education. General secondary education is being expanded from 10 to 12 years—of which 9 will be basic and mandatory. Enrollment between 7 and 15 years of age ranges from 95 and 100 percent, according to the Survey of Living Standards. The net enrollment rate (NER) for basic secondary education is 89 percent compared to 114 percent for gross enrollment. The GER for upper secondary education in 2005 was 89 percent, while the NER was 70 percent. It follows then that access to general secondary education is equitable—to illustrate 42 percent of the enrollments correspond to 40 percent of the poorest households. Percentages are higher if vocational education is included. Gender is not an issue in education.

62. *The Bank has supported government's efforts to set the foundation of higher quality education.* These efforts have included (a) a new National Curriculum and Syllabi, including training over 8000 teachers in the new curriculum, (b) the unified university entrance examination and school based assessment; (c) the Computer Revolving Fund for information and communication technologies; and (d) an ambitious in-service teacher training program. Progress on all these fronts is on time. The results from the TIMMS 2007 examinations, when available, will set benchmarks from which to track impact.

63. *Looking forward, Armenia continues to face major challenges to putting in place a globally competitive labor force.* There have been substantial improvements in the efficiency and quality of secondary education, the primary focus of policy. With these accomplishments in place, the country can now shift attention to other development gaps. First, a significant gap in pre-school education, a responsibility of local governments, affects the school readiness of the first graders and disadvantages the poor. A second gap occurs at the level of Tertiary education. Public financing is low--.2 percent of GDP or around 8 to 9 percent of education spending. Tuition fees in public universities account for 30 to 40 percent of per-capita income. The reliance on tuition fees makes the financing of tertiary education volatile and, as in the case of per-school education, biases access against the poor.

B. Improved Access to Health Services

Table 10: CAS Goal: Increase Access to Health Services

Targeted Results	Status	Additional Achievements
Share of those who are sick and who use healthcare services rises in bottom consumption quintile from 22% and in rural areas from 26% in 2001 Public attitudes towards unhealthy behavior begin to change in response to information campaigns and some evidence of early use of lower risk behavior is observable.	Achieved (as of 2007, 27.7% of bottom quintile use health services) Information not available	• Increased Budget allocated to health system • Share of the population covered by trained and qualified family doctors and community nurses rises • Hospital sector consolidated so that a smaller number of providers are operating on adequate volumes
Health Systems Modernization APL I (FY04) APL II (FY07); PRSC		

64. In health the CAS supported (a) provision of affordable quality services and (b) increasing the utilization of these services by the poor. By 2004, the primary health care (PHC) system was already in place and guaranteeing all citizens a minimum, rather broad, package of services. Limited financing for the PHC package led to the emergence of unofficial payments, which limited the access of the poor to health services. In addition, a large hospital network absorbed resources that could have gone to finance primary health care.

65. The Health Systems Modernization Project (FY04) and the PRSC series also delivered Bank support to optimize the hospital sector, aiming at reducing excess infrastructure capacity and improving quality and efficiency of selected hospital networks. Following an initial pilot for hospitals in Yerevan, the Government has initiated the hospital optimization program in the regions.

66. *The public budget allocation to health has increased in real terms and as percentage of GDP.* The overall budget resources for health doubled between 2003 and 2006, even if the health sector allocation as a proportion of GDP increased only marginally from 1.2% in 2002 to 1.5 % in 2007. The incremental resources have gone to finance PHC as the PRSP intended. In addition, the strategy to consolidate hospitals and the number of contracts signed by the State Health Agency dropped from 125 in 2004 to 115 in 2006, still 15 above the target set in the PRSC. As contract simplification moves to the MARZ (regional) level the expectation is that the PRSC targets will be met by 2009.

67. *The consistent Government policy to strengthen PHC services has yielded significant results.* First, between 1999 and 2006, the gap between the richest and the poorest quintiles in using essential health services shrank. The utilization of basic health services (PHC) by the poorest quintile of population increased from 21.5% in 2003 to 27.7% in 2007. Second, the share of the population covered by newly trained family doctors and community nurses reached 58% in January 2008 when it was only 19% in 2003. Third, utilization rates increased 33% for outpatient services and 22% for hospitals. Measured differently, utilization of PHC services increased from 1 outpatient visit per person per year to 2.8. Fourth, the percentage of the population satisfied with quality of outpatient services has increased and access to PHC is better spread geographically, although access in rural areas lags national averages. Fifth,

it is estimated by the National Health Performance Report (a Bank supported initiative) that increased public financing has been accompanied by a reduction in private out of pocket expenditure.

68. The increase in life expectancy, the reported decrease in child mortality (between 2000 and 2005 according to health surveys) and the nearly universal access mothers have to doctor and hospital care point to steady health improvements. At the same time, statistics collected through the health system reported in 2006 an increase in child and maternal mortality. Authorities responded quickly targeting expenditures to forestall threats to child and maternal mortality. While the rapid public response is welcome, an accurate appreciation of trends will come only with a new health survey, as health statistics fluctuate from year to year. In fact, while year-year health statistics fluctuate, under five child mortality fell to 12.3 (per 1000 live births) and maternal mortality to just 15 (per 100,000 live births) with both being the lowest level recorded.

69. *Armenia is now in a position to make major gains in the delivery of health services.* First, the sector has shown it can absorb resources effectively. The effectiveness of the increased allocations can be monitored for access, quality and impact; the Bank project has put this monitoring infrastructure in place. Second, the government can lower the out-of-pocket expenditures and make the Basic Benefit Package by (a) streamlining benefits, (b) continuing the reform of the hospital system to liberate funds to finance basic health services, (c) assigning more funds from the budget, and (d) normalizing out-of-pocket payment as copayments for services not included in the basic package.

C. Increased access to and better quality of water services.

Table 11: CAS Goal: Increased Access to and Better Quality of Water Services

Targeted Results	Status	Additional Achievements
% of population connected to piped water that has service 24 hrs a day increases from 22 % in 2003;	Achieved.	New institutional framework for the delivery of water and sanitation services in place and working.
Share of households heating with gas-based systems increases by 20% from 2003/2004 baseline to be determined in July 2004	Achieved	Plan to improve heating in urban areas under successful implementation.
Municipal Development Project (FY98); Armenia Water (FY04); Electricity T&D Project (FY99); Yerevan Water and Sanitation (FY06); Urban Heating Project (FY06);		

70. During the 1990s, a lack of investment resources and weak administrative practices led to a deterioration of the coverage and quality of water supply. The Government viewed the main problem as the management of the available water resources. Hence, Bank support began with the Municipal Development Project (FY02-06), which introduced an example of a performance-based management contract for the capital city, and the services of an international water operator were engaged to improve the functioning of the Yerevan Water and Sewage Company (YWSC) through hands-on training for the technical, financial, and management staff. The project financed emergency investments in Yerevan and helped develop a regulatory framework. This resulted in improved water management, increased financial viability of the utility and improved water supply and quality in Yerevan. The management contract worked well setting the basis for a follow-on lease contract. The legal framework for private sector participation is in place and working. IEG confirmed the satisfactory rating for the outcome of the project.

71. The CAS helped the Government consolidate this public/private partnership through the Yerevan Water and Sanitation (FY05), which financed investments under a new lease contract between the Government of Armenia (represented by SCWE) and a private operator. The positive results of the combined efforts under the two consecutive projects in Yerevan include moving from seven hours of water availability to an average of 19.5 hours a day and increasing the percentage of the population with 24 hours access over 70% in Yerevan today. In addition, the focus of the Municipal Water and Wastewater Project (FY04) is on improving water and wastewater services outside the capital city, covering 45% of the population. Under the project, the Government recruited an international water operator to manage Armenia Water Supply Company (AWSC) under a management contract. While the lease came to an end in FY09, it was renewed with Additional Financed Bank support thus further improving sustainability of the overall water supply system. Important results include increasing drinking water availability from 6 hours in 2004 to 12 hours in 2008. SIF-II and SIF III also financed water supply investments in small communities. Nationally, the percentage of population with sustainable access to improved water source went from 87.6 percent in 2000 to 94.1 percent in 2007 (as recorded by the National Statistics Agency).

72. Armenia has succeeded in attracting private operators to work in water sector utilizing a gradual approach that began with a simple management contract to address the critical situation of Yerevan. The positive results attained set a basis for longer contracts and are sustaining an approach to delivery of water and sanitation services that has been difficult to implement in other transition and developing countries.

73. In addition to supporting water and sewage sector, during this CAS the Bank is supporting provision of safe, clean and affordable heating to the residents of the multi-apartment buildings, and the urban schools. The Urban Heating Project (FY06) is targeting support to multi-apartment buildings and schools. The results (up to 2007) include: (a) 46 percent of households in multi-apartment buildings use safe and clean gas-based heating solutions in 2006-2007 season compared to 11% in 2003-2004; (b) 97 urban school's heating systems rehabilitated in 2006-2008; and (c) Renewable Resources and Energy Efficiency Fund providing capital grants to the urban poor for installation of gas heaters and connection to the gas network.

Rating of Pillar III: Satisfactory

74. *The CASCR rates as satisfactory outcomes under pillar III. The results foreseen from Bank assistance have been delivered. The public/private approach piloted and then expanded on water and sanitation has been innovative, has worked and has delivered results. Key achievements in education include increased allocation of public resources, attention to inputs that go into quality (curriculum modernization, teacher training), and expansion of mandatory education to a 12 year cycle. Still, substantive challenges remain commensurate with the objective of turning Armenia into an ideas economy able to assure access to quality education to all. In health, larger budgetary allocations have contributed to achievement of results most notably in access to health service by the poor and availability of family trained doctors. Health expenditures, improved water supply, rising incomes and better health practices all contributed to a rise in the life expectancy of the population. The achievements in water supply, and the contribution of the Bank in this effort through supporting a public-private partnership, are particularly noteworthy.*

III. World Bank Group Performance

75. Overall, the Bank has delivered the CAS program on time, with high quality, and with strong ownership by the Government. The Bank has leveraged limited budget resources available for a small economy to prepare complementary policy and investment operations, and targeted analytical work that has helped the Government to strategically consider policy options. Areas for further strengthening

include a greater focus on governance and more outreach to civil society in developing programs and disseminating analytic work.

Lending

76. *The high quality of supervision and implementation on ongoing projects has contributed to a timely achievement of results.* From 2005 to 2008, only one project was temporarily in problem status and this was addressed (the Public Sector Modernization Project had a moderately unsatisfactory rating from December 2007 to August 2008). Second, a 2005 review found that project accounting and quality control practices were satisfactory. Third, the disbursement ratio has averaged over 30 percent per annum during FY05-08, among the best performances of Bank clients.

77. *The delivery of new operations followed the original program closely, but was also implemented with flexibility to changing circumstances.* Most operations proposed in the CAS have been delivered, either during the CAS or shortly thereafter, with the main exception of an Infrastructure Project proposed for FY08, given the strong involvement of MCC in transportation and Irrigation with Bank support (subsequently three small-scale infrastructure projects were delivered in FY09). As the CAS Progress Report (CPR) indicated, flexibility was shown in including an operation to address the emerging risk of Avian Influenza in FY07. The CPR further proposed new lending in three ongoing areas where there was strong implementation and additional funds were needed to carry progress to the next stage: (a) Judicial reform II; (b) Heath Systems APL II, and (c) Additional Irrigation. A new area proposed in the CPR for action in FY08 – Traffic Management – was ultimately not prepared as the Government decided to proceed in this through other channels. In FY08, Armenia was declared creditworthy to begin IBRD borrowing in addition to IDA, although it did not do so until FY09.

78. *The PRSC series has been particularly effective in guiding the overall policy dialogue, complementing several related investment operations.* The PRSC series (four operations, corresponding to the high case of the CAS) concentrated on the themes the CAS had identified as a priority, mainly: (a) improving the environment for private sector growth; (b) improving public sector financial management and (c) addressing social sector issues. An ample body of solid analytical work supported the PRSC dialogue and the selection of benchmarks. The PRSC framework (a) complemented the work of projects in advancing sector reform agendas (such as environment, health, education, and social assistance), and (b) facilitated both the dialogue and technical assistance in areas not covered under projects (such as taxation and customs reform, aviation policy, and the financial sector).

Analytical Work

79. *The pace and quality of analytic work has been maintained and followed the CAS guidelines.* Most of the analytic work anticipated in the CAS was delivered (see CASCR Annex 2). A substantive body of the analytical work was prepared to support the PRSC dialogue, notably the Country Economic Memorandum that covered competitive challenges and whose content has been widely disseminated in book form (e.g. *The Caucasian Tiger: Sustaining Economic Growth in Armenia*). *The Caucasian Tiger* has indeed become a case study in how to develop second generation reforms in a post-Soviet economy in transition. Annual programmatic public expenditure reviews have reviewed infrastructure, education, health and social assistance expenditure issues. It is noteworthy that in anticipation of the new Governments need for policy briefings to maintain policy continuity, the Bank prepared a just-in-time broad series of policy notes (for example, on tax, customs, public expenditures, education policy, aviation, pensions etc). Also of note, two analytic pieces – the Poverty Assessment and the Public Expenditure and Financial Assessment (PEFA) – were both prepared by the Government with the support of the Bank (rather than the other way around) thus ensuring strong ownership.

80. *A 2006 QAG review rated the Bank analytic work as between satisfactory and highly satisfactory.* The QAG review of Armenia's FY02-FY05 AAA focused on 14 out of 22 tasks, which absorbed 90 percent of the total resources. QAG rated the execution of the analytic program satisfactory, but called it borderline highly satisfactory. QAG found analytic work "to be an essential ingredient of Armenia's success story, with notably impact on the Government's decision-making on policy reforms, consensus building on reform and design and implementation of programs (especially the PRSCs) underpinning the country's good economic performance and its significant progress towards reducing quality." At the same time, QAG called for a broader degree of dissemination, including planning at inception.

Monitoring and Evaluation

81. *Monitoring and evaluation proceeded at both the project level and the country level.* At the country level, this was facilitated through periodic Country Portfolio Reviews (CPRs), the last of which took place in 2007 and was results oriented. The following 2008 Country Portfolio Review was merged with the preparation of this CASCR. In addition, the CMU tracked on a continuous basis the milestones set under the CAS; this tracking informed the drafting of the CPR and the preparation of the CASCR. Monitoring was facilitated as PRSP indicators were used where appropriate, and the Government prepared a comprehensive review of results under PRSP-1 in September 2008.

82. A CAS Progress Report (CPR), presented to the Board February 2007, maintained the results expected under the CAS and slightly revised the lending portfolio and the AAA agenda in ways that have been noted already. The CPR presented preliminary lessons and recommendations that the CASCR incorporates.

Working with Government

83. *The previous CASCR highlighted the strong relationship the Bank has with the Government at all levels*, and in particular the positive role that the local office has played in the dialogue with the authorities. The QAG review made the same point and this CASCR ratifies the finding. The local staff combines experience with recurrent training, and several have gone on to positions in the Government or private sector. Greater supervision responsibility has also been assigned to the local staff and this has contributed to a well performing portfolio and positive policy dialogue in all sectors.

84. *The interface with the Government is also supported by effective Project Implementation Units (PIU).* Initially PIUs were self-standing administrative bodies, but have changed their legal status several times and most are now more integrated with line Ministries than before and also have oversight Boards (including the line Ministry, the Ministry of Finance and the Ministry of Justice). A few have the status of a Fund (Armenia Social Investment Fund and Renewable Energy Fund) but these also have developed a strong interface with the Government and are overseen by Boards (for example, the Chairman of the Board for both Funds is the Prime Minister).

85. The effectiveness of these PIUs and their experience in the management of Bank projects (procurement, FM, disbursements etc.) have contributed to the satisfactory status of projects and high disbursement rates in Armenia. They have also become effective support units (including on policy matters) for their respective Ministries who at times call on them for work outside of Bank operations, taking into account their professionalism and performance. While both the Government and the Bank agree that the ultimate goal would be to fully integrate project management into Ministries using their own structure and staff (in line with the Paris Declaration on Aid Effectiveness), this would need to be done carefully going forward so as not to reduce the strong expertise developed over many years.

Coordination with Other Partners

86. *Coordination with the IMF has been effective and complementary*. The IMF supported the 2003 PRSP through a three year PRGF approved in May 2005, after the previous PRGF expired in December 2004. Besides maintaining macroeconomic stability and prudent monetary and fiscal policies, the 2005 PRGF operation focused on buttressing the financial sector as well as public revenues. This in turn has enabled the government to finance social and growth expenditures. The two institutions have collaborated closely in these areas and financed complementary technical assistance (for example on tax administration reforms). The 2005 FSAP roadmap has been implemented with the support of the two institutions.

87. *Coordination with other donors in Armenia has been good, emerging mostly from individual efforts but within the overall framework of the PRSP and MTF set by the Government.* Examples of harmonization include: the work on water where the development partners' support is covering most of the country; there has been close work with MCC in irrigation and in the allocation of competitive grants to farmers, likewise with UNICEF in pre-school education; while co-financing arrangements with bilateral donors (Dutch and Swedish) have supported reforms in the Judicial system; export promotion, and forest management. The PSMP project provides a framework for coordinating technical assistance to the Government on public sector issues.

Management of Risks

88. The risks identified were realistic and though they did not materialize over the CAS period, more recently vulnerability to external economic shocks has emerged. Internal political tension and change during the CAS period did not cloud economic performance or perspectives, as it was feared it might happen. The country did not experience major natural shocks. Regional political conflict (mostly related to Nagorno-Karabakh) neither intensified nor weakened and any long lasting impact on Armenia of the recent Georgia developments is uncertain. Lastly, the external environment was more beneficial than it had been expected. With hindsight, it was providential that the CAS focused on improving the financial sector which has proven resilient thus far in the current global economic crisis, but more attention to building public savings and to diversifying exports could have helped them further in the current situation.

Rating Bank Performance: Satisfactory

89. *The CASCR rates Bank performance as satisfactory. Overall, the CAS was well-aligned with the priorities of government and showed selectivity in its interventions. It aligned the annual adjustment operation with related investments, and in designing investments, the Bank and the Government piloted innovative techniques that were later scaled up (like private participation in the water sector). A strong local staff as well as effective PIUs have contributed to a well run portfolio. In addition, the Bank has carried out diagnostic work and develop options in a timely manner for the government (for example, in providing just-in-time policy notes for the new Government in FY08) and these have also fed into new Bank operations (as recommended by the previous CAS Completion Report). Analytic work has also been notable in ensuring the product was fully owned by the client (for example, the PEFA or the Poverty Assessment). The result has been a steady approach to reform avoiding wide swings in policy or direction. Admittedly in certain areas such as governance, progress has not been as fast as had been hoped. More could also be done by the IFC if the corporate environment were to improve.*

IV. Lessons and Recommendations

90. *The Armenian experience shows that reform works well when there is steady commitment to reform over more than a decade.* Armenia's outstanding performance on growth and poverty reduction during the CAS period has strong roots in its early and sustained commitment to rely on the private sector to generate economic activity and employment, with a vision of a limited and effective state. The

Government has used a medium term planning approach through the PRSP and the MTEF as a powerful disciplining devise. Likewise, the strength of the Bank's engagement can be traced not just to its activities during the CAS period but a long and deep relationship of trust built over more than a decade. This includes a strong local country office staff and effective PIUs that have contributed to the policy dialogue and a well run portfolio. All this provided fertile ground for the Bank's annual budget support operation as well as just in time analytic work (for example, policy papers for the new Government in FY08) to yield results.

91. *A key element in making the Bank's program effective has been the complementary re-enforcing package of annual policy support, related investments, and selected analytic work.* For example, health investments were combined with health policy targets in the DPL as well as a Public Expenditure analysis focusing on the health sector. By making these interventions focused and complementary, the Bank leveraged modest resources to obtain results.

92. *The use of programmatic instruments, focusing work in areas that the Bank has built up expertise over a long time period, has enabled it provide quick and expert support*. On the policy side, each annual program has built on the achievements of the previous one. In investments, many interventions (such as water, judicial, health) have built on past efforts, mostly as APLs or Additional Finance. Several pieces of analytic work have also been programmatic in nature, including the annual poverty assessment and public expenditure review. At the same time, the Bank should also stand ready to respond to emerging priorities (as it did for Avian Influenza).

93. *Public/private partnerships and making local public service entities more autonomous works in Armenia.* The Bank has explored public private partnership through the FIEF operation, through supporting management contracts in the provision of water services, and in the provision of road services. This experience has generally been positive and suggests it could be scaled up to other sectors. Similarly, the Government has improved services in health and education by increasing local autonomy in schools and hospitals, while strengthening their financing and accountability.

94. *Results indicators need to be chosen which are both relevant and easily measured.* Where results indicators relied on those measured by the Government in the PRSP or the annual Poverty Assessment or surveys under specific Bank projects, they have proven robust and useful. Other results indicators (for example, relying on the BEEPS) have run into difficulty as they rely on efforts outside of the team or Government. It is also important not to set indicators too high on the results chain (i.e. general satisfaction with judicial services or changes in the public's health behavior) raising questions as to whether the indicators accurately gauge impact of the Bank's program.

95. *The vulnerability of growth continues to be a concern.* As a small economy, Armenia will be unlikely to achieve full diversification. Rather, the focus should be on: (a) reducing barriers to accessing external markets (customs, air travel, rail, roads, etc.); (b) creating an investment environment that favors entry and innovation; and (c) provisions to soften external shocks (such as a sound financial sector, improved corporate governance and careful debt management). Rural development poses a particular challenge as it still employs a substantial percentage of the population and has increased at a slower rate than the overall economy. In developing a policy response to external shocks, it would be particularly important to resist protectionist tendencies and continue to build an open and competitive economy, while protecting the poor and those people most affected.

96. *Further progress on governance is likely to depend on clear high level commitment rather than technical fixes.* Early moves on governance ranked the country high in ECA but now other countries are catching up and in some cases passing Armenia by. While the Government is improving the management of taxes and customs, these continue to show up as areas of high concern to the population (though there may be some lags related to recent reforms). Many areas of governance reforms – like public

administration, civil service reform, and the establishment of a level playing field for businesses – will likely require a concerted effort over a long period of time. A more transparent business environment and improved corporate governance would strengthen the sustainability of growth and improve competitiveness, while also enabling greater IFC operations.

97. *The shift to IBRD lending will bring about changes*. Armenia will become a blend country during the next CAS. This will provide Armenia with more funding options to choose from and with a greater funding envelope. A likely greater emphasis on infrastructure is therefore expected, but this should not come at the expense of capacity building and the social sector. Middle income status is also likely to intensify expectations of high quality (which the Bank has thus far met in Armenia). It will also be important to strengthen collaboration across the Bank group, including IDA, IBRD, IFC and MIGA.

98. *There is an opportunity to build and gradually rely more on country systems.* A modest foundation has been established in the current CAS with many PIUs now integrated into Ministries. However, further strengthening of procurement and financial management beyond Bank projects is needed. The use of the country PFM systems for projects implementation is currently being discussed with the government. The country system elements to be used under Bank projects in the CPS period are planned to include the Treasury system for maintaining the projects designated accounts. The other country systems will be assessed to be used as the government progresses with the PFM reforms. Particularly, the accounting system will be used upon introduction of IPSAS and automated accounting system by the government, and auditing - when the COC develops adequate capacity to conduct audits following international auditing standards. The government staffing and internal controls will be used, when the designed public internal audit system is introduced. The challenge forward will be to preserve the capital and experience that has accumulated in PIUs while strengthening country systems and line ministries, in both policy and administrative areas.

CASCR Table 12: Planned Projects and Actual Deliveries

FY	**CAS Plan**		**Actual Deliveries**	
	Project	**US$M**	**Project**	**US$M**
2005	PRSC/PRSC TA	20-25	PRSC	20
	Rural Development	15-25		
	Yerevan Water II	20	Yerevan Water	20
2006	PRSC II	20-25	PRSC II	20
	Social Inv Fund III	15-25	Rural Development	20
	Urban Heating	15	Urban Heating	15
			Renewable Energy	5
			Avian Influenza	6.25
2007	PRSC III	20-25	PRSC III	28
	Renewable Energy	5	Social Invest Fund III	25
	Public Sector II	0-20	Judicial Reform II	22.5
	Infrastructure	10-30	Health APL II	22
2008	PRSC IV	15	PRSC IV	18.5
	Rural Development II	10-30	Add Finance - Irrigation	5
Total		170- 220		227.25

CASCR Table 13: Planned and Realized Analytic Work

Underway at time of CAS	**Status**
Social Protection Study	FY04
Financial Sector TA	FY04
Poverty Assessment Follow-up TA	FY04
Anti-corruption IDF	FY04
CFAA Follow-up	FY04
CPAR Follow-Up	FY03
Country Economic Memorandum	completed FY07
Rural Sector Strategy and Action Plan	completed FY06
Treasury Action Plan Pilot (IDF)	completed FY05-06
Public Procurement (IDF)	completed FY07-FY08
Planned at time of CAS	
Private/Financial Sector Services	On-going
Labor Market Dynamics	completed FY07
Programmatic Poverty Assessments	On-going—annual delivery
Programmatic Public Expenditure reviews	On-going—Annual delivery
Country Environment Assessment	
Private/Financial Sector Services	FY08—To be delivered FY09
FIAS Follow-Up	On-going
Annual Business Survey	On-going
Competition Policy (IDF)	On-going
Not in the Original CAS Document	
PPIAF on railways restructuring /concession	FY07-08
ROSC	FY08
Public Sect Accounting Standards (IDF)	FY08-09
Public Debt Management (IDF)	FY07-08
PEFA	FY08-09
Policy Notes	FY08

ATTACHMENT: SUMMARY TABLE OF THE ARMENIA CAS COMPLETION REPORT

Long Term goals	Issues of Concern in the CAS	Status at completion	Lessons Learned
Goal One: Promote Private Sector Economic Growth			
Private sector grows and becomes more diverse	Growth is driven by construction and diamond exports but there are concerns about its diversity and sustainability.	Economic growth beyond expectations, but remains concentrated in non-traded sectors, and exports are weak.	As a small economy, Armenia will be unlikely to achieve full diversification. Rather, the focus should be on reducing barriers to markets and improving the investment environment
(i) Public sector agencies serve population efficiently; governance improves; judicial system enforces laws and contracts fairly.	-- Budget system still has problems, especially for budget classification, expenditure rationalization and reallocation, budget formulation, and financial reporting of non-financial enterprises. Public procurement lacks transparency. -- Concerns that inadequate levels of public financing could impair financing of basic services fostering social instability Government agencies at central and local levels lack motivated staff and efficient systems. First phase of judicial reforms has not yet led to a completely independent judiciary. Enforcement of court decisions often delayed and inconsistent. Unclear and inefficient procedures to enable citizens to protest against government agency acts.	Comprehensive budget, following updated classification, well aligned with PRSP. Up-to-date reporting on budget execution. Unified single treasury in place. The main gaps concern implementation of internal controls. Improved reporting and oversight of non-financial enterprises. Improvement in public procurement currently being assessed (via the CPAR). Real resources available to the government increased with rising income; in addition the ratio of tax to GDP went from 14 percent in 2003 to 16.1 percent in 2007. Public salaries increased as a percentage of GDP. Civil service law mandating merit hiring under implementation. Fiscal sources of local governments strengthened. Constitutional amendments set basis for an independent and effective judiciary; Judicial Code developing constitutional amendments came into operation in 2008. 2008.	Early on Armenia posted an investment climate and quality of governance that stood out among CIS and ECA countries. However, Armenia is falling behind competitors. Although technical improvements are being made, further progress on results will depend on clear commitment of the Government to improve governance (particularly in tax and customs)

		Available statistics show (a) improved operation and transparency of judicial system and (b) greater user satisfactory with court services improving.	
(ii) Financial services adequate for private sector growth.	Low loans to/GDP ratio reduces stability of the banking sector Corporate governance of the banking sector is weak. There are no credit bureaus to monitor credit operations, which reduces confidence in banks. Debt recovery through the judicial system is unreliable. Financial intermediation is available only at a high cost.	Loans to GDP increase to 13.58 percent in 2007 compared to 5.68 percent in 2003. Umbrella finance regulatory agency under Central Bank in place implementing Basle principles has brought banking corporate governance to international standards. Legislative changes strengthening creditor rights, improving civil procedures for debt recovery, and simplifying procedures for certification of property sales and registration of secured credit. These legislative changes jointly with a new facility for registering pledges of movable property in the central cadastre registry provide an adequate legal framework for most secure transactions in Armenia. Interest rates still high despite bank consolidation driven by higher minimum capital requirements and competition from foreign banks.	Strong regulatory oversight and competition have provided a less vulnerable financial sector. Nevertheless, there is potential to further consolidate the sector, increase access, and reduce rates. Improvements in non-financial corporate governance would improve conditions to deepen the non-banking financial sector and finance the upgrading of the productive capacity of the country.
(iii) Communications infrastructure promotes economic growth.	Telecoms constrain to private sector development because lack of competition was leading to: low quality, high cost services, especially corporate networks and internet; limited reach especially rural	Telecom monopoly eliminated; sector open to competition, three telecom operators now in place. Umbrella regulatory agency (PRSC) for services covers energy, telecom, railways and water. Significant	Progress made in lifting perceived constraints in electricity, telecommunications and to a lesser extent land transport; however, Armenia remains challenged in accessing external markets and an aggressive approach to

	areas. Transport of people and goods is time consuming and expensive especially in rural communities.	improvements in the availability and reliability of basic services. Railroad concession issued. Ongoing progress to open air travel to competition and by-pass pre-existing privileges.	improve logistics and reduce the cost of accessing external markets is much needed (customs, roads and railways, aviation, standards, etc.)
(iv) Economic growth based on more sustainable use of natural resources.	Capacity to enforce environmental impact assessment legislation is weak. Deforestation and poor land management further impoverish poor people and increase impact of natural disasters	Law on forestry/logging and agency responsible for its enforcement in place. A larger number of communities capable of managing commons (forests/watershed.) Eliminated risks posed by old dams to around half a million people.	Government has worked on a selected set of priority environmental issues (forestry, dam risks); for the future, the government needs to identify priorities out of a broader environment agenda. Current analytical work by the Bank can help prioritize and cost an agenda.
Goal Two: Make growth more pro-poor			
A larger share of the population benefits from economic growth and the vulnerable are adequately protected.	Anxiety about slow growth of poverty incidence despite high economic growth.	Poverty rates fall across the board. Poverty incidence fell from 55 percent of households in 1999 to 25 percent in 2007. Absolute poverty fell from 21 percent in 1999 to 3.8 percent 2007.	Strong analytic support based on Government ownership. Progress in poverty reduction supported by Bank programs in rural areas and social protection (and also rapidly growing remittances). Still many people are clustered just above the poverty line so vulnerable to shocks.
(i) More people benefit from economic growth.	Growth has concentrated in the urban areas (Yerevan and others.) Informal economy at 45% of formal economy. Information about the job market difficult for the unemployed to access.	Growth spreads outside Yerevan, including rural areas. Official estimates put informal economy at 35% of formal economy. 2004 Labor Code introduces flexibility into the labor market. Government commenced implementation of the recommendations of the Labor Market study to improve availability of information, matching, etc. Preliminary results are encouraging including high satisfaction (77%) of job-seekers with services provided by state employment service.	Concerns remain with underemployment given low labor force participation. Attention to the quality of growth and matching of skills continue to merit attention. The role of Armenians working abroad and remittances on underemployment needs further analytic work.
(ii) Rural areas do not have entrenched poverty.	Only small share of farmers produce agriculture surplus	Since 2001 agriculture value added and productivity have grown	Multiple harmonized operations (land tenure, irrigation, technology

	because irrigation is unreliable, lack of improved inputs, technologies and marketing difficulties. Institutional reforms in agriculture not yet complete. Agriculture vulnerable to natural disasters. Few opportunities for off-farm income generation.	rapidly driven by irrigation improvements (increased area, greater efficiency in use of electricity, less losses of water), access to quality inputs, technology, and marketing infrastructure. Stronger rural institutions including: (a) 11 autonomous technology centers and (b) water management associations covering all irrigated areas in the country. New SEEDS law in place and investments in testing labs. New water management institutions and investments have reduced demand for electricity and overall costs. Significant reduction in rural vulnerability to natural disasters. With economic growth off-farm opportunities in rural areas have increased.	transfer, credit, etc.) helped integrate agriculture into the national economy and benefit from the rapidly growing demand. Still, productivity growth has been lower than in the general economy and absorbing a sizeable percentage of the population the rural areas remain fragile.
(iii) The vulnerable are adequately efficiently protected.	Pensions too low—21% of average wage in 2003. Administration of cash transfers is not efficient enough and leads to wastage and unnecessary delays. Benefit system is not transparent enough, leading to confusion amongst potentially eligible beneficiaries.	Real pensions increased rapidly with wages, even if ratio of pensions to average wage remained constant around 20 percent. In addition, pension/average wage increased to 25% in 2008. Targeting of social assistance improves (76.7 of the family benefits go to the poorest two quintiles.) Satisfaction with social benefits system improves (94.8 % of pensions and 92.6% of social assistance delivered on time. 78.3% percent of pension and 82.2% of pension beneficiaries are satisfied. Pensions and social benefits have contributed to the reduction in poverty (In the absence of social transfers	High income growth facilitates targeting by (a) providing public resources and (b) by reducing the number of eligible beneficiaries. While a more efficient system of social assistance is in place, efforts should be made to make it easy for the poor to access benefits and for improved accuracy of screening. Improved targeting and efficiency needed to face up to difficult situations to come.

		poverty would have risen from 26.5 to 32.8 percent in 2006.)	
Goal Three: Reduce Non-income Poverty (Population has adequate basic services (health education, water, waste water treatment, heat and transport.)			
(i) Education: Maintain well educated population with increased share of people completing appropriate skills training and finding employment in changing economy.	Curriculum is not appropriate; Skills and incentives for teachers do not match needs of a market economy Inadequate facilities and equipment (including heating and 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.	Updated Secondary Education Curriculum; Budgetary allocations to education increase from 2.2 in 1997 to 2.96% in 2007. Annual average teacher salary from 43% of GDP per-capita in 2003 to 100% in 2008. Ambitious re-training program implemented; General secondary education extended to 12 years with 10 mandatory; Cohort from 7 to 15 is in school close to 100%; Gross enrolment rate for upper secondary (voluntary) education at 89 %, net at 70 %. Enrollment in pre-school remains low, at around 22%.	Steady long-term commitment to improving education has paid-off. The system of per-capital grants and school autonomy is firmly in place. General secondary education has posted major improvements in access, efficiency, and quality. The gaps are in pre-school and tertiary education. Attention to skills is also needed to help the reconversion of the economy.
(ii) Increase overall health status of the population.	People cannot afford services because formal and informal payments are high; Public expenditures on health are low and poorly targeted (hospitals absorbed 53% of public health expenditures in 2001); Women's reproductive health may be deteriorating. People engage too often in risk behavior.	Higher allocation of public resources to health with additional resources targeted to Primary Health care system—from 1.2 % in 2003 to 1.5% in 2007. Access of the poor to the basic health system improves (gap in access of bottom and top quintile has closed.) Informal payments reduced, but still high; Health improvements as measured by secular increase in life expectancy---.from 66.4 years in 2000 to 72.4 years in 2008.	Broadly defined Primary Health Care induces side-payments and reduces satisfaction; therefore, streamline Primary Health Care introducing official premium and protect the poor. Continue increasing budgetary allocations to health. Improve tracking and monitoring to ascertain effectiveness. Continue hospital rationalization.
(iii) The population has increased access to basic infrastructure services, which improves their quality of life	The poor financial conditions of utilities have prevented investment in infrastructure. Crumbling water and sanitation infrastructure is	New institutional framework for the delivery of water and sewage in place based on regulation and private participation. There has been a substantial progress on water. In Yerevan,	Sequential approach to address energy situation and bringing private agents under the umbrella of a regulatory framework worked in Armenia. Given the difficulties the same approach has experienced

	leading to increasing rates and/or sudden outbreaks of water borne deceases. Many urban households are forced to heat with wood, which is expensive and has environmental costs.	supported by the Municipal Development and a subsequent Yerevan Water Supply Projects, hours of water availability increased from 7 in 2003 to 19.5 hours in 2007, and around 74% of Yerevan population has 24 hour service. The availability of safe drinking water is over 95 percent in Yerevan and most urban centers. Under the Municipal Water & Wastewater Project, these efforts are expanded outside Yerevan and it is estimated that 25.8% of the population in the service area now has access to 24 hour water supply. With development partners' support efforts to improve water sanitation services cover most of the country (with the exception of some self-served rural communities). World Bank support for gas-based heating has already produced positive results (46% percent of households in multi-apartment buildings utilize safe and clean gas-based heating solutions in 2006-2007 as opposed to 11 percent in 2003-2004.)	in other countries, the Armenian experience should be studied for the lessons it can teach others**.** The investment needs continue to be great.

Annex 2: Armenia FY09-12 CPS Results Matrix

Strategic Objective 1: Addressing Vulnerabilities

Results Area 1: A post-crisis Armenia that regains macro-stability and is poised for high growth
Outcome 1: Macro stability maintained through appropriate external and domestic fiscal adjustment
Outcome 2: Tax regime and administration reformed
Outcome 3: Financial intermediation rises, with growth in SME credit lines to rise as a share of total credit

Results Area 2: Adverse poverty impact limited amidst assured health and social protection
Outcome 1: Income poverty impacts are limited through employment generation from job-creating programs and through improved poverty targeting. Phased introduction of multi-pillar pension reforms
Outcome 2: Increased utilization of basic health services by the poor, with a decline in out-of-pocket payments.
Outcome 3: Urban households and schools employ safe gas-based heating
Outcome 4: Improvement of solid waste management service quality

Results Area 3: Rural and environmental risks decrease
Outcome 1: Irrigated area rises as institutions for water management develop.
Outcome 2: Rural output and employment is supported.
Outcome 3 International best practice compliant mining code under implementation.
Outcome 4: Preparedness for handling natural disasters is developed.

Strategic Objective 2: Strengthening Competitiveness for Post-Crisis Growth

Results area 4: Governance is strengthened; as a result public sector efficiency rises
Outcome 1: Conflict of interest among public officials is substantially diminished; and corporate governance rules are enforced and fair market competition is established; Judicial decisions are rule-bound and better enforced
Outcome 2: Improved performance of public administration and revenue collection agencies
Outcome 3: Efficiency of public expenditure allocation increased as a result of the program budgeting and financial accountability reforms

Results area 5: Foundation for knowledge economy and competitiveness strengthened
Outcome 1: Infrastructure in support of knowledge-based economy being developed. Strategy being implemented for increased internet penetration, amidst the laying of a national ICT broadband backbone network.
Outcome 2: PPP framework in operation. Commercially valuable spectrum available for private sector use; operational Universal Services Fund; and civil aviation regime fully liberalized.
Outcome 3: In transport management, road network is improved and analysis and regulatory capacities strengthened.
Outcome 4: In energy, decommissioning of the nuclear plant being planned; PPP agreements financing new renewable energy based generation capacity; improved energy efficiency and transmission losses reduced.
Outcome 5: In water, improved service reliability and water quality, greater operating efficiency. Closer alignment of service tariffs with costs.
Outcome 6: A growing private sector faces more open competition and access to finance.
Outcome 7: In education, increase of net preschool (5 years old) enrollment rate. Tertiary education financing expands through higher education financing reform and introduction of competitive innovation funds and a student loan scheme. The national Quality Assurance system in line with European Higher Education Area is fully functional.

Development Partners

Civil Society

Engagements:
National and Local Level
Private Sector

ARMENIA: FY 9-12 CPS Results Matrix

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
CPS Objective 1: Addressing Vulnerabilities	
Issues and Obstacles: • Sharp contraction of external demand, remittance and capital inflows, financing availability and deterioration in terms of trade. • The contraction in GDP over 2009-10 will lead to a rise in poverty. • Tax regime permits significant leakages and is non-neutral. • Financial intermediation still significantly below potential. • Access to health care hindered by high informal payments. HIV/AIDs and TB rates worrisome. Non-communicable disease incidence on the rise. • A sharper targeting for the family poverty benefit would raise efficiency of social protection. • Household and school heating solutions expensive, unsafe, with detrimental environmental and health impact. • Current municipal solid waste management system is economically, socially, and environmentally sub-optimal. • Agriculture productivity gains hindered by insufficient irrigation, input quality and marketing difficulties. Food safety and quality in agro-processing sector still weak. Crop and livestock productivity and preparedness to address livestock disease outbreaks and other veterinary emergencies need to be improved. • Absence of a modern fiscal regime and environmental standards in mining hampers revenue raising and development. • Rudimentary natural disaster preparedness at present, despite high vulnerability, with no use of insurance instruments.	
Results area 1: A post-crisis Armenia that regains macro-stability and is poised for high growth ***Outcome 1*: Macro stability maintained through appropriate external and domestic fiscal adjustment** *Indicator:* GDP growth, share of tradable sectors in GDP, fiscal deficit, inflation. Baseline: GDP contraction (-8%) in 2009, share of tradable in GDP = 60 percent, fiscal deficit (-6) % of GDP, inflation up to 5.5%. Target: positive GDP growth in 2011-2012, percentage share of tradable in GDP rises by 2012, inflation below 5 percent in 2012, fiscal deficit below 5 percent of GDP in 2012 ***Outcome 2*: Tax regime and administration reformed** *Indicator*: Tax/GDP ratio, Baseline: Tax/GDP=16.8% in 2008 Target: Tax/GDP =17% in 2012 ***Outcome 3:* Financial intermediation rises, with growth in SME credit lines to rise as a share of total credit**	**New loans**: DPL Series, SME line of Credit (FY09), new road, energy and water projects (noted below) **AAA:** Policy notes to address crisis. Economic report to address post-crisis growth. Public expenditure choices. Trade study to support EU-FTA. Banking diagnostics and policy advice paper. **IFC:** IFC financing and advisory services to banks and selective direct financing. BEE work improving the environment for the growth of the private sector. **Lending**: Access to Finance for Small and Medium Enterprises Project, FIEF 2 **Proposed:**, PFMCAP, DPO

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
Indicator: Helping SMEs withstand the crisis and position for recovery Baseline: SME sector employment as % of total employment is 41% in 2007; Target: SME sector employment as % of total employment is expected to reach 50% by 2012;	
Results area 2: Adverse poverty impact limited amidst assured health and social protection ***Outcome 1*: Income poverty impacts are muffled through employment generation from job-creating programs and through improved poverty targeting.** *Indicator*: Reduction in poverty. Baseline: Poverty headcount ratio – 24.9% of total population (2007). Target: A fall in poverty headcount by 2012 after a crisis-related rise in 2009-10. ***Outcome* 2: Increased utilization of basic health services by the poor, with a decline in out-of-pocket payments.** *Indicator*: Increased utilization of basic health services by the poor. Increase of NCD service volume at primary care level. Baseline: Access hindered by high informal payments. Non-communicable disease incidence rising Target: Greater use of primary care facilities, especially by the poor. Preventive measures taken on non communicable diseases. ***Outcome 3*: Urban households and schools employ safe gas-based heating** *Indicator*: Baseline: 96 schools with safe gas-based heating (2007); 45% of households in multi-apartment buildings have safe gas-based heating (2007). Target: At least 50% of households in multi-apartment buildings have safe gas-based heating (2012); the number of urban schools with safe gas-based heating is at least 104 (2012). *Outcome 4*: **Improvement of solid waste management service quality** *Indicator:* Baseline: Poor frequency of solid waste collection (2008) Target: Increased frequency of waste collection.	**Ongoing Loans**: ASIF, RESCAD, Social Assistance, Health APL, Urban Heating Project **New Loans:** ASIF-AF**,** Lifeline Roads, DPO series**,** **AAA**: Poverty Assessment **IFC:** Support for SME and microfinance development. Possible support for PPPs in heath or municipal services. **Ongoing/New:** Social assistance project DPO to strengthen poverty targeting and adequacy **AAA:** Programmatic Poverty Work **Ongoing:** Health Systems Projects (APL1&II), **AAA:** Health Financing study **On-going**: Urban Heating Project **On-going:** PPIAF Study on Solid Waste PPIAF grant to support PPP transaction advisory services. **AAA**: PPIAF for transaction advisory services for the PPP of Yerevan Municipal Solid

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
	Waste Management
Results area 3: Rural and environmental risks decrease	
***Outcome 1*: Area returned to irrigation rises as institutions for water management develop.** *Indicator*: Baseline: Irrigated area comprises 130,000 ha (2008). Target: Irrigated area increased to 134,000 ha (2011)	**On-going:** Dam Safety Project, Irrigation, Dam Safety II Project **Proposed:** Irrigation Project
***Outcome 2:* Rural output and employment is supported.** *Indicator*: Agricultural and food exports. Livestock disease prevalence. EU/Russia compliant food safety certification to producers and agro-processors. Baseline: Processed and high value agri-food exports are limited, high prevalence of livestock diseases. Target: Export opportunities improve for several agri-food products to EU, Russia and CIS countries; National comprehensive control program is being implemented for brucellosis and other zoonotic diseases.	**On-going:** ASIF, RESCAD, AIP Project **Proposed:** Agricultural Competitiveness Project **AAA:** Agricultural competitiveness study, Agri-food trade study
***Outcome 3:* International best practice compliant mining code under implementation.** *Indicator*: Baseline: Deficient mining code hindering efficient and transparent allocation of resources (2008) Target: Fiscally, environmentally and socially sound mining code adopted and enforced (2012)	
***Outcome 4:* Preparedness for handling natural disasters is developed.** *Indicator*: GoA develops a prioritized plan to retrofit at-risk key public facilities/buildings. Development of an institutional framework for establishment of catastrophe insurance facility. Baseline: Weak institutional framework for disaster risk management and duplication of responsibilities. Absence of a comprehensive disaster risk management strategy. Target: Institutional framework for disaster risk management strengthened. A comprehensive disaster risk management strategy developed.	**New Loans**: DPOs **IFC**: Existing portfolio in mining, with potentially new investments to follow. Possible investments in transport/logistics to benefit regions outside Yerevan. **Ongoing:** GFDRR grant " Armenia: Designing Sustainable Institutional Arrangements for Disaster Risk Management"

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
	Proposed: AAA on Disaster Risk Insurance; GFDRR grant on institutional strengthening
CPS Objective 2: Strengthening Competitiveness for Post-Crisis Growth	
Issues and Obstacles: • Conflict of interest pervasive in the public sector, distorting competition and business environment. Incentives for better performance of civil servants are weak. • Revenue-raising agency (customs, tax) particular source of discretionary behavior. "Behind the border" practices are not transparent and fall short of EU standards. • Judiciary not sufficiently rule-bound. • In public administration and expenditure management, lack of strategic planning, policy formulation and performance management capacity; public procurement outdated. Incentives for better performance of civil servants are weak. • Public financial decisions rely on command-oriented management and financial controls, and undeveloped audit systems. Complete and consolidated government financial statements absent. Fiduciary controls over Non Commercial Organizations are weak. • Low level of e-literacy, lack of ICT infrastructure and insufficient IT penetration in rural communities. Inadequate framework for private participation in infrastructure and utility services; inadequate spectrum management and monitoring framework in telecommunications; non-competitive civil aviation market. • Corporate financial reporting framework is weak, impeding development of corporate sector and attraction of investments. • Education: Access to preschool education is limited. Inadequate relevance of upper secondary education. Tertiary education is underfunded, non-competitive, accountability weak, inadequate financing schemes. • Energy: Strategy towards nuclear power plant lacking. Financing for generation needs unidentified. Price, tax and demand management policies for energy efficiency inexistent. Average age of transmission infrastructure is very high; electricity supply interruptions frequent. • Water: Quality is poor, supply unreliable, sewerage is deteriorated, ill-functioning treatment plants. Revenues below cost recovery outside Yerevan. Private sector participation has to be extended	
Results area 4: Strengthening governance with resulting rise in public sector efficiency ***Outcome 1*: Conflict of interest among public officials is substantially diminished; and fair competition in commerce is established. At least 60 percent of firms agree that implementation of laws is consistent and predictable.** Baseline: Conflict of interest pervasive in the public sector. Vested interests distort competition and business environment. Anti-corruption strategy weak and ineffective. Target: Sound progress towards elimination of ministerial, parliamentarian and civil	**Ongoing:** PSMP, JRP II **New loans**: DPL Series, E-govt project, PSMP II, PFMCAP **AAA**: Policy notes. TA to customs. Trade study to support EU-FTA. PEFA support. CFAA update. **IFC**: Advisory services on the business-enabling environment promoting a more transparent and competitive private sector.

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
servant involvement in business. Enforcement of corporate governance rules (see below). Competition Commission exercises new powers without hindrance; and certifies de-monopolization in key markets. ***Outcome 2*: Business surveys show near-elimination of complaints of revenue agency behavior.** Baseline: Revenue-agency related complaints a major black spot in governance.Revenue-raising agency (customs, tax) particular source of discretionary behavior. "Behind the border" practices are not transparent and fall short of EU standards. Target: Modern business processes providing for integration of information base and management across customs and tax. Reliance solely on risk-based management methods. Behind the border reforms as EU FTA is negotiated. Business surveys show near-elimination of complaints of revenue agency behavior. Self-assessment of taxes rises. Automatic green channel use in customs rises. Judicial Decision Database, Case Management and Recording Systems used in all rehabilitated courts. ***Outcome 3*: Program budgeting leads to efficient expenditure allocations; and civil service performance appraisal is introduced. Judicial decisions are rule-bound. Strengthened accountability, transparency and efficiency in the use of public funds.** Baseline: Judiciary not sufficiently rule-bound. In public administration and expenditure management, lack of strategic planning, policy formulation and performance management capacity; public procurement outdated. Incentives for better performance of civil servants are weak. Public financial decisions rely on command-oriented management and financial controls, and undeveloped audit systems. Complete and consolidated government financial statements absent. Fiduciary controls over NCOs are weak. Target: Use of precedent in judicial practice. Implementation of the new judicial code.	

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
Transition to program budgeting. A performance appraisal and performance based pay system is effective across the civil service. Phased implementation of e-procurement reforms. Government financial position and performance is reliably reported in the consolidated financial statements. Strengthened system of accountability and increased transparency and efficiency in the management of public funds. Amendments are made to the Law to incorporate program budgeting. 2011 budget is prepared in programmatic format. Performance appraisal introduced. Public e-tendering system operational. Public internal financial control and audit system based on EU model established. Accrual standards in line with IPSAS are adopted. The fiduciary control methodology is introduced for non-commercial entities.	
Results area 5: Strengthening knowledge and competitiveness ***Outcome 1*: In support of a knowledge-based economy with the necessary infrastructure, strategy being implemented for increased internet penetration, amidst the laying of a national ICT broadband backbone network.** *Indicator*: Increase computer and internet penetration. Build, equip & operate techno-parks, business incubators, and university-based Technology Transfer Centers. Baseline: home computer penetration - 25%; a) low share of e-services provided by state entities b) population internet penetration – 18%; c) absence of IFRS and ISAs supporting accounting and auditing methodologies d) IT workforce – 5000 Target: The expected level of improvement in the main indicators by 2012 is as follows: a) home computer penetration - 35%; b) increased share of e-services provided by state entities c) population internet penetration – 40%; d) introduction of IFRS and ISAs supporting accounting and auditing methodologies e) IT workforce – 10,000	**Ongoing:** PSMP, JRP II **Proposed** : E-society, innovation and competitiveness project, PSMP II, PFMCAP

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
Outcome 2: **PPP framework in operation. Commercially valuable spectrum available for private sector use; operational Universal Services Fund; and civil aviation fully liberalized.** *Indicator*: Baseline: Some of the commercially valuable spectrum still not available for private use (2008); Around 100,000 people without basic telephony services (2006); competition constraints in civil aviation (2008) Target: More commercially attractive spectrum available for private use (2012); access to basic telephony services improves (2012); fully liberal civil aviation regime (2012)	**On-going**: PPIAF for Design of Universal Services Fund for the Telecommunication Sector of Armenia **New Loans:** e-govt/ICT project (FY10), **AAA**: Strategy for building a knowledge economy; advisory note on regulation to support PPP, radio spectrum allocation and civil aviation reforms.
Outcome 3: **In transport management, road network is improved and analysis and regulatory capacities strengthened.** *Indicator*: Baseline: Some sections of the primary road and significant share of the secondary road network need rehabilitation (2008) Target: 100 km of secondary road network rehabilitated (2012); 150 km of primary road network rehabilitated (2012)	**New Loans:** Lifeline Roads Improvement Project (FY09), Additional Financing for Lifeline Roads Improvement Project (FY10); Further Road Projects (FY10-11), **AAA**: Construction standards, road maintenance strategy. PPIAF for feasibility study of rural road maintenance, **IFC**: Advisory work and possible investment support to PPP in infrastructure, health and climate investment.
Outcome 4: **In energy, financing for new renewable energy based generation capacity; improved energy efficiency and transmission losses reduced.** *Indicator*: Baseline: 134 MW installed capacity of renewable based generation (2008); transmission losses of 1.5% (2008); public buildings are energy inefficient (2008) Target: Increase in installed capacity of renewable based energy generation; Transmission losses below the baseline (2012); reduction of energy consumption of pubic buildings (2012)	**On-going**: Renewable Energy Project; GeoFund grant **IFC:** Financing for possible energy project, energy efficiency survey
Outcome 5: **In water, improved service reliability and water quality, greater operating efficiency. Closer alignment of service tariffs with costs.** *Indicator 1*: Share of consumers with continuous water supply rises in Yerevan and in AWSC service area. Baseline: In 2008 - share of consumers with continuous water supply in Yerevan is 75.5% (average daily duration in hours - 18.1 hour); and in AWSC service area is 50% (average daily duration - 12 hours). Target: In 2011 - share of consumers with continuous water supply in Yerevan increases to 82.5% and in AWSC service area to 70%. *Indicator 2*: In AWSC service area cost recovery improves.	**New Loans:** Energy Supply Reliability and Energy Efficiency Project (FY09-10), hydro/renewable energy project (FY11-12). **IFC:** Possible direct or indirect investment in renewable energy. Support for energy efficiency financing through banks. **On-going**: Yerevan Water and Wastewater Project, Municipal Water and Wastewater Project.

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
Target: The level of cost recovery in AWSC service area increases and the budget subsidies are phased out by 2012.	**New loan**: Additional Financing to Municipal Water and Wastewater Project **AAA:** Water and sanitation sector review. Urban study.
***Outcome 6*: A growing private sector faces more open competition and access to finance.** *Indicator 1*: Corporate transparency increases. Baseline: Corporate financial reporting framework is weak. SME lack relevant financial reporting standards to follow restricting access to finance. Target: The quality and public availability of full financial statements for public interest entities enhanced. Financial reporting standards for the SME are introduced and access to finance is improved.	**New Loans:** PFM project AAA: accounting and auditing ROSC update.
Indicator 2: Competition Commission's capacity is strengthened and access to finance for SMEs is maintained. Baseline: Competition Commission's enforcement capacity is weak. Legal framework needs to be strengthened. Access to finance is at risk. Target: Commission's enforcement capacity strengthened and legal framework improved. Re-intermediation with deposits to GDP rising. SME credit rises as a share of total bank credit.	DPL Series, SME line of Credit **IFC:** IFC financing and advisory services to banks and selected direct financing. BEE work improving the environment for private sector growth.
***Outcome 7*: In education, increase of net preschool (5 years old) enrollment rate. Tertiary education financing expands through higher education financing reform and introduction of competitive innovation fund and student loan scheme. The national Quality Assurance system in line with European Higher Education Area is fully functional.** *Indicator 1*: Better access to preschool education Baseline: only 31% of 5-years old are enrolled in preschool education services Target: established new public preschool classrooms in 70 communities increasing 5-years old enrollment up to 37% enrollment *Indicator2*: More equitable and effective higher education financing system is developed. Baseline: merit-based scholarships are the only public funds that support students in higher education Target: new student loan scheme is designed and piloted to support needy-students; merit-based scholarships are partly replaced with need-based scholarships Baseline: no public funds provided for tertiary education institutions for quality improvement and innovation. Target: competitive innovation funds are developed. *Indicator3*: The national Quality Assurance system is in line with European Higher Education Area.	**On-going:** FY09, Education Quality and Relevance Project, APL1 **New:** Education Quality and Relevance Project, APLII **IFC**: Support on student loan scheme

END-FY12 CPS RESULTS AREAS AND OUTCOMES	WORLD BANK GROUP PROGRAM
Baseline: The National Quality Assurance Agency is just established; Target: The National Quality Assurance Agency is fully functional in line with the requirements of the European Higher Education Area; Internal Quality Assurance units in all public universities are established and are functioning in accordance with the national QA standards.	

Annex 3: Public Consultations on the CPS

The public consultations held in Yerevan reviewed the directions of the proposed Country Partnership Strategy for Armenia, as well as specific programs. Bank staff met with representatives of NGOs, academia, professional associations, think-tanks, private/banking sector representatives, and the media. Background presentations were delivered to initiate public feedback and comments. The main issues discussed are as follows:

Progress of Reforms. The pace and scope of reforms was a recurrent issue in the consultations. Participants noticed that reforms could have been more visible, while there is a growing public demand for higher public sector efficiency. Despite the crisis, stronger commitment and political will are required to make real changes. Moreover, the level of public participation in the planning stage of reforms and the actual decision making is deemed insufficient.

Governance and Anti Corruption. Improving governance and reducing corruption is a challenge for Armenia's development agenda and perceived by most participants as a key precondition for high and sustained growth. The Bank's role is seen as decisive in helping raise the efficiency of judiciary and enforcing existing regulations. Enforcing laws on management of conflict of interest situations involving public officials is seen as particularly important for promoting a competitive business environment. Participants proposed bigger involvement of the Bank in the Government's anti-corruption strategy.

Competitiveness. The participants unanimously agreed with the focus of the CPS on boosting the economy's competitiveness. The Bank's role in providing further advice and assistance through structural reforms to improve the investment climate and promote competitiveness is rated as prominent.

E-society. Private sector representatives stressed the importance of investments that promote the high-tech sector and the knowledge-based economy, in order to take advantage of the country's human potential. This could open new horizons for the younger generation among which the emigration tendencies are still high.

Local Self-Governance. The Bank was also recommended to intensify its work with local governments, which are seen as effective counterparts in some areas. Further decentralization of government functions could lead to more inclusive governance and support economic development in rural areas, where the poverty rates are still high.

Agriculture. Participants mentioned the need for promotion of lower-cost lending instruments for farmers. The lack of proper access to financing is seen as an obstacle for the rural economy as a whole, and a condition for boosting export of agricultural products. The Bank's continuous involvement in rural infrastructure improvement, including in irrigation, is seen as key for the development of the sector.

Environment. The participants are concerned with the excessive use of natural resources in the country and the lack of proper capacity for environmental impact assessments. They would like to see continuous emphasis on environmental protection in the Bank's CPS, linking it to improvement in the quality of people's lives.

Media Freedom. The participants see insufficient media freedom in the country, which could slow progress towards better accountability at all levels of governance and the eradication of corruption.

Armenia's performance has slightly worsened according to the Governance Indicators, especially in terms of Voice and Accountability index.

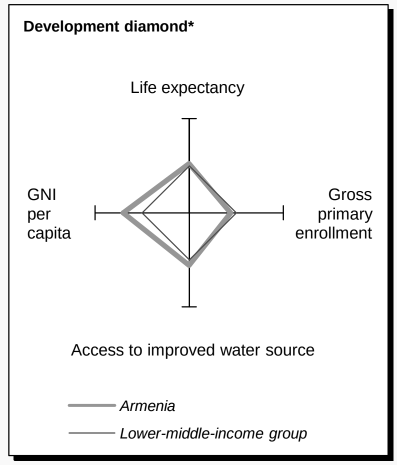
Monitoring and participation. Civil society representatives expressed their readiness to take a bigger role in monitoring and supporting the implementation of the Bank's activities in Armenia. Greater civil society participation could help the Bank better assess the effectiveness of project implementation and mitigate risks of corruption.

Annex 4: Country at a Glance

Armenia at a glance

9/24/08

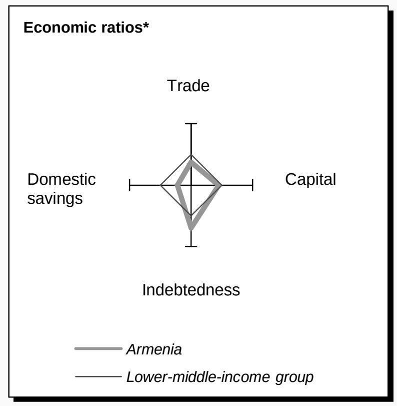
POVERTY and SOCIAL	Armenia	Europe & Central Asia	Lower-middle-income
2007			
Population, mid-year *(millions)*	3.0	445	3,437
GNI per capita *(Atlas method, US$)*	2,640	6,052	1,887
GNI *(Atlas method, US$ billions)*	7.9	2,694	6,485
Average annual growth, 2001-07			
Population *(%)*	-0.4	0.0	1.1
Labor force *(%)*	-0.3	0.5	1.5
Most recent estimate (latest year available, 2001-07)			
Poverty *(% of population below national poverty line)*	51	..	..
Urban population *(% of total population)*	64	64	42
Life expectancy at birth *(years)*	72	69	69
Infant mortality *(per 1,000 live births)*	21	23	41
Child malnutrition *(% of children under 5)*	4	..	25
Access to an improved water source *(% of population)*	98	95	88
Literacy *(% of population age 15+)*	99	97	89
Gross primary enrollment *(% of school-age population)*	98	97	111
Male	96	98	112
Female	100	96	109



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

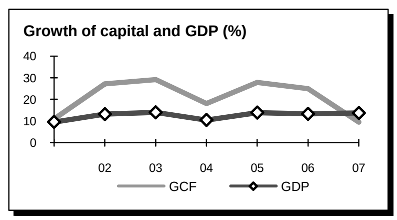
	1987	1997	2006	2007
GDP *(US$ billions)*	..	1.6	6.4	9.2
Gross capital formation/GDP	..	19.1	33.6	31.7
Exports of goods and services/GDP	..	20.3	22.0	19.0
Gross domestic savings/GDP	..	-18.9	19.2	16.9
Gross national savings/GDP	..	0.3	31.6	29.1
Current account balance/GDP	..	-18.7	-3.8	18.7
Interest payments/GDP	..	0.8	0.3	..
Total debt/GDP	..	38.9	32.5	..
Total debt service/exports	..	5.1	7.0	..
Present value of debt/GDP	..	..	23.0	..
Present value of debt/exports	..	..	61.9	..

	1987-97	1997-07	2006	2007	2007-11
(average annual growth)					
GDP	-6.9	10.7	13.3	13.7	7.6
GDP per capita	-5.1	11.2	13.6	14.0	7.6
Exports of goods and services	-28.4	16.5	-4.3	9.1	13.3

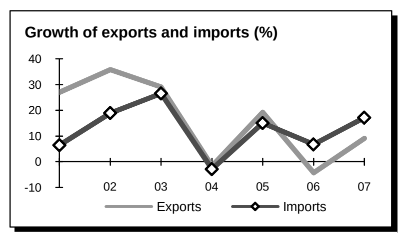


STRUCTURE of the ECONOMY

	1987	1997	2006	2007
(% of GDP)				
Agriculture	..	32.0	19.6	18.3
Industry	..	33.2	43.6	43.6
Manufacturing	..	24.4	16.8	15.1
Services	..	34.8	36.8	38.1
Household final consumption expenditure	..	107.7	69.5	73.8
General gov't final consumption expenditure	..	11.2	11.3	9.2
Imports of goods and services	..	58.3	36.5	33.8



	1987-97	1997-07	2006	2007
(average annual growth)				
Agriculture	-1.3	6.2	0.4	2.5
Industry	-15.9	13.7	18.5	11.8
Manufacturing	-8.9	6.5	-1.1	3.0
Services	7.3	11.7	19.4	24.3
Household final consumption expenditure	-3.9	6.8	14.1	16.4
General gov't final consumption expenditure	-2.0	8.7	19.8	17.4
Gross capital formation	-9.8	17.8	25.0	9.6
Imports of goods and services	-19.8	9.6	6.7	17.1



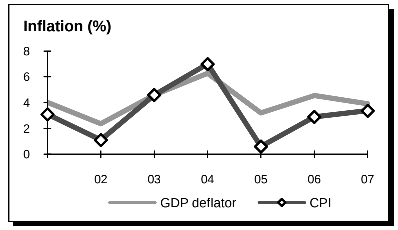
Note: 2007 data are preliminary estimates.

This table was produced from the Development Economics LDB database.

* 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.

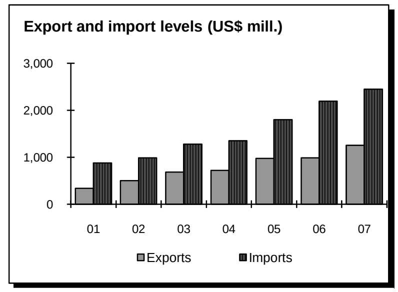
PRICES and GOVERNMENT FINANCE

	1987	1997	2006	2007
Domestic prices				
(% change)				
Consumer prices	..	14.0	2.9	3.4
Implicit GDP deflator	..	17.7	4.6	3.9
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	19.7	16.0	18.3
Current budget balance	..	-1.7	2.6	2.4
Overall surplus/deficit	..	-5.8	-1.5	-2.0



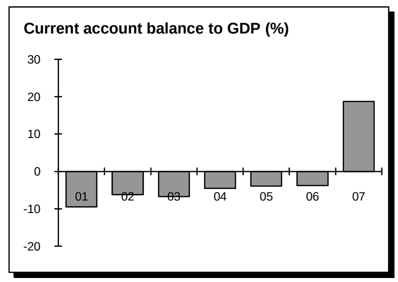
TRADE

	1987	1997	2006	2007
(US$ millions)				
Total exports (fob)	..	232	985	1,253
Gold, jewelry, and other precious stones	..	55	301	..
Machinery and mechanical equipment	..	32	21	..
Manufactures	..	100	310	349
Total imports (cif)	..	892	2,192	2,449
Food	..	273	341	..
Fuel and energy	..	208	351	..
Capital goods	..	118	501	647
Export price index *(2000=100)*	..	..	104	116
Import price index *(2000=100)*	..	..	122	135
Terms of trade *(2000=100)*	..	..	85	86



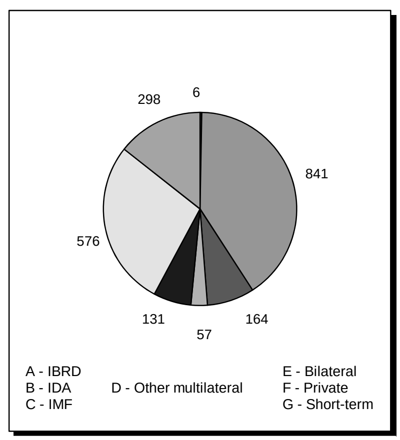
BALANCE of PAYMENTS

	1987	1997	2006	2007
(US$ millions)				
Exports of goods and services	..	330	1,407	1,708
Imports of goods and services	..	953	2,328	3,032
Resource balance	..	-622	-921	792
Net income	..	99	99	104
Net current transfers	..	217	580	822
Current account balance	..	-307	-242	1,719
Financing items (net)	..	354	614	-1,413
Changes in net reserves	..	-47	-372	-306
Memo:				
Reserves including gold *(US$ millions)*	..	239	1,072	1,365
Conversion rate *(DEC, local/US$)*	..	490.6	416.0	342.1



EXTERNAL DEBT and RESOURCE FLOWS

	1987	1997	2006	2007
(US$ millions)				
Total debt outstanding and disbursed	..	638	2,073	..
IBRD	..	10	6	5
IDA	..	240	841	965
Total debt service	..	24	167	..
IBRD	..	1	1	1
IDA	..	1	13	14
Composition of net resource flows				
Official grants	..	34	56	..
Official creditors	..	100	66	..
Private creditors	..	0	108	..
Foreign direct investment (net inflows)	..	52	343	..
Portfolio equity (net inflows)	..	1	-1	..
World Bank program				
Commitments	..	107	57	96
Disbursements	..	77	64	93
Principal repayments	..	0	7	8
Net flows	..	77	57	85
Interest payments	..	2	7	7
Net transfers	..	76	50	78



Note: This table was produced from the Development Economics LDB database. 9/24/08

Armenia
Annex B2: Selected Indicators* of Bank Portfolio Performance and Management
As Of Date
03/09/2009

Indicator	**2006**	**2007**	**2008**	**2009**
Portfolio Assessment				
Number of Projects Under Implementation [a]	18	17	17	19
Average Implementation Period (years) [b]	3.4	3.2	4.3	3.8
Percent of Problem Projects by Number [a, c]	0.0	0.0	5.9	0.0
Percent of Problem Projects by Amount [a, c]	0.0	0.0	3.5	0.0
Percent of Projects at Risk by Number [a, d]	0.0	0.0	5.9	0.0
Percent of Projects at Risk by Amount [a, d]	0.0	0.0	3.5	0.0
Disbursement Ratio (%) [e]	24.7	36.2	34.4	35.3
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	26	9
Proj Eval by OED by Amt (US$ millions)	676.2	157.5
% of OED Projects Rated U or HU by Number	7.7	0.0
% of OED Projects Rated U or HU by Amt	10.9	0.0

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 B3: IBRD/IDA Program Summary – Armenia

Proposed IBRD/IDA Base-Case Lending Program

Fiscal Year	Project ID	US$ (million)
2009	ASIF AF	8.0
	RESCAD AF	2.0
	SME Line of Credit	50.0
	Water AF	20.0
	Lifeline Roads	25.0
	Education Quality & Revelance	25.0
2010	ASIF AF	7.0
	Social Assistance AF	5.0
	Irrigation	30.0
	Rural Roads	36.0
	DPC-1	60.0
	Roads 1	43.0
	E-Armenia (incl. Ed. Innovation Fund)	24.0
	Public Sector Management	9.0
2011/12	Agriculture	14.0
	DPC 2	25.0
	DPC 3	10.0
	Roads 2	68.0
	Public Financial management	8.0
	Energy Efficiency & Transmission	76.0

Armenia: IFC Investment Operations Program

Commitments (US$,M)

	2006	2007	2008	2009*
Gross	8.2	3.3	25.8	39.87
Net**	8.2	3.3	25.5	36.87

Net Commitments by Sector (%)

	2006	2007	2008	2009*
CAG				
CGM	63.0			12.0
CHE				
CGF	37.0	100.0	98.5	87.0
CFN				
CIN				
CIT				
COC			1.5	1.0
CSF				

Net Commitments by Investment Instrument (%)

	2006	2007	2008	2009*
Equity		39.4	39.4	32.0
Guarantee			1.5	2.0
Loan	100.0	60.6	59.1	66.0

* As of March 31, 2009

** IFC's Own Account only

Annex B4: Summary of Non lending Services - Armenia

As Of Date
03/09/2009

Product	*Status in FY*	*Cost (US$000)*	*Audience*[a]	*Objective*[b]
Recent completions				
Rural Infrastructure Strategy	FY06	125	G,D	K,PS
Poverty Assessment (programmatic)	Annual	100pa	G,D	K,PS
Public Expend. Review (programmatic)	Annual			
Treasury Pilot (IDF Grant)	FY05/06	50	G	K,PS
Labor Market Dynamics	FY07	70	G,D,B, PD	K,PS, PD
"The Caucasian Tiger"(Econ. Report)	FY07	250	G,D, B, PD	K, PS, PD
PPIAF on Railways Restructuring	FY07	350	G, PD	K, PS
Policy Notes for new government	FY08-09	300	G,D,B,PD	K,PS,PD
Underway/Planned				
Poverty Assessment (programmatic)	annual	100pa	G,D,B,PD	K,PS
Public Expend. Review (programmatic)	annual	150pa	G,D,B	K,PS
Country Environmental Study	FY08	175	G,D,B,PD	K,PS,PD
PPIAF on railway concessioning	FY07-08	450	G	K,PS
CPAR/CFAA Update	FY08	100	G,D,B,PD	K,PS,PD
Public Procurement (IDF)	FY07/FY08	45	G	K,PS
TA for Statistical Capacity Building	FY06/07/08	45	G	K,PS
Financial Sector	annual	100	G,D,B,	K,PS
CEM	FY11	250	G,D,B,PD	K,PS,PD
Energy Sector	FY11	100	G,D,B,PD	K,PS
Natural Disaster	FY11	100	G,D,B,PD	K,PS
Health Financing	FY12	150	G,D,B,PD	K,PS,PD
CFAA	FY12	150	G,D,B,PD	K,PS,PD
Social Protection/Pension	FY12	150	G,D,B,PD	K,PS,PD

a. Government, donor, Bank, public dissemination.
b. Knowledge generation, public debate, problem-solving.

Annex B5: Armenia – Key Exposure Indicators

Update from LDB

Armenia - Key Exposure Indicators

Indicator	Actual			Estimated			Projected		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total debt outstanding and disbursed (TDO) (US$m)[a]	1877	1858	2010	2910	3309	4003	4624	5103	5376
Net disbursements (US$m)[a]	54	-18	221	823	387	557	513	381	140
Total debt service (TDS) (US$m)[a]	175	138	148	173	208	229	274	388	537
Debt and debt service indicators (%)									
TDO/XGS[b]	99.2	78.7	72.2	85.0	90.3	137.2	156.0	156.9	147.1
TDO/GDP	52.5	37.9	31.5	31.6	27.7	44.3	52.2	56.8	58.1
TDS/XGS	9.3	5.9	5.3	5.0	5.7	7.8	9.2	11.9	14.7
Concessional/TDO	..	..	..	..	..	..	..	..	0.0
IBRD exposure indicators (%)									
IBRD DS/public DS	1.0	1.6	1.7	2.2	2.1	4.3	9.1	13.4	16.7
Preferred creditor DS/public DS (%)[c]	61.3	90.4	94.1	93.1	91.8	85.7	82.8	86.1	86.7
IBRD DS/XGS	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.4
IBRD TDO (US$m)[d]	7	7	6	5	5	19	72	143	200
Of which present value of guarantees (US$m)									
Share of IBRD portfolio (%)	0	0	0	0	0	0	0	0	0
IDA TDO (US$m)[d]	776	744	843	973	1019	1153	1212	1244	1258
IFC (US$m)									
Loans									
Equity and quasi-equity /c									
MIGA									
MIGA guarantees (US$m)									

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 B6: Armenia - Key Economic Indicators

Indicator	Actual			Estimate			Projected		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
National accounts (as % of GDP)									
Gross domestic product[a]	100	100	100	100	100	100	100	100	100
Agriculture	25	21	20	20	19	19	19	19	19
Industry	38	45	45	44	46	44	45	46	47
Services	37	34	35	36	35	37	36	35	34
Total Consumption	90	84	80	83	88	92	93	91	89
Gross domestic fixed investment	24	30	36	36	37	33	32	32	33
Government investment	4	4	5	5	5	4	5	5	5
Private investment	20	26	31	31	33	29	27	27	28
Exports (GNFS)[b]	27	29	23	19	14	14	15	17	19
Imports (GNFS)	42	43	39	39	39	40	40	41	42
Gross domestic savings	10	16	20	17	12	8	7	9	11
Gross national savings[c]	25	29	34	31	25	20	18	20	23
Memorandum items									
Gross domestic product (US$ million at current prices)	3577	4900	6384	9204	11929	9033	8853	8985	9255
GNI per capita (US$, Atlas method)	1160	1500	1960	2640	3370	3370	3290	3150	3260
Real annual growth rates (%, calculated from 96 prices)									
Gross domestic product at market prices	10.5	13.9	13.2	13.8	6.8	-8.0	-2.0	1.5	3.0
Gross Domestic Income	10.5	13.5	13.3	12.9	5.1	-7.0	-1.5	1.6	3.1
Real annual per capita growth rates (%, calculated from 96 prices)									
Gross domestic product at market prices	10.9	14.2	13.5	14.1	7.1	-7.7	-1.7	1.6	3.0
Total consumption	5.4	8.7	9.1	17.7	11.9	-3.5	-1.0	-0.2	0.7
Private consumption	4.9	7.6	8.6	18.0	12.4	-3.6	-1.0	-0.5	0.4
Balance of Payments (US$ millions)									
Exports (GNFS)[b]	1071	1416	1510	1777	1665	1279	1353	1525	1747
Merchandise FOB	738	1005	1025	1197	1100	837	897	1006	1143
Imports (GNFS)[b]	1628	2124	2536	3589	4702	3595	3577	3702	3882
Merchandise FOB	1196	1593	1921	2797	3753	2843	2822	2922	3066
Resource balance	-557	-708	-1026	-1813	-3038	-2315	-2224	-2177	-2135
Net current transfers	430	524	694	945	1104	834	794	824	888
Current account balance	-20	-52	-117	-589	-1548	-1230	-1222	-1133	-996
Net private foreign direct investment	246	233	450	701	709	510	640	770	835
Long-term loans (net)	45	79	85	390	407	567	517	380	138
Official	44	36	69	181	170	260	257	160	95
Private	1	43	16	209	237	308	260	220	43
Other capital (net, incl. errors & ommissions)	-239	-72	-30	58	199	-356	104	189	207
Change in reserves[d]	-33	-188	-388	-560	233	508	-39	-206	-184
Memorandum items									
Resource balance (% of GDP)	-15.6	-14.4	-16.1	-19.7	-25.5	-25.6	-25.1	-24.2	-23.1
Real annual growth rates (YR96 prices)									
Merchandise exports (FOB)	5.9	29.1	1.5	14.7	-16.5	-18.1	-0.3	7.3	8.7
Primary	-1.1	8.6	9.2	4.9	-24.4	-33.0	-3.5	12.5	15.0
Manufactures	36.2	93.1	-12.0	35.9	-2.2	2.4	2.6	2.8	2.9
Merchandise imports (CIF)	12.0	37.7	29.5	50.2	8.1	-14.8	-4.3	0.5	1.9

(Continued)

Armenia - Key Economic Indicators

(Continued)

Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012
		Actual			Estimate		Projected		
Public finance (as % of GDP at market[e] prices)									
Current revenues	15.4	16.2	16.0	21.0	20.9	22.0	22.5	22.8	22.8
Current expenditures	13.8	14.7	13.4	15.8	17.0	17.8	17.9	18.0	18.0
Current account surplus (+) or deficit (-)	1.6	1.5	2.6	5.2	3.8	4.1	4.6	4.8	4.8
Capital expenditure	3.7	3.9	4.7	7.0	5.8	5.1	6.2	6.4	6.4
Foreign financing	2.2	1.0	1.4	2.5	1.8	3.1	3.0	2.0	1.2
Monetary indicators									
M2/GDP	15.0	16.3	18.3	22.0	19.8	20.4	20.8	21.7	22.2
Growth of M2 (%)	22.3	27.8	32.9	42.3	4.3	1.7	5.0	10.1	9.5
Private sector credit growth / total credit growth (%)	109.4	66.6	309.4	108.3	56.4	89.5	57.2	119.1	160.6
Price indices(YR96 =100)									
Merchandise export price index	92.5	96.5	96.2	98.1	112.0	104.1	111.9	117.0	122.3
Merchandise import price index	90.3	87.5	82.2	81.6	86.6	77.0	79.9	82.2	84.7
Merchandise terms of trade index	102.4	110.4	117.0	120.2	129.3	135.3	140.2	142.3	144.4
Real exchange rate (US$/LCU)[f]	87.2	97.5	106.3	122.6	144.4	..	..	..	..
Real interest rates									
Consumer price index (% change)	7.0	0.6	2.9	4.4	10.6	7.2	5.2	4.2	4.1
GDP deflator (% change)	6.3	3.2	4.6	4.2	8.5	7.0	5.0	4.0	4.0

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 B7: Armenia Social Indicators

	Latest single year			Same region/income group	
	1980-85	1990-95	2001-07	Europe & Central Asia	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	3.3	3.2	3.0	445.1	3,437.1
Growth rate (% annual average for period)	1.5	-1.9	-0.4	0.0	1.1
Urban population (% of population)	67.1	66.3	63.9	63.6	41.7
Total fertility rate (births per woman)	2.5	2.0	1.3	1.6	2.3
POVERTY					
(% of population)					
National headcount index	..	..	25 %	..	..
Urban headcount index	..	..	24.7%	..	..
Rural headcount index	..	..	25.5%	..	..
INCOME					
GNI per capita (US$)	..	450	2,640	6,051	1,887
Consumer price index (2000=100)	..	68	126	159	144
Food price index (2000=100)	..	85	114	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Share of income or consumption					
Gini index	..	..	28.8	..	..
Lowest quintile (% of income or consumption)		..	12.7%	..	..
Highest quintile (% of income or consumption)		..	51.0%	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	1.8	4.1	2.0
Education (% of GDP)	..	..	3.2	4.6	4.7
Social security and welfare (% of GDP)	..	..	..	0.0	0.0

Social Indicators (Continued)

Net primary school enrollment rate					
(% of age group)					
Total	..	..	82	91	90
Male	..	..	80	92	91
Female	..	..	84	90	89
Access to an improved water source					
(% of population)					
Total	..	91	98	95	88
Urban	..	99	99	99	96
Rural	..	75	96	88	82
Immunization rate					
(% of children ages 12-23 months)					
Measles	..	96	92	97	77
DPT	..	98	87	95	75
Child malnutrition (% under 5 years)	..	..	4	..	25
Life expectancy at birth					
(years)					
Total	69	70	72	69	69
Male	67	66	68	64	67
Female	72	73	75	74	70
Mortality					
Infant (per 1,000 live births)	54	41	21	23	41
Under 5 (per 1,000)	65	48	24	26	54
Adult (15-59)					
Male (per 1,000 population)	158	216	197	299	202
Female (per 1,000 population)	85	119	88	123	128
Maternal (modeled, per 100,000 live births)		..	76	44	300
Births attended by skilled health staff (%)		..	98	95	69

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 or at any time before the survey.

World Development Indicators database, World Bank - 10 September 2008, Bank staff estimates.

Annex B8: Operations Portfolio (IBRD/IDA and Grants

Armenia

Operations Portfolio (IBRD/IDA and Grants)

As Of Date 03/09/2009

Closed Projects **31**

IBRD/IDA *	
Total Disbursed (Active)	208.62
of which has been repaid	0.00
Total Disbursed (Closed)	775.34
of which has been repaid	35.55
Total Disbursed (Active + Closed)	983.95
of which has been repaid	35.55
Total Undisbursed (Active)	175.19
Total Undisbursed (Closed)	0.45
Total Undisbursed (Active + Closed)	175.64

Active Projects

		Last PSR Supervision Rating			Original Amount in US$ Millions					Difference Between Expected and Actual Disbursements [a/]	
Project ID	**Project Name**	**Development Objectives**	**Implementation Progress**	**Fiscal Year**	**IBRD**	**IDA**	**GRANT**	**Cancel.**	**Undisb.**	**Orig.**	**Frm Rev'd**
P099630	Judicial Reform Project 2	S	MS	2007		22.5			14.37184	-4.827297	
P083352	RENEW ENERGY	S	S	2006		5			1.153829	-0.221964	
P099832	AVIAN FLU - AM	S	S	2006		6.25			3.081369	2.6416103	
P115109	Access to Finance for SME	#	#	2009	50				50		
P074503	EDUC QUAL & RELEVANC	S	S	2004		19			2.419709	1.4615408	-2.82851
P114409	GEOFUND 2: Armenia Ge	#	#	2009			1.5				
P073974	HEALTH SYS MOD (APL #	S	S	2004		19			3.040814	2.5344682	2.34145
P104467	HLTH SYS MOD (APL2)	S	S	2007		22			19.61929	8.3990906	
P064879	IRRIG DAM SAFETY	S	S	1999		26.6			2.361129	1.6874945	1.777495
P088499	IRRIG DAM SAFETY 2	S	S	2004		6.75			1.857243	1.4779912	
P055022	IRRIG DEVT	S	S	2002		29.9			0.391489	-8.00753	-4.37677
P115486	LIFELINE ROADS IMPROV	#	#	2009		25			23.71047		
P063398	MUN WATER & WW	S	S	2004		43			19.17004	-0.422124	
P060786	PUB SECT MOD	MS	S	2004		10.15			2.034268	1.8057909	
P090058	RENEW ENERGY (GEF)	S	S	2006			3		1.40002	0.7500203	
P087011	RUR ENT & AGRIC DEVT	S	S	2006		22			3.836622	-2.566236	
P094225	SIF 3	S	S	2007		33			13.81323	-5.608109	
P087620	SOC PROT ADMIN	S	S	2004		5.15			0.482812	0.1208398	0.12084
P057880	URBAN HEAT	S	S	2006		15			2.775845	0.3693034	
P087641	YEREVAN WATER/WW SE	S	S	2005		20			11.06922	11.628017	
Overall Result					50	330.3	4.5		176.5892	11.222907	-2.9655

Armenia
Committed and Disbursed Outstanding Investment Portfolio
As of 3/31/2009
(in USD millions)

		Committed					Disbursed & Outstanding				
Commitment FY	**Institution**	**Loan**	**Equity**	****Quasi equity**	***GT/RM**	**Participant**	**Loan**	**Equity**	****Quasi-equity**	***GT/RM**	**Participant**
2003	ACBA Leasing	0.33	0	0	0	0	0.33	0	0	0	0
2008	ASHIB	15.00	7.80	0	0	0	15.00	7.80	0	0	0
2004/2007/2008/2009	Armeconombank	1.63	0	0	0.68	0	1.63	0	0	0.68	0
2001/2004	Hotel Armenia	0	0	2.31	0	0	0	0	2.31	0	0
2006/2007/2009	Inecobank	5.25	1.30	0	0	0	5.25	1.30	0	0	0
2006	NAREK	5.20	0	0	0	0	2.20	0	0	0	0
2009	Lydian Intl	0	0.40	0	0	0	0	0.40	0	0	0
Total Portfolio		**27.42**	**9.50**	**2.31**	**0.68**	**0**	**24.42**	**9.50**	**2.31**	**0.68**	**0**

*Denotes guarantee and risk management products.
**Quasi Equity includes both loan and equity types.

SEPTEMBER 2004

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