

**FOR
AGENDA**

EBD/08/106

November 3, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Armenia—Second Poverty Reduction Strategy Paper**

Attached for consideration by the Executive Directors is the second poverty reduction strategy paper prepared by the government of the Republic of Armenia. This paper and the associated joint staff advisory note (EBD/08/105, 11/3/08), together with the paper on the staff report for the 2008 Article IV consultation and request for a three-year arrangement under the Poverty Reduction and Growth Facility (EBS/08/116, 11/3/08), are tentatively scheduled for discussion on **Monday, November 17, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of the Republic of Armenia indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Ms. Castello Branco (ext. 38577), Mr. Bonato (ext. 36712), and Mr. Floerkemeier (ext. 38322) in MCD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, November 11, 2008; and to the European Bank for Reconstruction and Development, the European Commission, the Food and Agriculture Organization, the Organisation for Economic Cooperation and Development, and the United Nations Development Programme, following its consideration by the Executive Board.

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REPUBLIC OF ARMENIA

SUSTAINABLE DEVELOPMENT PROGRAM

Yerevan
October 2008

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- (ii) Members of the PRSP Working Group headed by the Deputy Minister of Finance Souren Karayan (Head of the PRSP Working Group)
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Government of the Republic of Armenia

LIST OF ABBREVIATIONS

AIDS	Acquired Immunodeficiency Syndrome
bln.	Billion
CBA	Central Bank of Armenia
CIS	Commonwealth of Independent States
CPI	Consumption Price Index
DFID	Department for International Development
EBRD	European bank for Reconstruction and Development
ECA	Europe and Central Asia
ENP	European Neighborhood Policy
EU	European Union
GDP	Gross Domestic Product
GFS	Government Financial Statistics
HDI	Human Development Index
HIV	Human Immunodeficiency Virus
ILO	International Labor Organization
ISLC	Integrated Survey Labor Conditions
IMF	International Monetary Fund
km	Kilometer
LFS	Labor Force Survey
MCA	Millennium Challenge Account
MDG	Millennium Development Goals
MTEF	Midterm Expenditure Framework
mln.	Million
MCB	Minimal consumption basket
NGO	Non Governmental Organization
NPV	Net Present Value

NSS	National Statistical Service
OECD	Organization for
PPP	Purchasing Power Parity
SDP	Sustainable Development Program
PRSP	Poverty Reduction Strategy Paper
RA	Republic of Armenia
SME	Small Medium Entrepreneurship
SPA	Social Partnership Agreement
UNDP	United Nations Development Program
UN	United Nations
USA	United States of America
USAID	United States Agency for International Development
USSR	Union of Soviet Socialist Republics
VAT	Value Added Tax
WB	World bank
WHO	World Health Organization

Participatory Process in the PRSP Review

Establishment of partnership in the PRSP implementation process

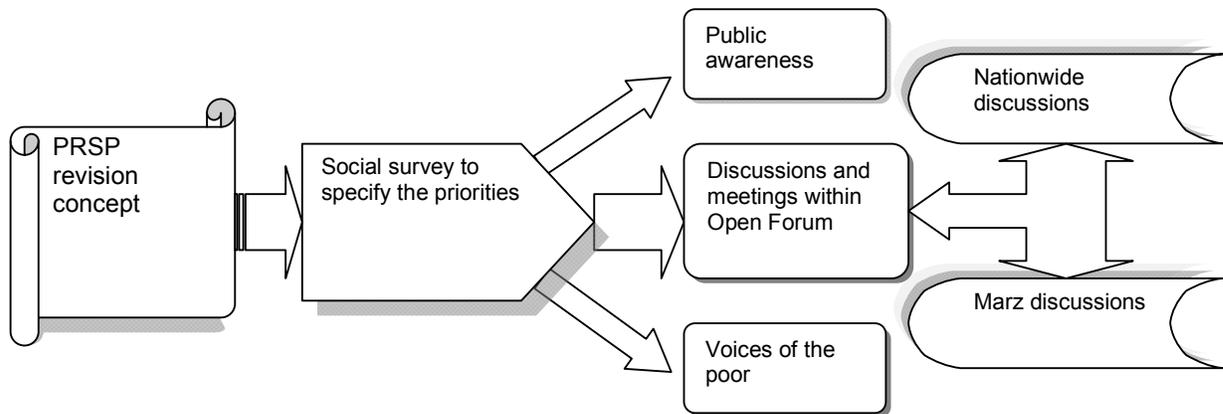
1. The objectives and mechanisms to ensure the public participation and partnership in PRSP development, implementation and monitoring process after PRSP approval were established by PRSP implementation partnership agreement signed on October 30, 2004. The agreement stipulated the key objectives of the partnership; the rights and obligations of the parties, as well as institutional entities ensuring the partnership – Steering Committee, Working Group and Open Forum. The parties to the agreement are: RA Government, communities, Armenian Apostolic Church, trade unions, Union of Manufacturers and Businessmen and five groups of NGOs. The agreement has been signed for a period of three years and its validity period expired in 2007.
2. According to the agreement parties, there has been a considerable progress in perceiving each other's position more clearly and even agreeing upon the standpoints. Within the scope of PRSP implementation process an efficient dialogue between various parties representing the public has launched and has deepened the confidence between the Government and the public.
3. At the same time there are still big opportunities for further development of the partnership and its improvement. The issues addressed both during the working group sessions and a series of discussions organized with that purpose come to prove it.
4. In particular, the public participation and partnership experience gained within the Armenian PRSP framework and the challenges of that process were summarized during the discussions that took place on July 12-13, 2007. The results of surveys conducted by independent experts were also presented. The coalitions and parties represented in the RA National Assembly took active participation. The representatives of all factions and parties of the National Assembly actively participated in the meeting.
5. Based on the results of the discussion, the further steps for developing the social partnership were identified and a responsible expert group was formed during the Working group session that took place on September 14, 2007. In the result of the activities of the expert group the PRSP Social Partnership Concept and The PRSP Social Partnership Agreement draft. The latter were also presented for wide public discussion and the Social Partnership Agreement with relevant amendments have been approved by the PRSP Working Group and PRSP Steering Committee.

The description and purpose of PRSP review participatory process

6. According to the “Poverty Reduction Strategy Paper (PRSP)” approved by the RA Government on August 8, 2003 (decree No 994-N), the program document shall be revised once in two years – based on the results of monitoring and evaluation of PRSP indicators and measures, as well as taking into account the recommendations submitted by all concerned parties in regard to the process improvement.

7. PRSP revision process has been launched in 2006 and the principles for its organization and implementation have been approved on May 19, 2006 at the session of PRSP Steering Committee. Thus, the key objective of PRSP revision participatory process was to endure the real and targeted participation of the public so that the recommendations and approaches of the public are at best reflected in the revised PRSP.

8. The mechanisms to ensure the PRSP revision participatory process are presented below:



They have also stipulated the following conceptual approaches in regard to organizing the participatory process:

- PRSP revision process should be anchored on the “bottom-up” principle, i.e. the revision process shall be launched from the bottom – the society – up to the decision makers in the Government;
- The entities responsible for PRSP revision shall maximum support the participatory process – to ensure the necessary environment for discussions and negotiations between the civil society and public governance bodies;
- In PRSP revision process, one should focus on how to institutionalize the PRSP monitoring and evaluation system – taking into account the capacity building of governmental and non-governmental organizations.

9. Thus one can state that the PRSP revision process that lasted about 2 years has been implemented by ensuring broad participatory process. All the stakeholders of the Armenian society have been actively engaged in it.

Social surveys

10. Based on the fact that within the past few years Armenia has developed and continues to implement a Poverty Reduction Strategy Paper, with numerous institutions, organizations and individuals engaged in developing, implementing and supervising the process, as well as taking into account that today the program needs to be revised and rectified, a social survey has been conducted to identify PRSP revision priorities. The survey was aimed at identifying the PRSP revision priorities from the

viewpoint of developing, implementing and supervising parties. . There were 207 active participants of the process included in the survey

11. The objective of this survey was to get classified range of the PRSP revision priorities. In this regard, according to the answers “Business and investment environment” occupies the 1st place, with 18% received from the respondents. “Public governance” and “Health” sectors – rated as No 1 by 15% of respondents, share the second place. The third and fourth places occupy “Pension security” (14%) and “Education”.

Meetings and discussions

12. Discussions envisaged by PRSP revision concept have been organized both at nationwide and marz levels. The findings of the issues identified by negotiation parties and PRSP Open Forum and then summarized by the PRSP coordination and monitoring division of RA Ministry of Finance and Economy underlied the topics of discussion. The discussions were also based on the results of social survey implemented with the purpose to revise PRSP priorities.

13. The nationwide level discussions were of two types – professional and public. By and large, there were 20 discussions organized on this level, of which 16 were professional and 4 public. The discussions were organized in the towns of Yerevan, Tsakhkadzor and Dilijan.

- The following titles were suggested as topics for **professional discussions**:
 - (i) Objectives of the key indicators: macroeconomic; tax and budgetary; income and human poverty; demographic and regional disproportions;
 - (ii) Opportunities to include gender equality approaches in PRSP policies;
 - (iii) Poverty line: registration and targeting issues; inequality issues;
 - (iv) Qualitative indicators system to evaluate the efficiency of the general education;
 - (v) Pre-school education system;
 - (vi) Guaranteed state order of medical aid;
 - (vii) Effective management of water resources (rehabilitation of environmental balance of the Lake Sevan, issues of stream water cleaning);
 - (viii) Present situation with the Armenian forests, issues of illegal logging and ways to solve them. Issues of targeted use of environmental fees;
 - (ix) Issues of improvement of environmental situation in the big Armenian cities (Yerevan);
 - (x) Public service accessibility;
 - (xi) Demographic issues within PRSP;

-
- (xii) Pension system reforms;
 - (xiii) Increase of employment policy efficiency;
 - (xiv) Increase of family benefits system efficiency;
 - (xv) Proportional regional development and local self-governance;
 - (xvi) Development of public participation mechanisms and partnership.

▪ **Public discussions included the following topics:**

- (i) Issues concerning the healthcare service quality and economic accessibility of medication;
- (ii) Judicial reforms;
- (iii) Issues of population with special needs within the PRSP framework;
- (iv) Public governance reforms.

14. The discussions organized on marz level have been only in public format. The discussions scheduled for all marzes of the country involved all stakeholders.

15. The topics chosen for marz discussions address the most acute local problems, including employment, small and medium entrepreneurship, education and health service development programs. Taking into account that the territorial development in Armenia has generated certain challenges, as the development of marzes does not achieve at least half of Yerevan development, one of the PRSP revision process objectives was to solve this issue, and mitigate the difference directing the projects to marzes.

16. More than a thousand people participated in 18 discussions that took place in marzes.

17. ***Business environment and small and medium entrepreneurship*** sector discussions organized in all 10 marzes (Tavush, Kotayk, Syunik, Vayots Dzor, Shirak, Lori, Armavir, Aragatsohn, Ararat, Gegharkunik) included the following topics:

- “Opportunities and challenges for non-agricultural employment in rural areas: access to financial resources”;
- “Issues and perspectives for the development of small and medium entrepreneurship”;
- “Targeting and efficiency of employment projects”.

18. ***The health sector*** discussions organized in Shirak, Syunik and Tavush marzes included the following topic:

- “Ensuring physical accessibility of health services”;

19. *The education sector* discussions organized in 5 marzes (Shirak, Tavush, Syunik, Gegharkunik, Lori) included the following topic:

- “Activities related to the school management systems”.

20. The recommendations developed during the nationwide and marz discussions have been submitted to PRSP Working group and experts responsible for PRSP revision with a purpose to reflect them in the PRSP revised version.

Public awareness

21. During the first phase of public awareness activities related to the PRSP revision process numerous observations, comments and recommendations took place in media publications. More than 20 articles, analysis, interviews concerning the PRSP revision process were reflected in media, with the participation of PRSP Working group members and experts. In addition, the head of the Working group took part in the “Direct phone line” initiated by “Iravunk” paper.

22. A “PRSP revision process: results, alarms and progress trends” booklet was published with the aim to present media coverage of discussions that took place within the framework of public awareness raising activities concerning the PRSP revision participatory process, as well as the issues and recommendations raised during professional and public discussions. Another publication entitled “PRSP revision process: results, alarms and principles” was disseminated through 10 marz papers as inserts.

23. A series of programs with the participation of PRSP Working group and PRSP experts have been broadcast various by TV channels including H1 (“Dzeragir”); SHANT (“Herankar”), and H2 (“Lraber”) channels. In addition, the “Hrazdan” marz TV company initiated an extensive program about the Tsakhkadzor seminar activities. A “PRSP achievements and progress trends” TV movie has been shot and broadcast by a number of TV companies. The latter has been placed also on PRSP site.

24. The www.prsp.am site regularly updates comprehensive information about PRSP revision process placed in the section “PRSP revision”.

25. A social survey on PRSP revision participatory process conducted in 2006 by the “Analytical-information center of economic reforms” was realized through the PRSP site. The social survey was aimed at studying the public opinion about the following issues: why does the PRSP approved three years ago in August 2003 need to be revised; what are the preconditions and principles of revisions; what are the objectives of the Armenian Government and what will the society gain as a result of such revision; how all of these will help to improve the social state of the poor and vulnerable population;

how will we know if the PRSP is working in the new reality (the indicators and guidelines); as well as a number of other relevant issues.

26. 500 respondents from various marzes and communities, as well as from the capital representing different social groups (specialists, scholars, civil servants, pensioners, employers and the unemployed) took part in the survey.

Voices of the poor

27. A series of surveys, including the “Voices of the poor” survey conducted within the PRSP framework were aimed at ensuring the people’s participation in the PRSP revision process. The cornerstone of the methodology used to get the people’s opinion was that the people are keenly aware of their own living conditions and therefore, they should present the required data on the basis of what they know; they should analyze their own situation; they should identify their own problems and find the best solutions; and they should observe and assess the public policy, strategies, plans and projects developed for them. As a result of the conducted surveys, recommendations to improve the situation in various sectors (education, health, agriculture, social security) were obtained.

Second Phase of the Participatory Process and the Main Results

28. After the presentation of the PRSP edited version to the PRSP Steering Committee on December 28 2007 and was presented to all stakeholders for further consideration. At the same time 700 copies of the PRSP edited version were published and during the workshop organized on January 13 2008 it was presented to the 200 participants and mass media

29. For presentation of the main PRSP priorities and incorporation of recommendations number of articles, interviews with the participation of the PRSP Working Group members took place in media. Number of Debates and interviews were broadcasted also by TV. Sector discussions with the involvement of relevant Ministries and state agencies have been organized.

30. Parallel to this, among the population of marzes and NGO representatives discussions and meetings have been organized with the purpose of providing information about the PRSP. Starting from January 15, 2008 workshops and meetings have been organized in eight marzes to this end and over 600 representatives of different organizations have taken part in the meetings. For assuring efficiency of the above-mentioned meetings publication of friendly version of the paper was organized (700 copies)¹.

¹ Starting from September 16-26 2008, presentation of the PRSP in 9 marzes has been organized in 9 marzes of Armenia after its approval by the Steering Committee on September 10, 2008.

31. The draft of the PRSP edited version has been translated and presented to all international organizations operating in Armenia. The draft of the PRSP edited version has been allocated also on a PRSP web page providing an opportunity to all stakeholders to present their position about the paper./

32. As of March 2008 comments and recommendations concerning the PRSP edited version have been submitted by state-governance bodies (26), NGO sector (14) and the donor community (6).

33. The following basic changes have been introduced in the paper based on the submitted recommendations:

- Macroeconomic and fiscal framework has been completely revised taking into account the 2007 outcomes, tendencies developed during 2008 and the current challenges, particularly the projected increase of consumption prices and the GDP deflator, higher nominal GDP in terms of unchanged real growth, stable currency exchange rate has been foreseen for the whole period of program implementation. The structure of economy has been reconsidered targeting larger share of industry and service sectors, mostly due to reduction of construction.
- The demographic projections underlying the project have been revised
- The paper has been revised taking into account the 2006 household survey results. Because of changes in macroeconomic, demographic and fiscal projections the following core projections have been revised: poverty line, MCB, minimum and average salary rates, pension and benefit rates.
- Changes have been introduced in the certain chapters and sections devoted to the development of certain aspects. The main changes are the following:
 - a) The paper reflects long-term intentions of the RA Government to achieve leading positions in the sphere of business environment, finances, health care and education in the region.
 - b) In the Economic development chapter sections devoted to the development of financial system, changes of the structure of economy and institutional modernization of the country have been incorporated. The business environment improvement benchmarks have been revised.
 - c) The chapter of regional development has been added, section devoted to introduction of e-governance and Maintaining Public Order, the principles of related to the development of infrastructures has been expanded and are presented by separate sections. The youth issues have been highlighted in a special section, a chapter devoted to the urban development has been added.

d) In the social security chapter the principles of transition to accumulative pension system are highlighted and presented in detail. A target related to the basic pension has been added, Main direction of current pension system reforms have been revised, the problems of disabled have been highlighted and the ways of their solution have been identified.

- At the same time in all sections of the paper content and technical changes have been introduced taking into account the comments and recommendations of submitted by the stakeholders and the results of discussions.

34. In April 2008 the revised paper was also presented to all stakeholders for consideration. A joint outgoing meeting has been organized in May 2008 and the paper revised based on the recommendations submitted during the meeting has been discussed and approved during the outgoing Working Group meeting held from September 1-3, 2008.

35. Like in the first stage of the PRSP participatory process, in the second round of discussions as well, representatives of different layers of society, central and local administration representatives, NGOs, Trade Unions, business and donor community representatives were actively involved in the PRSP participatory process and PRSP discussions.

36. On September 10, 2008 The PRSP Steering Committee discussed and approved the PRSP revised document . Members of the PRSP Steering Committee, Working Group and the donor community representatives participated in the meeting. During the meeting it was decided to rename the paper into a Sustainable Development Program (SDP) with the view of the fact that the paper differs from the first document by its content and structure it is also more inclusive and can serve as a strategy for social-economic development of the country.

37. Renaming of the paper supposes also introduction of certain changes and amendments in the institutions and structure of the program participatory management. However this system will be guided by the principles of exercising the participatory management mechanisms in the implementation process PRSP which is anchored on the ideology of social partnership.

38. The purpose of SDP Social Partnership is to harmonize the interests of different settings representing various public institutions, social groups and layers. It also seeks to consolidate their efforts aimed at successful implementation of the program, monitoring and evaluation, and if necessary revision of the paper. It is aimed at:

- Assuring equal opportunities for all stakeholders involved in the poverty reduction and development process to present their views and interests

-
- Creating preconditions for increase of program implementation efficiency through the public participation in the decision making, policy development, implementation, monitoring and evaluation processes.
 - Contributing to the establishment of favorable environment for the civil society.

39. According to the SDP Social Partnership Agreement the SDP Participatory Management system should consist of two levels, the SDP Steering Committee and the SDP Working Group.

40. For assuring efficient involvement of the civil society in the SDP elaboration, monitoring and evaluation processes as an equal partner the SDP social partnership institutes' organizational system will be developed (SDP Civil Society Network). The activities of the latter should be aimed at consolidating all stakeholders over the solution of concrete problems, organizing and coordinating the SDP participatory process activities, targeting successful solution of the poverty reduction problems.

41. The SDP Civil Cooperation Network is a system which consists of Negotiation Groups, The SDP Civil Cooperation Network Secretariat and the SDP Civil Cooperation Network Steering Committee. The mechanisms of establishment of the SDP Civil Cooperation Network and its structural units, the framework of right and obligations are presented in the SDP Social Partnership Agreement. The NGO sector representatives signing the Agreement will establish the SDP Civil Cooperation Network, including its charter and regulations.

1. Key Results of Poverty Reduction Strategy Paper (PRSP-1) Implementation and Justification of Strategy Paper Revision

1.1. *Key target indicators and strategic priorities of PRSP*

42. The Poverty Reduction Strategy Paper (PRSP-1) was approved by the RA Government in August 2003 for the 2003-2015 period. Actually since the independence of Armenia the PRSP is the first long-term strategic program aimed at social and economic development.

43. The main objective of the program is substantial reduction of the material poverty. According to the program, it is envisaged to get the poverty incidence to 19.7% by 2015 and the extreme poverty incidence to 4.1% as compared with 50.9% and 16%² in 2001, respectively. Together with the reduction of the material poverty PRSP aims at reducing the very high level of income inequality in Armenia from 53.5% in 2001 up to 44.6% in 2015.

44. With regards to human poverty reduction the program was aimed at: maintenance of the present human potential and its further development; reduction of the human poverty expressions; improvement of the population health, reproduction potential and welfare level, including increase of the accessibility level of the general education and health service quality; reduction of infant and maternal mortality rate; improvement of the quality and accessibility of drinking water and other primary services.

45. Such selection of PRSP-1 key objectives was conditioned by the scope of material poverty; insufficient participation of poor people in the economic, social and political life of the country; their “voiceless ness”, as well as by the fact that the poverty of more than the half of the population constitutes a threat to the stability and further economic and social development of the society.

46. Necessity to reduce human poverty, or in the wide sense, to ensure sustainable human development was identified as the second key objective of PRSP-1 because of a certain social perception according to which the poverty reduction includes not only increase of the material resources of the poor, but also a substantial increase of their opportunities to benefit from the basic social services and welfare, as well as to participate in social and economic life of the country. In addition, the existence of high quality human capital is the major precondition for the modern economic development, and without it in the long-term perspective it is impossible to ensure a sustainable economic growth.

47. In order to achieve the aforementioned objectives, the poverty reduction strategy was composed of three major directions: a) ensuring a rapid and sustainable economic growth; b) implementing an active and targeted social and income policy focused on the

² According to the poverty assessment methodology used during the program development.

vulnerable social groups (including the poor and extremely poor); c) modernize the country's government system, including improvement of the public governance system and provision of expansion of resource package at the disposal of the country.

48. Provision of stable and rapid economic growth, as well as maintenance of poverty reduction oriented economy growth and its further deepening was the PRSP-1 priority. Based on the fact that they envisaged to supplement PRSP with RA long-term stable development strategic program, which should deeper deal with the development and implementation of an economic policy necessary to ensure a sustainable economic growth, PRSP economic growth policy was mainly aimed at the poverty reduction, provision of the participation of the poor population in the economic life of the country and increase in the earned income. The implementation of the abovementioned policy, which took place in 2001-2006, should become the key factor for the reduction of material poverty.

49. In this regard the following two directions of public policy can be identified:

- Promotion of self-employment and entrepreneurship by means of improving the business and investment climate, as well as increase of lending resources and cost reduction in the conditions of macroeconomic stability and liberal economic system;
- Channeling of the public investment resources exclusively to the elimination or mitigation of those infrastructure constraints formed in the economy, which in medium or long-term perspective might hamper economic growth or human development aimed at the poverty reduction; in particular construction and reconstruction of the rural roads, modernization of the irrigation system and provision of the efficiency growth; implementation of the drinking water projects, school reconstruction and modernization, etc.

50. The implementation of the targeted social policy was the second main strategic priority of the PRSP identified for the reduction of material poverty (especially extreme poverty) and income inequality, which together with the relevant income policy should have been aimed at:

- In social support area: better targeting of family benefits and highest possible involvement of the poorest population in the system. It was envisaged to increase the sizes of the family benefits so that the food poverty threshold might be surpassed;
- In social insurance area: increase of the efficiency; transfer of payment of non-insurance pensions to the state budget, and increase of the pension sizes so that that they might surpass the overall poverty threshold, as well as increase of the pension differentiation and creation of the preconditions to make a transfer from pension based on the service period to accumulative pension system.
- In the area of income policy: giving a priority to primary incomes, in particular ensuring progressive salary growth for the lower-paid salaried employees working in

the budgetary and social infrastructure sectors, taking into account that the mentioned group of employees should at least twice surpass the overall poverty threshold, and that the legally stipulated minimal salary should be relevant to the overall poverty threshold. Such an approach will help to solve the social issue of the working “poor” and reduce the income inequality.

51. The key priority underlying the human development and the human poverty reduction policy is the progressive development of the major social services, in particular education and health, which may be ensured through the increase of their efficiency and accessibility. The PRSP-1 envisaged achieving the aforementioned objectives by deepening the reforms in the mentioned sectors considering the education and primary health as high-priority directions. In parallel with the reforms, it was envisaged to increase the amount of public financing deemed a major means to ensure the development of social infrastructure. In particular it was envisaged that budget expenditures in the education sector in 2015 would increase by 1.7 percentage points of GDP compared with 2002 and will amount to 4% of GDP. It was expected to increase the state budget expenditures in the health sector to 2.5% of GDP in 2015 as compared with 1.2% of GDP registered in 2002.

52. The next priority of PRSP is to improve the efficiency of public governance at all levels, including the development and consistent implementation of anti-corruption strategy; increase of public participation in the decision making process through enhanced public awareness, development of social partnership, social inclusion and social participation.

53. The PRSP-1 places high emphasis on the necessity to enhance the financial capacities of the state stipulating that sustainable dynamics of economic growth should not be hampered. It was envisaged to ensure such growth mostly by means of tax revenues (annual increase of 0.3-0.4% of GDP) mainly through the improvement of tax administration and simplification of the tax system and keeping the residual of the consolidated budget within safe limits.

1.2. Key outcomes of PRSP implementation in 2003-2006

54. The main results of 4.5 years of PRSP implementation are presented in Table 1.1³. As the table shows, the actual indicators of the material poverty and inequality are significantly lower than those envisaged in PRSP (the reduction of extreme poverty and income inequality should be particularly emphasized: while the actual level of extreme

³ The last column of the Table shows the year, which according to PRSP forecast is relevant to the actual value of 2006. The poverty and inequality estimates are presented as by 2005 – according to the pertinent household survey results. The deviation of the actual and PRSP-1 envisaged indicators is calculated as relation between actual and registered indicators – expressed in percentage. The positive deviation means that the actual indicators are higher than the envisaged ones and the negative means that they are lower.

poverty in 2005 was relevant to the target indicator of PRSP projected for 2014, the Gini coefficient of income inequality in 2005 was lower than the target indicator projected for 2015).

55. Such a reduction of poverty and inequality was mainly conditioned by the rapid economic growth of recent years, the actual rate of which in 2003-2006 more than twice surpassed the PRSP forecasts⁴. The rapid economic growth is the major reason for the unprecedented growth of the salaries (in 2006 the actual average salary was 68% higher than that envisaged in PRSP), which in its turn became the major factor for poverty reduction.

Table 1.1. Main Results of PRSP Implementation, 2006

Indicators	2006			PRSP-1 (year)
	PRSP-1	Actual	Deviation	
Economic sector and welfare level				
GDP, billion drams	1918.4	2656.2	38.5	2010
GDP, per capita, thousand drams	595.0	824.6	38.6	2010
GDP, million US dollars	3239.4	6384.5	97.3	2015
GDP, per capita, US dollars	1004.8	1982.1	97.2	2015
Average monthly salary, thousand drams	38.3	64.3	68.0	2013
Average monthly pension, thousand drams	10.1	11.5	13.4	2007
Average monthly benefit, thousand drams	4.4	3.8	-12.8	2005
Economic growth (2003-2006), %, average annual	6.2	12.9	106.7	
Inflation (2003-2006) %, annual average	3.0	3.8	2.6	
Exchange rate (1000 drams/1 US dollar	1.7	2.4	42.3	
Poverty and inequality				
Number of poor, % of population*	41.0	34.5	-15.8	2007
Number of extreme poor, % of population *	14.2	5.5	-61.3	2014
Gini coefficient of income concentration,%*	0.491	0.359	-26.9	2015**
Human development				
Infant mortality rate (per 1000 live-born)	14.4	13.9	-3.5	2007
Maternal mortality rate (per 100000 live-born)	22.0	24.0	8.9	2005
Consolidated budget operations				
Total revenues and grants, billion drams	422.9	540.3	27.8	2008
Total revenues and grants, % of GDP	22	20.3	7.7	
Total expenditures, billion drams	461.5	574.7	24.5	2008
Total expenditures, % of GDP	24.1	21.6	-10.4	
Residual (addition), % of GDP	-2.1	-1.3	-38.1	
Social expenditures				
Total, billion drams	207.5	242.8	17.0	2008
% of GDP	10.8	9.1	-15.4	

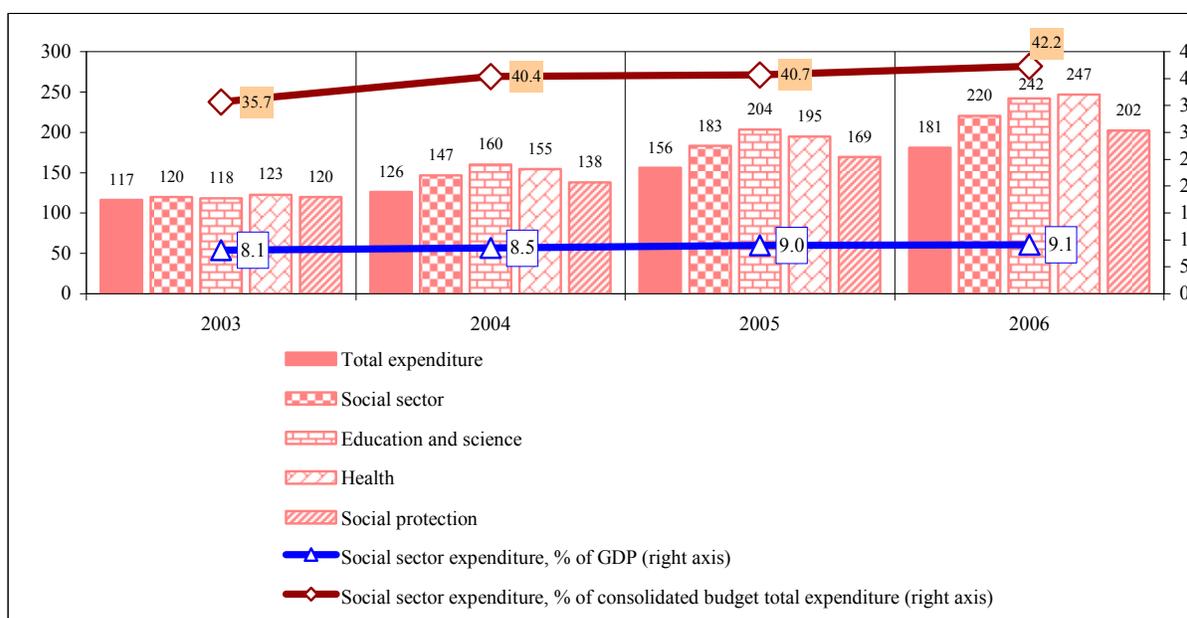
⁴ The economic growth of the country continues also in 2007 – as by the data of the first 6 months it is 13.8 %.

of which				
Education and science, billion drams	63.0	78.4	24.4	2008
% of GDP	3.3	3.0	-10.6	
Health, billion drams	35.5	39.5	11.2	2007
% of GDP	1.9	1.5	-19.7	
Social protection and insurance, billion drams	109.0	124.9	14.6	2007
% of GDP	5.7	4.7	-17.3	

* The poverty and inequality indicators estimated in 2005 on the HS basis with the use of an old methodology are presented in order to compare them with PRSP.

** The indicator surpasses the level of 2015.

Figure 1.1. Social sector expenditures of the consolidated budget in 2003-2006 (% as of 2002- left axis) and their ratios to GDP and total public expenditures (% , right axis)



56. At the same time as a result of dram appraisal since 2003 up to the present, which is mostly conditioned by the impact of external factor on Armenia and which was impossible to envisage within the PRSP framework, in 2006 the nominal GDP (in US dollar) and per capita GDP are almost twice more than those envisaged in PRSP and are relevant to the target indicators of 2015.

57. As shown in the Figure, the financial resources which were at the state's disposal in 2003-2006, were growing slower than the GDP and as a result did not demonstrate a progressive growth⁵. This is mainly explained by the sector structure of 2003-2006 economic growth⁶, as well as by a low efficiency of tax and customs administration,

⁵ In 2003-2006, the gross revenues and grants of the consolidated budget increased (in nominal terms) by an average of 15.3% per annum, consolidated budget expenditures GDP by 16% and 18.2 % respectively.

⁶ In 2003-2006 40-75% of the economic growth was provided by the construction (with average annual growth rate of 31.1%), as well as transport, communication and trade sectors (with average annual growth rate of 13.6%),

which did not allow to expand the tax basis and reduce the tax reserves as much as it was necessary.

58. Nevertheless, as shown in Figure 1.1, in 2003-2006, the social expenditures, as envisaged by PRSP, were growing faster than the overall expenditures of the consolidated budget and GDP, as a result of which their share in GDP increased by 1.1 percentage points and in the consolidated budget by 7.6 percentage points. It is fully consistent with the PRSP targets, according to which the public resources growth should be channeled to develop social sector in order to reduce material poverty and income inequality, and ensure human development.

Table 1.2. Distribution of consolidated budget expenditure growth in 2003-2006 (billion drams, in current prices)

Indicators	2003	2004	2005	2006	Monetary growth
billion drams in current prices					
Social sector	21.9	29.8	39.9	41.0	132.6
Of which					
Education and science	6.0	13.6	14.0	12.5	46.0
Health	3.6	5.1	6.4	8.4	23.5
Social protection and insurance	12.3	11.2	19.5	20.1	63.1
<i>% as compared with the growth of overall expenditures</i>					
Education and science	11.3	43.9	14.7	15.9	17.9
Health	6.9	16.5	6.7	10.7	9.1
Social protection and insurance	23.4	36.2	20.4	25.7	24.5

59. Thus, it should be mentioned that the most of the target indicators of PRSP in 2003-2006 can be considered as surpassed, with the rate varying within the interval of 1 -10 years. At the same time, in relation to a number of indicators the targets of PRSP have not been achieved. In particular, together with the progressive growth of public revenues, the proportion between the average pension and average salary (in 2006 it was 17.9% instead of 26.3% projected by PRSP), as well as the size of per capita family benefits envisaged by PRSP-1 were not achieved.

1.3. Justification of the PRSP Revision Necessity and major priorities of Sustainable Development Program

60. The aforementioned analysis of the PRSP-1 implementation outcomes obviously comes to prove the relevance of selected key objectives and strategic priorities of the program, which is especially about the promotion of sustainable economic growth as the

the aggregate sum of which in GDP of 2003 was 32.5% and in 2005 -37 %. The aforementioned sectors are still characterized by a higher degree of shadow economy and consequently, by a lower level of tax collections.

major factor contributing to poverty reduction, as well as about the redistribution of public resources aimed at solving the social problems, fostering the elimination of extreme poverty and human development.

61. At the same time, the economic growth rates in 2003-2006 (which were twice more than those expected), as well as the substantial growth of public expenditure capacities have lead to a situation that in medium and long-term perspective PRSP targets and the values of the major indicators will be substantially surpassed, which steeply reduces the degree of realism of PRSP and the opportunity of using it as the major strategic program determining the long-term development of the country.

62. A number of other factors come to witness the need of revising the PRSP and elaboration of the Sustainable Development Program (SDP_, which also limit the further use of PRSP. These factors can be divided into two groups: factors that condition the PRSP modernization and factors that condition the need to expand or change the priorities of the issues, targets and developed policies discussed in within the PRSP framework.

63. In particular, the factors of the first group are conditioned by:

- the revised methodology measuring the material poverty starting from 2004 and the raised extreme poverty and poverty thresholds, which together with the extreme poverty and poverty reduction process that in 2003-2005 turned to be faster than expected, condition the need for the development of new and higher targets for the reduction of the material poverty and elimination of extreme poverty;
- the economic growth, which was twice higher than expected and which on the one hand expanded the state's financial capacities and on the other hand identified the new challenges for economic growth, the solution of which requires that the priorities of public policy and expenditures are defined more precisely or revised.

64. The factors of the second group are mainly conditioned by the following new circumstances:

- According to the analysis of both the economic reforms and economic policy that took place in Armenia during the recent years and the experience of transition countries, the economic growth of the country in the long-term perspective, as well as the degree of the country's modernization and increase of the institutional capacities will be greatly conditioned by the successful execution of so called "second generation" of reforms⁷. The fast and effective implementation of these reforms in

⁷ As shown in section 8 of this program, if the "first generation" reforms (privatization; liberalization of the prices, foreign trade and exchange rate) in Armenia could be considered as successfully implemented and with the level of their implementation now Armenia is comparable with EU-10 (new EU members) countries, then with the "second generation" reforms (restructuring of enterprises, competition promotion policy, financial sector reforms, infrastructure sector reforms) Armenia, according to EBRD 2006 estimates, at present is not only substantially conceding all EU-10 countries, but also lags behind Kazakhstan and Russia (Transition Report, EBRD 2006).

medium and long-term perspective, together with the maintenance and deepening of the economic growth aimed at improvement of living conditions of the population, will become one of the priorities of the economic policy of the Government. The mentioned priorities have not been duly reflected in PRSP, and their inclusion in the strategic plan of country development requires a substantial enlargement of the economic policy coverage and the necessary measures to be taken.

- The Government finds that the Sustainable Development Program (SDP) should become the main long-term strategic development document and the basis for other strategic programs (particularly those concerning sector development). This in its turn means that a range of new areas, priorities and targets which were missing in the PRSP-1, should be reflected in the new document including such issues as fostering economic competition and limiting and eliminating the existing monopolies; increasing the country's involvement into the global economy; promoting the export; ensuring the country's institutional capacity growth; modernizing the economic, social and administrative institutions; creating the basis and developing a new, knowledge-based economy, etc.
- During the implementation of PRSP, together with double-digit economic growth, substantial decrease of poverty and inequality disproportions in territorial development, which were weakly expressed in the past, began to rapidly deepen, and today, they have already created precarious conditions. As the study of the modern international experience of regional development shows, the economic development, which lacks a proper territorial policy, as a rule, deepens territorial disproportions. In this regard, the development and implementation of an active territorial policy in the scope of the Sustainable Development Program aimed at the mitigation of disproportions of the territorial development and acceleration of economic growth of underdeveloped regions will be one of the main strategic priorities of the Government;
- The present demographic situation in Armenia is characterized as a situation of so called "zero" reproduction, which actually does not ensure the simple and expanded reproduction of population and which in the long-term perspective will lead to a number of social and economic problems. Particularly, in case the total fertility rate remains at the existing (low) level⁸ considerable ageing of the population⁹, decrease in the labor force volume and increase (up to 40%) in the number of people requiring potential care (0-15-year-old population and those at the age of 60 and above) will be registered in upcoming decades. Under these circumstances, improvement of demographic situation in the country as well as the development and implementation of a policy aimed to increase the fertility rate and support the

⁸ At present it makes 1.4; according to forecasts, in 2025 this indicator will reach 1.6. However, the total fertility rate should make 2.1 and more to ensure simple reproduction.

⁹ According to UN forecasts reflected in 2007 Report in Armenia the share of the population at the age of 60 and above will make 22.6% in 2025 (as compared with 14.4% in 2007). (See UN DESA, World Population Aging 2007, pp. 144-145).

young families should become the main priorities of the Government. These priorities were not considered in the PRSP.

1.4. Goals and strategic priorities of Sustainable Development Program

65. The successful implementation of PRSP resulted in a substantial reduction of poverty. In 2005 it decreased to 29.8%, in 2006 to 26.5%. As of the extreme poverty, it decreased to 4.6% and 4.1% respectively¹⁰. Although it may be assumed that the problem of extreme poverty is mostly solved; however, the poverty still remains a serious social issue, which is able to endanger the social stability of the country and to hamper the economic development in the long-term perspective. Therefore, improvement of the living conditions of the population, including the elimination of extreme poverty, well continues to remain the key objective of the Sustainable Development Program.

66. SDP envisages to get the material poverty level to 8% in 2012 thus mostly overcoming it and to bring the level of extreme poverty to 1.2% thus practically eliminating it. At present, the available information and conducted analysis of the poverty make it possible to foresee the target indicators for reducing poverty also in the territorial context differentiating such territories as the capital, other towns of the country and rural areas¹¹. Such an approach is aimed at further reduction of territorial differences of poverty levels through the development and implementation of territorial development policy.

67. Together with the country's economic growth and the financial resources at the disposal of the state, PRSP-2 envisages that in 2018 at the latest the poverty threshold will be equal to the minimal consumption basket (MCB)¹². According to the program goals, the poverty level assessed on the MCB basis in 2021 will make 11.4%, of which the extreme poverty level will make 1.9%.

¹⁰ Calculated according to the new poverty assessment methodology, which is being applied in household surveys since 2004.

¹¹ In 2021, it is expected to reduce the poverty levels (including extreme poverty) in Yerevan to 3.2% and 0.4%, in other towns of the country to 8.1% and 1.5% and in rural areas to 9.1% and 1.6% (in 2005 respective indicators were in Yerevan 23.9% and 3.6%, in other towns of the country 37.8% and 7.2% and in rural areas 28.3% and 3.2R%).

¹² In 2006, the poverty threshold was equal to 21555 dram (per an adult per month), and the respective MCB was 31961dram or 148% of poverty threshold (for the third quarter). The poverty level in 2006, using MCB as the poverty threshold was 39.8% and the extreme poverty level was 6.2% (using the minimum consumption basket, as the extreme poverty line). In the Sustainable Development Program document the MCB (is calculated by NSS on the basis of the list, structure and nutritious ness of food products developed by the MOH) and the life-supporting minimum budget should be used as equivalents with view the of the fact that the size of the minimum life-supporting budget is not legally stipulated yet. In the future, after defining the quantitative indicators for the latter, the MCB and the minimum life-supporting budget should become equivalent.

68. The overcoming of human poverty and ensuring of human development will be the second set of SDP core objectives. It is expected that during the period of 3-4 years Armenia will switch from the group of countries with a middle level of human development ¹³ to the group of countries having high level of human development, and that in the future the country will permanently increase its human development index (HDI) with the aim that in 2021 through the policy ensuring the advanced development of the social sector it will be in the range of 0.86-0.87.

69. The next goal of the Sustainable Development Program will be to restrain the deepening of existing economic growth disproportions through development and introduction of the targeted territorial policy ensuring the accelerated development of weak regions¹⁴.

70. The main strategic and expenditure priorities of the Sustainable Development Program will not be changed; although as compared with PRSP-1 they envisage a substantial expansion of the areas covered by them. The strategy of SDP will also be composed of three main priority directions in order to: ensure sustainable and rapid economic growth; implement the targeted social and income policies aimed at the active and vulnerable (including the poor) social groups; and modernize the country's administration system, including the increase of the efficiency of the public governance and provision of the advanced growth of the resources package at the disposal of the country. At the same time the mentioned priorities will be brought about in parallel with measures aimed to tackle such crucial issues as environmental protection and effective management of natural resources.

71. One of the major differences between PRSP-2 and PRSP-1 is the steep expansion of the policy measures aimed to ensure the lasting economic growth, which is necessary to take into account the challenges and circumstances newly emerged in the public policy.

72. The economic priorities of RPSP-1, which were connected with the economic growth, poverty reduction, including the involvement of poor population into the economic life of the country through the permanent improvement of business and investment climate; promotion of the local and foreign investments and advanced development of small and medium entrepreneurship, as well as channeling of state investment resources to the settlement of the accumulated infrastructure issues, will remain priorities also for PRSP-2.

¹³ According to the UNDP Human Development Index (HDI), at present Armenia is ranked among the groups with middle level of human development (in 2004 HDI value for Armenia was 0.768). The group of countries having 0.8 – 1 HDI include countries with high level of human development. See Human Development Report 2006, UNDP 2006.

¹⁴ According to estimates the Yerevan share in Armenian GDP in 1999 from 42.1% in 2006 has grown up to 57.2% or annual 4.3%. SDP forecasts that the Yerevan share in GDP will continue to grow, but at lower speed (around 0.5% percentage point) – reaching 63.2 percent, after which it will be stabilized and in the long-term it will go down.

73. At the same time the following will be regarded as PRSP-2 economic policy priorities:

- Targeted territorial policy –to mitigate the territorial development disproportions;
- Intensive policy of the “second” generation reforms – to ensure the modernization of the country and the nearest approach to the standards of the developed countries;
- Policy aimed at ensuring free economic competition and monopoly limitation - to create and maintain equal conditions for all those involved in economic activities;
- Policy aimed at the increase of the country’s competitiveness, the major characteristics of which are: promotion of output growth; ensuring of competitive levels of unit labor force value; promotion of new, higher value added forming jobs;
- Export promotion and increase of the country’s involvement into the global economic system, including intensification of EU integration process within the ENP, including the establishment of free trade regime with EU and unilateral elimination of visa regime;
- Intensive adaptation of the country’s economic institutions and legislation to the EU requirements and standards;
- Establishment and development of new and knowledge-based economy’s key elements and institutions.

74. The targeted social policy, like in PRSP, will continue to remain the SDP second strategic priority, which will be aimed at:

- In social assistance area: ensuring the increase in the sizes and targeting of the family benefits and possible maximum involvement of the poor population in the system, with the view that up to 2012 the number of the beneficiary families will be equal to the number of poor families, and in 2021 it will be equal to the number of poor families estimated by MCB. It is envisaged to increase the sizes of the family benefits so that in 2020-2021 they might make 70% of the poverty threshold¹⁵. In 2010, they envisage getting the family benefit targeting rate is expected to reach 78%; then starting from 2015 it should to make 90%¹⁶ and keep that level in the future.
- Family benefit policy of, in contrast to the PRSP, which was aimed at the reduction of extreme poverty, under the conditions of steep decrease of the extreme poverty and substantial increase of the state’s financial opportunities will be mainly aimed at helping out of poverty the vulnerable social groups that have limited possibilities to get involved into the economic life on their own.

¹⁵ In 2006 the average family benefit made 25.2% of poverty threshold.

¹⁶ Calculated as the share of the family benefits received by the population belonging to the first three income deciles – in the overall volume of the family benefits. In 2001 it was 27% and in 2005 - 40.1%.

-
- In social insurance area: the main expenditure priority of SDP will be the steep increase of pensions with the view that in 2012 the average pension will be equal to minimal consumer basket and in 2018 it will make 150% of MCB maintaining that proportion in the future, which will enable to supplement the existing pension system with the accumulative pension system.

75. In the employment area the state policy will be focused on sustainable and continuous improvement of the labor force competitiveness; mitigation of imbalance between the labor force demand and supply; creation of job opportunities for young people, especially those living in rural areas; expansion of programs aimed to ensure employment opportunities for noncompetitive groups of the population, particularly disabled; and on building social cooperation and partnership. At the same time, indicators characterizing the real level of unemployment will help targeting this crucial problem. To ensure the efficiency of the mentioned process certain measures will be taken to improve the quality of respective statistical methods and increase the reliability of statistical data.

76. In the area of revenue policy: it is projected to continue the policy of PRSP of giving priority to the primary revenues, in particular increase of the salary of budgetary and social infrastructure employees with the view that starting from 2015 they will at least 1.4 times surpass per capita GDP indicator. In addition, the minimal salary will be stipulated in a way that the persons with minimal salary and their family members be able to get saved from poverty thus eliminating “the working poor” phenomenon.

77. The main priority of human development strategy will continue to remain the advanced development of fundamental social services, in particular education and health through increase of their efficiency and accessibility. SDP envisages achieving these priorities through continuous complex reforms of the mentioned sectors, where the general education and primary health care will be regarded as priority directions. There will be an increase of public financing, which is deemed as the main device of ensuring the development of social infrastructure. In particular, in comparison with 2006, the public expenditures in education (as compared with GDP) are envisaged to increase by 1.8-percentage point - by 2021 getting them to 4.5% of GDP. It is planned that in 2021 the public expenditures in health sector will make 3.5 % of GDP instead of 1.5% in 2006.

78. The third main strategic priority of SDP is the increase of public governance efficiency at all the levels of governance, including substantial updating¹⁷ and consistent implementation of anti-corruption strategy; enhancement of public participation in the decision making process by means of increasing public awareness and assuring gender equality, through the promotion of social partnership, social inclusion and social participation as well as through intensive introduction of e-governance systems.

¹⁷ The RA Government will be developing a new anti-corruption strategy (See The GoA Program, Yerevan, April 2008)

79. The next priority will continue to remain the increase of the state financing capacities, which will mainly be ensured by tax revenues¹⁸ 8.2% GDP growth¹⁹ - in 2021 getting them to GDP 25.6%, which will require ensuring average annual growth of tax revenues not less than 0.3-0.4% of GDP. Taking into account that SDP does not envisage the increase of tax burden and the tax and customs reforms will be mostly aimed to simplify and make transparent the tax collection processes and procedures, as well as that during 2003-2006 they failed to ensure PRSP-1 stipulated tax collection rate, the main priority of public governance will be to ensure tax and customs administration improvement and tax and customs authorities institutional capacities growth.

80. The Sustainable Development Program envisages keeping the deficit of the consolidated budget within safe limits, i.e. within 2 - 2.5% of GDP . The state resource package²⁰ in 2021 will make 29.2 % of GDP and as compared with 2006 it will grow by 6.6% percentage points. According to the SDP main goals, this growth will be directed to increase the values and shares of social expenditures in the public expenditures. The main public expenditure policy will be to ensure the distribution and maximum technical efficiency of expenditures. This will be achieved by the completion of the preparatory activities necessary for the transition to program budgeting during the period of 2012-2015. Then, during 2018-2021 the three-year budgeting principle will be adopted.

81. Significant extension of the SDP priorities (as compared with PRSP-1), particularly those concerning the economic policy and the spheres of state interference, implies the existence of relevant tools required to ensure the properly scheduled and efficiently managed distribution of limited resources between the mentioned priorities and spheres. These tools will be based on adopted strategies or sectoral peculiarities (the time required to achieve expected outcome; the number and character of measures to be taken, i.e. one-time, regular or permanent measures; resources to be provided, etc.) and will represent annual action plans of the government including measures related to respective strategies or spheres as well as respective SDP indicators, which will serve as their annually registered outcome. The action plans will need to be developed and approved every year based on scrupulous revision of previous activities and evaluation of previous results.

82. One of the major peculiarities of the program will be the use of three types of indicators including target indicators, settlement indicators and performance benchmarks. The settlement indicators are volumetric, have forecast and indicative nature and show the directions of possible development; and the results will not be used to evaluate the program implementation dynamics. In contrast to them, the target indicators and performance benchmarks are directly related to the Government policy and reflect it.

¹⁸ Including the mandatory social insurance payments.

¹⁹ As compared with 2006.

²⁰ Consolidated budget expenditures.

83. The performance benchmarks will be broadly used for the planning and evaluation of SDP policy results and will be mostly built up by the means of application of internationally accepted evaluation systems, including the World Bank developed assessments of business environment quality; investment climate and governance quality indicators; EBRD published assessments on transition to market economy; corruption prevalence indicators²¹, UNDP Human Development Index, etc.

²¹ Published by “Transparency International”

2. Overview of Poverty and inequality in Armenia and the PRSP Goals

2.1. Economic growth and material poverty overview in Armenia in 1999-2005

84. The results of household surveys (HS)²² regularly implemented since 1998 on the annual basis obviously witness that the inequality as well as the number of poor, including very poor population gradually decrease (see Table 2.1).

Table 2.1. Key indicators of economic growth and poverty as compared with PRSP-1 target indicators

Indicators	1999	2003			2004			2005			2006		
	Actual	Actual	PRSP	Actual/ PRSP, %	Actual	PRSP	Actual/ PRSP, %	Actual	PRSP	Actual/ PRSP, %	Actual	PRSP	Actual/ PRSP, %
Per capita GDP, thousand dram	305.8	505.9	489	103.4	593.6	533	111.3	697.1	545.8	127.7	824.6	631.5	130.5
Per capita GDP, US dollars	571.4	874.1	780	112.0	1113	904	123.0	1523	921.6	165.2	1,982.1	1,061.0	186.7
Poor population, % as compared with overall population *	55.1	42.9	46.2	92.8	39	43.7	89.2	34.5	41.0	84.2	...	...	...
<i>Including very poor population, % of total population *</i>	22.9	7.4	15.2	48.6	7.2	14.7	49.0	5.5	14.2	39.0	...	...	...
Poor population, % of total population **	56.1	...	...	...	34.6	...	...	29.8	...	...	26.5	...	...
<i>Including very poor population, % of total population **</i>	21	...	...	...	6.4	...	...	4.6	...	...	4.1	...	...
Gini coefficient of income concentration	0.57	0.434	0.51	85.10	0.395	0.498	79.3	0.359	0.497	72.2	0.369	0.483	76.4

²² Since 2001 – every year.

Indicators	1999	2003			2004			2005			2006		
	Actual	Actual	PRSP	Actual/ PRSP, %	Actual	PRSP	Actual/ PRSP, %	Actual	PRSP	Actual/ PRSP, %	Actual	PRSP	Actual/ PRSP, %
<i>20% of poorest population's incomes ratio to 20% of richest population's incomes</i>	3.6	7.5	6.9	108.7	10.6	7.4	127.0	9.5	7.3	139.9	7.6	8.4	90.4
<i>Memorandum article</i>													
<i>Number of population by the end of the year, mln</i>	3. 227	3.212			3.216			3.219			3.223		

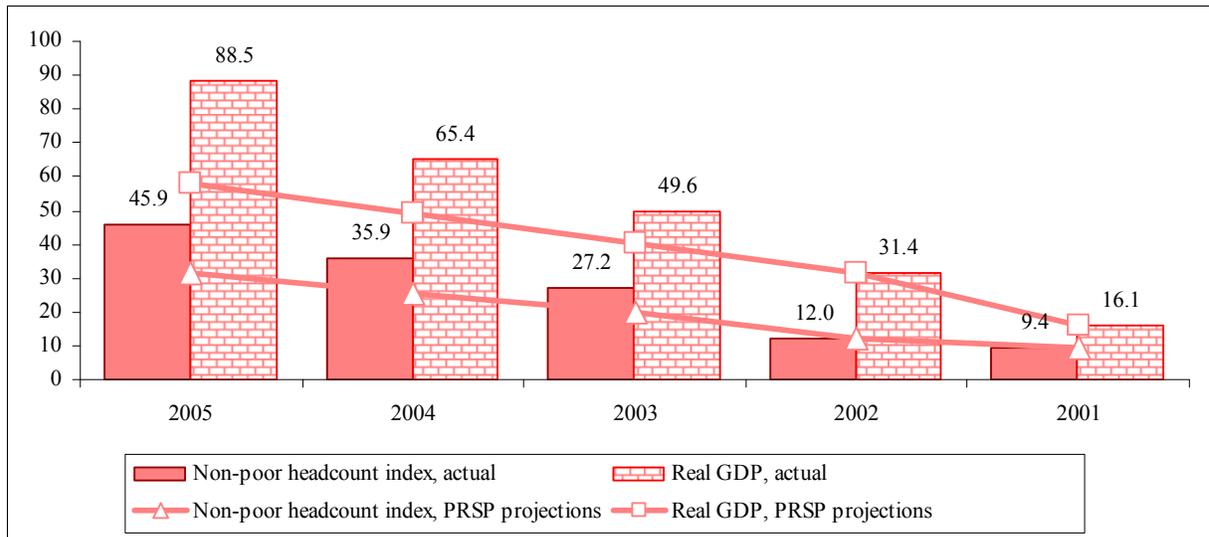
* Calculated by the methodology used in 1996-2003 – per capita monthly expenditure structure aimed at current consumption based on the general poverty line (share of poor in population) and daily consumption of 2100 kilo calories food poverty line (share of very poor in population). This methodology was used in PRSP to calculate the target indicators of poverty reduction.

** Calculated by new methodology used since 2004. The consumption aggregate together with the consumption of food, non-food commodities and services, the value of the long-term usage goods used by the households is also included. The equivalent of consumption of one adult person – taking into account the existing differences between the consumption of adults and children is used as well. In addition, in 2004 they have recalculated the food poverty line, which has been passed in 2004 equivalent of average daily 2 232 kilo calories food in Armenia and which will be applied in several follow-up years.

85. As envisaged by PRSP, economic growth remains the main factor contributing to the reduction of poverty. As the 2003-2005 economic growth rates were higher than those envisaged by PRSP (average annual growth rates of GDP in that period were 12.8% instead of envisaged 6.3%), the poverty reduction dynamics were higher than PRSP targeted indicators. Figure 2.1 obviously shows the link between the economic growth and poverty reduction²³.

²³ The table shows it as an accumulative growth of the non-poor population share as compared with 1999. The economic growth is characterized by the aggregate growth of GDP in 1999-2005.

Figure 2.1. Economic growth and poverty reduction in Armenia in 1999-2005 (cumulative percentage change to 1999)



86. The quantitative analysis of the link between economic growth and poverty reduction in 1999-2005 shows that in those years, one percent of economic growth resulted in an increase of non-poor population by 0.547 percentage points, which in its turn led to the reduction of poverty incidence from 55.1% to 34.5%.

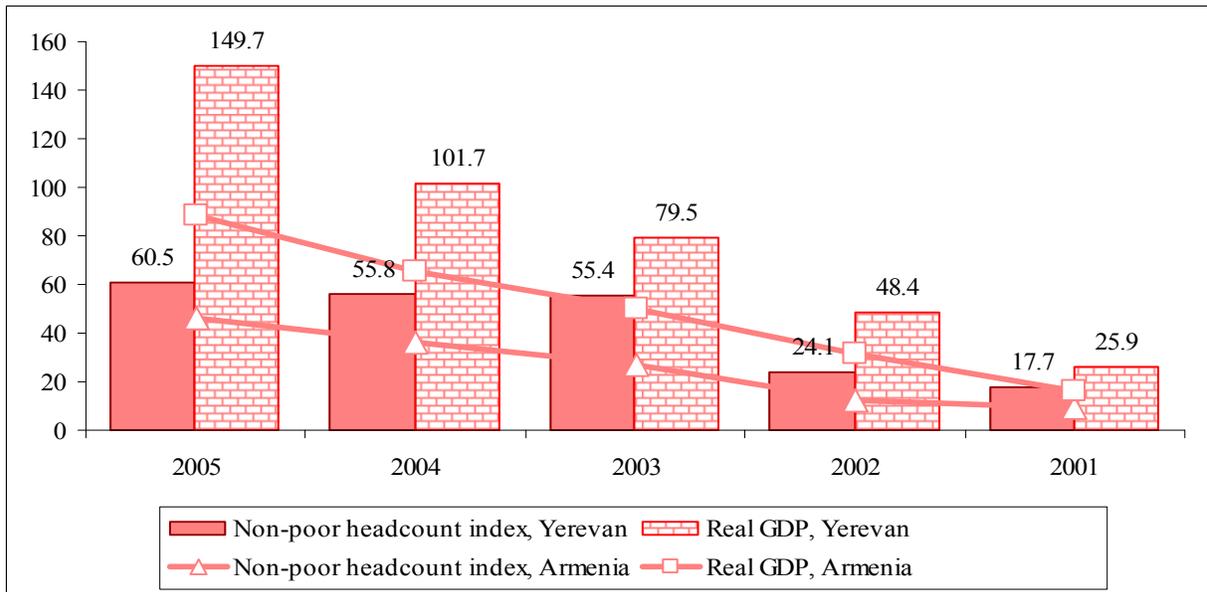
87. The most tangible poverty reduction took place in Yerevan – from 54.7% in 1999 to 27.3% in 2005²⁴ (calculated on the basis of new methodology, the poverty in Yerevan made 23.9% in 2005 and 21.0% in 2006 instead of 58.4% in 1999).

88. Such reduction of poverty was conditioned by essentially faster economic growth in Yerevan²⁵, as compared with the marzes of Armenia. At the same time in Yerevan, the degree of the economic growth aimed at the poverty reduction especially in 2003-2005 was much lower than the average rate estimated for the entire Armenia. This stems from the qualitative analysis of link between the economic growth and poverty reduction in Yerevan in 1999-2005, according to which each percent of economic growth in those years resulted in increase of non-poor population share by 0.431 percentage points (0.547 percentage points in Armenia). This in turn is conditioned by non-linear nature of the economic growth and higher degree of disproportion in Yerevan, than in rural areas and other towns.

²⁴ By old methodology.

²⁵ With the purpose of poverty territorial picture analysis and forecast, as well as analysis and forecast of economic development territorial disproportions “Avag Solutions” Inc. has developed and applied a territorial GDP settlement methodology. These settlements and forecasts are thoroughly presented in PRSP territorial development section.

Figure 2.2. Economic growth and poverty reduction in Yerevan in 1999-2005 (cumulative percentage change to 1999)



89. The poverty has been reduced also in other towns of Armenia. It should be mentioned that irrespective of the fact that the economic growth dynamics in other towns of Armenia was substantially slower than in Yerevan (in 1999-2005 the average annual growth rate in Yerevan was 16.4%, in other towns 7.7%, in rural areas 5.2%, the average growth rate in Armenia was 11.1%), the degree of poverty reduction-oriented growth in other towns was two times higher than in Yerevan - making it 0.906 percentage points of poverty reduction in case of 1% of economic growth. This was caused by a higher start-up level of poverty and lower level of inequality in other towns, as compared with Yerevan.

Figure 2.3. Economic growth and poverty reduction in other towns in 1999-2005 (cumulative percentage change to 1999)

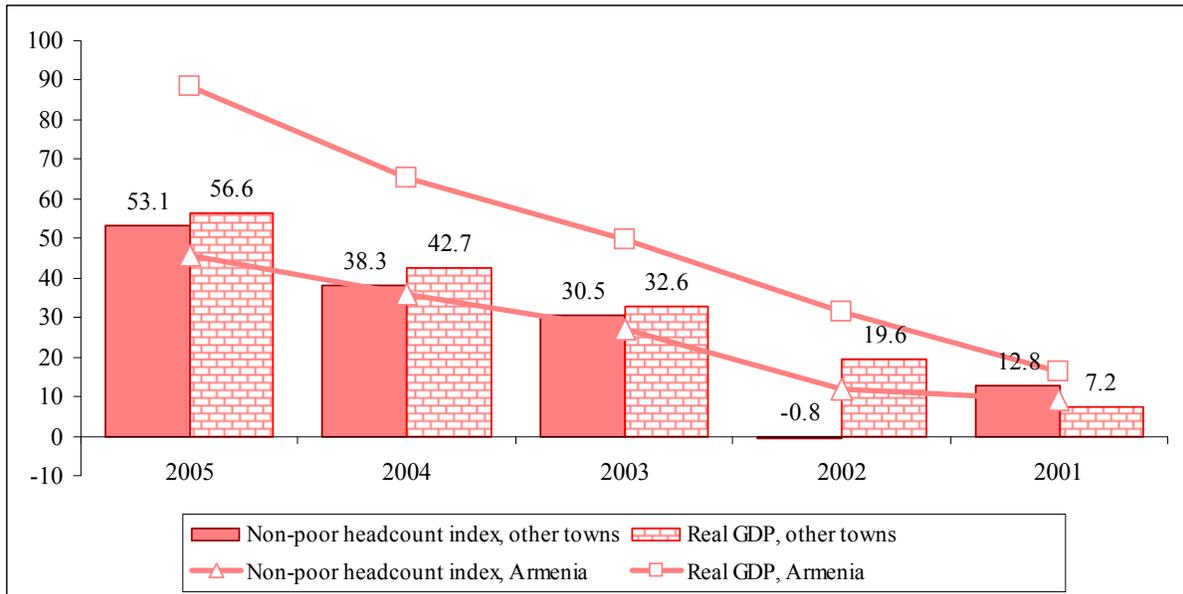
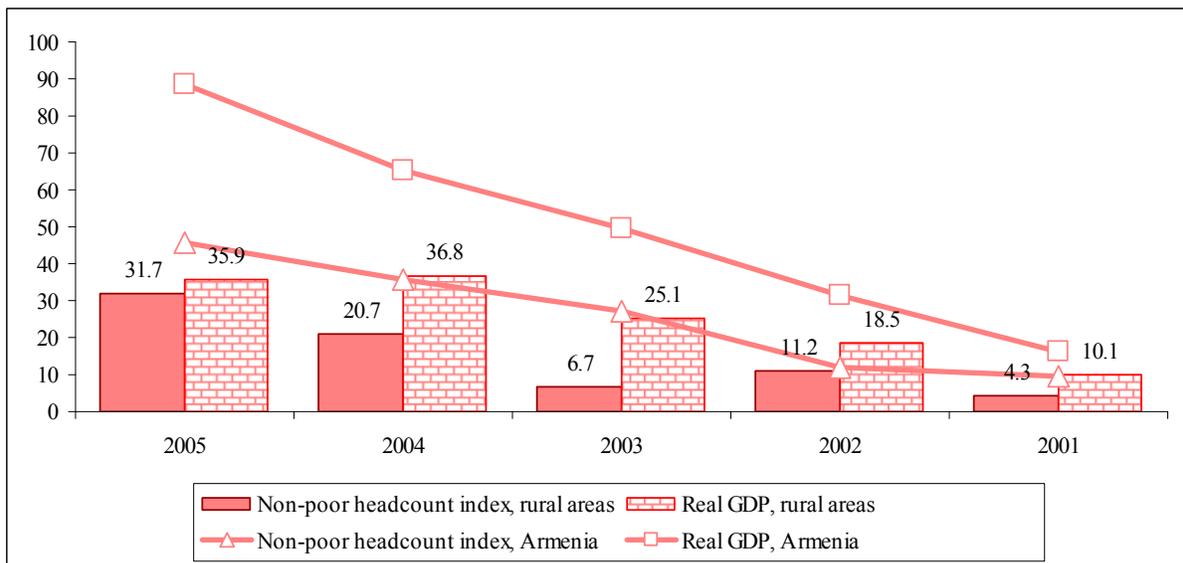


Figure 2.4. Economic growth and poverty reduction in rural areas in 1999-2005



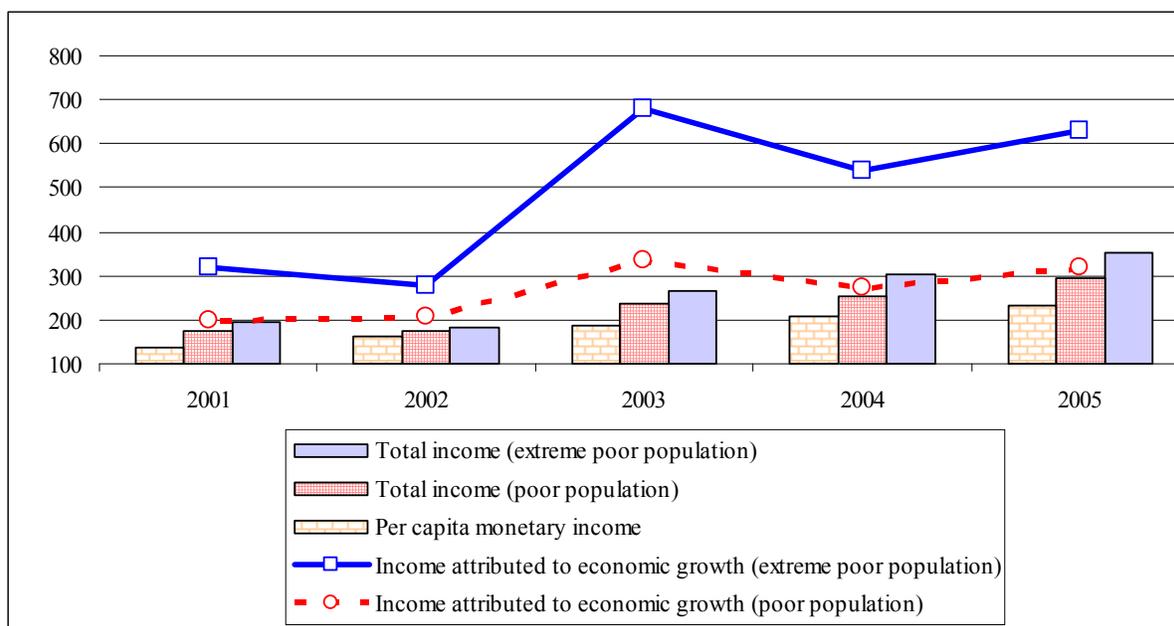
90. In absolute figures, poverty reduction in rural areas is the lowest as compared with Yerevan and other towns; however, the poverty reduction trend degree in 1999-2005 in rural areas was higher, than in Yerevan, but lower than in other towns - making 0.709 percentage points in case of 1% of economic growth, which is also explained by lower start-up level of poverty and inequality degree of income distribution.

91. The impact of the economic growth of Armenia on the poverty reduction process has been mostly expressed by the means of labor income increase of poor population (employment, self-employment and sales of agricultural products). Taking into account

that now Armenia is a labor exporting country, as well as the presence of large Armenian Diaspora, the impact of the external world on the poverty reduction process is expressed by the dynamics of foreign remittances and their distribution among various income groups of the population. And finally, the impact of the public social policy is conditioned by the increase of social payments, i.e. pensions and benefits (including family benefits) and their distribution among various income groups of the population.

92. As shown in the Figure 2.5. in the period under consideration the labor incomes of the poor and very poor population have grown faster than their overall monetary incomes and the latter have grown faster than the overall population monetary incomes²⁶ in nominal terms (352.6% and 630.8% as compared with 231.4% and 352.6% of general incomes and 231.4% of populations' average monetary incomes).

Figure 2.5. Dynamics of the population incomes in Armenia in 1999-2005 (in percentage as compared with 1999, in current prices)



93. Thus, in 1999-2005 the per capita incomes of poor²⁷ and very poor²⁸ population conditioned by internal economic growth (generated from labor and sales of agricultural products) have grown faster than the average monetary incomes, and this fact comes to

²⁶ Taking into account the gradually increasing deviation between the overall and labor incomes of the population calculated by HS and income statistics (in 1999 per capita overall incomes calculated by the income statistics constituted 148% of HS incomes and the labor incomes - 184.8%, while in 2005 that deviation was respectively 234.8% and 182.1%), as average monetary and labor income they have used the income statistics figures.

²⁷ Poor population is the population belonging to the first 4 income deciles of HS (which is approximately relevant to the level calculated on the basis of old methodology of poverty 2005, i.e. around 35% of population).

²⁸ Very poor population is the population belonging to the first income decile of HS (which is approximately relevant to the level calculated on the basis of old methodology of poverty 2005, i.e. around 5.5% of population).

witness that the poverty reduction trend of the economic growth, which existed in 1999-2001 has been maintained also in 2003-2005, i.e. during the PRSP implementation.

Table 2.2. Income dynamics of poor and very poor population of Armenia in 1999-2005 (in current prices, dram and percentage as compared with general incomes)

Indicators	2005				1999			
	Armenia	Yerevan	Other towns	Rural areas	Armenia	Yerevan	Other towns	Rural areas
Poor								
<i>in current prices, dram</i>								
Overall monetary income, including	6542.5	9855.7	5894.7	4901.3	2270.4	3368.4	1908.1	1809.7
Labor incomes	2881.3	6236.6	2620.5	1139.7	622.7	1281.2	406.7	345.5
From sale of agricultural products	466.0	1.1	102.5	1488.4	295.0	3.9	328.7	460.0
Social payments	2096.0	2276.0	2074.2	1850.3	816.0	954.8	869.9	689.4
Private remittances	440.4	796.4	361.0	292.2	77.0	195.4	28.7	33.7
Other incomes	658.9	545.6	736.4	130.7	459.7	933.1	274.2	281.1
Very poor								
<i>in current prices, dram</i>								
Overall monetary income, including	3241.8	5361.6	2526.4	2724.9	783.8	1286.1	542.9	624.5
Labor incomes	683.7	1915.2	521.8	283.0	110.9	254.3	35.1	70.2
From sale of agricultural products	256.4	1.4	23.4	684.4	48.8	0.0	55.4	75.8
Social payments	1519.0	2138.2	1268.7	1106.4	554.2	864.2	432.1	437.7
Private remittances	220.3	695.3	176.7	44.1	7.1	40.7	0.1	3.8
Other incomes	562.5	611.6	535.9	606.9	62.9	127.0	20.2	37.0
Poor								
<i>percentage as compared with general incomes</i>								
Labor incomes %	44.0	63.3	44.5	23.3	27.4	38.0	21.3	19.1
From sale of agricultural products	7.1	0.0	1.7	30.4	13.0	0.1	17.2	25.4
Social payments	32.0	23.1	35.2	37.8	35.9	28.3	45.6	38.1
Private remittances	6.7	8.1	6.1	6.0	3.4	5.8	1.5	1.9
Other incomes	10.1	5.5	12.5	2.7	20.2	27.7	14.4	15.5
Very poor								
<i>percentage as compared with general incomes</i>								
Labor incomes %	21.1	35.7	20.7	10.4	14.1	19.8	6.5	11.2
From sale of agricultural products	7.9	0.0	0.9	25.1	6.2	0.0	10.2	12.1
Social payments	46.9	39.9	50.2	40.6	70.7	67.2	79.6	70.1
Private remittances	6.8	13.0	7.0	1.6	0.9	3.2	0.0	0.6
Other incomes	17.4	11.4	21.2	22.3	8.0	9.9	3.7	5.9

94. As the Table 2.3 data show, in 1999-2005 the incomes of poor and very poor population grew up essentially faster, than the incomes of non-poor population²⁹, which comes to witness the reduction of income inequality between non-poor, poor and very

²⁹ Non-poor population is the population belonging to the first 5-10 income deciles, which is approximately relevant to the level calculated on the basis old methodology of poverty 2005, i.e. around 65% of population.

poor³⁰. From the other hand, the labor incomes of poor and very poor and non-poor have grown faster than the overall incomes, and this fact has conditioned the reduction of the general population's dependence on social and unofficial payments, as well as on other incomes.

95. Thus during the period of 1999-2005 a substantial increase of direct impact of economic growth on the poverty reduction took place due to progressive growth of labor incomes and involvement of poor and very poor population in the economic activities.

96. Table 2.3. shows the average elasticity of the population's incomes for 1999-2005 (the ratio of overall incomes and incomes conditioned by the economic growth to GDP per capita growth; the ratio of the social payments growth to the increased social insurance and social protection expenditures of the consolidated budget; and the ratio of increased unofficial remittances to the global economy growth³¹), which directly witness the progressive growth of all the aforementioned incomes of poor and especially very poor population and the impact of economic growth on redistribution of the poor and very poor. Eventually, these facts witness that the economic growth and social policy are directed towards poverty reduction.

Table 2.3. Monetary income flexibility of poor, very poor and non-poor population income in 1999-2005 (in current prices)

Indicators	1999-2005			
	Armenia	Yerevan	Other towns	Rural areas
Poor population				
Overall monetary income	1.48	0.96	3.04	2.81
Conditioned by economic growth	2.09	1.92	3.93	3.72
Conditioned by social policy	2.09	1.85	1.85	2.25
Conditioned by external economic growth	18.09	11.79	44.48	29.39
Very poor population				
Overall monetary income	2.47	1.58	5.31	5.53
Conditioned by economic growth	3.86	3.25	7.31	9.26
Conditioned by social policy	2.32	1.97	2.58	2.04
Conditioned by external economic growth	115.82	61.73	6773.4	41.07
Non-poor population				
Overall monetary income	0.27	0.30	0.51	0.06
Conditioned by economic growth	0.62	1.15	1.51	-0.09
Conditioned by social policy	2.75	1.61	1.98	4.53
Conditioned by external economic growth	-0.35	-0.50	-1.4	1.47
Monetary incomes of the population	1.02	0.77	1.37	1.44
Memo items				
Per capita GDP growth in current prices, %	226.8	301.1	168.7	160.8
Social expenditures growth, %	175.0			

³⁰ Nevertheless, a real reduction of inequality has smaller sizes than shown in HS results. Based on the continuous growth of the difference between average monetary incomes of HS and official statistics, in 1999 HS incomes constituted 67.4% of the official, in 2005 - 43.6%, which is conditioned by the decreasing participation of prosperous population in HS.

³¹ Measured as the average of global GDP per capita growth in 1999-2004.

Global economy growth, %	126.1	
Growth of population's monetary income, %	234.1	

97. The economic growth and social policy had poverty reduction orientation in Yerevan, other towns and rural areas. The Table also shows that the degree of the economic growth orientation towards poverty reduction was the lowest in Yerevan and highest in other towns. At this juncture, when in the entire Armenia, the social policy was almost equally oriented towards poverty reduction, the rapid poverty reduction in Yerevan was conditioned by approximately two times faster economic growth rate. Moreover, the growth of the average monetary income of the population in Armenia³² was substantially lower than the income growth of poor and especially very poor population. This means that not merely the poverty reduction but also the real reduction of inequality took place.

Table 2.4. Income dynamics of non-poor population in Armenia in 1999-2005 (in current prices, dram and percentage as compared with general incomes)

Indicators	2005				1999			
	Armenia	Yerevan	Other towns	Rural areas	Armenia	Yerevan	Other towns	Rural areas
<i>Non-poor population in current prices, dram</i>								
Overall monetary income	22707.7	27684.7	19810.6	18865.7	16957.1	17361.2	14685	18253.3
Labor incomes	14769.8	21798.2	13008.6	7768.7	4880.0	6485.5	5687.8	3289.8
From sale of agricultural products	2189.2	12.7	398.2	6218.7	4636.5	87.8	899.2	11529.5
Social payments	2428.8	1752.0	2613.3	2697.4	792.6	793.9	1052.1	613.9
Private remittances	2533.5	3496.6	2667.4	1398.9	2784.3	4025.7	4201.1	1011.9
Other incomes	786.3	625.2	1123.3	782.0	3863.7	5968.3	2844.9	1808.3
<i>percentage as compared with general incomes</i>								
Labor incomes	65.0	78.7	65.7	41.2	28.8	37.4	38.7	18.0
From sale of agricultural products	9.6	0.0	2.0	33.0	27.3	0.5	6.1	63.2
Social payments	10.7	6.3	13.2	14.3	4.7	4.6	7.2	3.4
Private remittances	11.2	12.6	13.5	7.4	16.4	23.2	28.6	5.5
Other incomes	3.5	2.3	5.7	4.1	22.8	34.4	19.4	9.9
<i>Non-poor/poor incomes ration percentage</i>								
Overall monetary income	347.1	280.9	336.1	384.9	746.9	515.4	769.6	1008.7
Labor incomes	512.6	349.5	496.4	681.7	783.7	506.2	1398.5	952.2
From sale of agricultural products	469.7	1119.8	388.3	417.8	1571.6	2252.2	273.6	2506.7
Social payments	115.9	77.0	126.0	145.8	97.1	83.1	120.9	89.1
Private remittances	575.3	439.0	738.8	478.7	3614.7	2060.1	14659	2999.7
Other incomes	119.3	114.6	152.5	598.2	840.5	639.6	1037.5	643.3

³² Calculated based on the official statistics, in contrast to the incomes of poor and very poor population, which are calculated based on HS results.

Non-poor/very poor incomes ratio	<i>percentage</i>							
Overall monetary income	700.5	516.3	784.1	692.3	2163.5	1349.9	2704.8	2923.0
Labor incomes	2160.4	1138.2	2493.2	2744.8	4401.9	2550.5	16214	4686.9
From sale of agricultural products	853.9	935.0	1702.1	908.7	9506.8		1624.5	15220.5
Social payments	159.9	81.9	206.0	243.8	143.0	91.9	243.5	140.2
Private remittances	1150.1	502.9	1509.4	3168.9	39438.1	9898.5	4201101	26839.8
Other incomes	139.8	102.2	209.6	128.9	6144.6	4698.0	14052.9	4883.3

98. As regards the income growth of non-poor population, the Table 2.4 shows that it significantly yields to the income growth of poor and very poor population, while the volume of unofficial remittances are even reduced in Yerevan and other towns. Given the aforementioned facts, the HS data concerning the non-poor population incomes cannot be considered fully reliable. However, the comparison of various data mentioned in the table comes to prove that although the incomes of non-poor population are underestimated, the incomes of poor and very poor population, including the labor incomes and unofficial remittances in 1999-2005 have really grown faster than the incomes of non-poor population. Once more, this comes to prove the ongoing nature of poverty reduction orientation of the economic growth.

2.2. Regional dimension of material poverty in 1999-2006

99. Despite the fast poverty reduction (including very poor) in the entire Armenia, the poverty level still significantly varies depending on marzes, rural and urban areas. This situation is mostly conditioned by the existing differences of economic development, as well as by the peculiarities of physical, geographical and infrastructure development of different regions. According to 2005 and 2006 HS data, the poverty incidence is higher in marzes affected by the earthquake; in bordering regions; in the regions with unfavorable conditions for agriculture, especially with small share of irrigated agriculture land; and in marzes with predominantly urban population.

Table 2.5. Number of poor and very poor population and economic development dynamics by marzes and in the rural-urban context, 1999-2006*

Indicators	2006		2005			1999		
	Poor %	Very poor, %	Poor, %	Very poor, %	Per capita GDP, thousand dram	Poor, %	Very poor, %	Per capita GDP, thousand dram
Armenia	26.5	4.1	29.8	4.6	697.1	56.1	21.0	307.3
Yerevan	21.0	3.5	23.9	3.6	1134.1	58.4	24.8	376.7
Armenia (without Yerevan)	29.1	4.3	32.7	5.1	469.3	55.2	19.5	271.0
Aragatsotn	27.5	2.6	32.3	3.1	383.1	60.5	22.8	300.5
Ararat	27.0	5.5	30.9	7.4	437.3	52.3	13.3	267.5

Armavir	30.8	3.4	31.6	3.8	439.3	41.7	10.2	350.9
Gegharkunik	29.8	2.6	36.8	2.9	417.0	49.9	11.3	244.4
Lori	27.0	5.5	28.8	5.8	389.1	62.6	30.0	219.3
Kotayk	32.0	8.1	34.5	8.7	523.3	61.7	24.5	317.7
Shirak	37.3	3.7	42.5	4.3	321.0	75.8	33.0	226.6
Syunik	25.3	2.1	28.9	2.3	1128.5	53.1	18.7	299.5
Vayots Dzor	11.4	1.3	19.2	1.8	616.2	34.7	12.9	276.3
Tavush	23.5	3.3	25.8	3.8	337.9	29.3	9.3	204.4
Other towns	35.8	6.6	37.8	7.2	427.2	65.5	27.4	241.2
Rural areas	23.4	2.4	28.3	3.2	479.8	48.2	14.1	295.3

Number of poor and very poor is given on the basis of new methodology.

100. Owing to a number of circumstances, such as non-representative nature of the 1999 HS; poverty assessment at marz level³³; various shares of urban population; and different levels of poverty and inequality start-up points (1999) in 1999-2006, the impact of the economic growth on the poverty reduction in marzes has been disproportional.

101. As Tables 2.5 and 2.6 show, everywhere the economic growth was accompanied by the reduction of poor and very poor; however, with different speeds. The biggest elasticity of poverty reduction as compared with the economic growth has been registered in Aragatsotn, Lori and Shirak marzes mainly due to a very high start-up level of poverty. In Yerevan, where the poverty reduction levels were the highest in Armenia, the economic growth rate was also the highest and the elasticity was consistent with the average Armenian.

Table 2.6. Poor and very poor population in 1999-2006 and the dynamics of economic development in 1999-2006 by marzes and village-city ratio*

Indicators	2006		2005			1999		
	Poor, %	Very poor, %	Poor, %	Very poor, %	Per-capita GDP, thousand drams	Poor, %	Very poor, %	Per-capita GDP, thousand drams
Armenia	26.5	4.1	29.8	4.6	697.1	56.1	21.0	307.3
Yerevan	21.0	3.5	23.9	3.6	1134.1	58.4	24.8	376.7
Armenia (without Yerevan)	29.1	4.3	32.7	5.1	469.3	55.2	19.5	271.0
Aragatsotn	27.5	2.6	32.3	3.1	383.1	60.5	22.8	300.5
Ararat	27.0	5.5	30.9	7.4	437.3	52.3	13.3	267.5
Armavir	30.8	3.4	31.6	3.8	439.3	41.7	10.2	350.9
Gegharkunik	29.8	2.6	36.8	2.9	417.0	49.9	11.3	244.4
Lori	27.0	5.5	28.8	5.8	389.1	62.6	30.0	219.3
Kotayk	32.0	8.1	34.5	8.7	523.3	61.7	24.5	317.7
Shirak	37.3	3.7	42.5	4.3	321.0	75.8	33.0	226.6

³³ See "Armenia's Social Overview and Poverty: Statistical Analytical Report", Yerevan, NSS, 2006, page 46.

Syunik	25.3	2.1	28.9	2.3	1128.5	53.1	18.7	299.5
Vayots Dzor	11.4	1.3	19.2	1.8	616.2	34.7	12.9	276.3
Tavush	23.5	3.3	25.8	3.8	337.9	29.3	9.3	204.4
Other cities	35.8	6.6	37.8	7.2	427.2	65.5	27.4	241.2
Rural areas	23.4	2.4	28.3	3.2	479.8	48.2	14.1	295.3

* Number of poor and very poor is presented according to new methodology

102. In both tables the link between the economic growth and poverty reduction is not of linear natures: the higher is the economic development rate, the lower (in case of equal conditions) is the respective elasticity. This is also proven by the data presented in Table 2.8, according to which in 1999-2005 two parallel processes took place in Armenia, i.e. the consistent differences of the economic development levels were combined with poverty reduction, including reduction of territorial differences of extreme poverty.

Table 2.7. Average territorial elasticity of poverty reduction and economic growth in 1999-2005 (in current prices)

Indicators	GDP growth rate	Poverty reduction rate	Elasticity
Armenia	126.8	88.3	0.70
Yerevan	201.1	144.4	0.72
Armenia (without Yerevan)	73.2	69.1	0.94
Aragatsotn	27.5	87.3	3.18
Ararat	63.5	69.3	1.09
Armavir	25.2	32.0	1.27
Gegharkunik	70.6	35.6	0.50
Lori	77.4	117.4	1.52
Kotayk	64.7	78.8	1.22
Shirak	41.6	78.4	1.88
Syunik	276.7	83.7	0.30
Vayots Dzor	123.1	80.7	0.66
Tavush	65.3	13.6	0.21
Other towns	77.1	73.3	0.95
Rural areas	62.5	70.3	1.13

Table 2.8. Dynamics of economic development and regional differences of poverty in 1999-2005

Indicators	2005	2004	1999
Per capita GDP			
Average, thousand dram (in current prices)	697.1	593.6	305.8
Average quintile deviation	314.8	223.5	59.0
<i>Number of poor</i>			
Average % to total population	29.8	34.6	56.1
Average quintile deviation	6.1	5.8	13.3

<i>Number of very poor</i>			
Average % to total population	4.6	6.4	21.0
Average quintile deviation	2.0	2.1	8.2

103. Table 2.8 shows that in case, when marz differences of economic development (which have been measured by average quintile deviation of per capita GDP) in absolute terms have grown almost 5 times during 1999-2005, the marz differences of poverty and extreme poverty (in absolute terms) have been reduced 2 and 4 times respectively. Thus, although gradually increasing, the economic development differences did not have a decisive impact on the speed of marz poverty and extreme poverty reduction and on the reduction of their differences.

104. This can be explained by a nonlinear nature of the link between the economic growth and poverty reduction, as well as by the fact that to assess the poverty in Armenia a unified consistent poverty line is being applied, which does not vary in parallel with the economic development and does not take into consideration the differences between marzes. Taking into account that in 1999-2005, the economic growth was registered in all Armenian marzes and keeping in mind the nature of the aforementioned link, one can mention that in 1999 in Armenian marzes with poverty level above the average it was reduced relatively faster (elasticity level higher than 1), while in marzes with below average poverty this process was slower (elasticity level lower than 1). As a result, the poverty levels came closer to each other.

105. According to SDP forecasts, the two mentioned phenomena will continue to combine during forthcoming 10-15 years, and in case of using the same poverty line the marz levels of poverty will be equal.

2.3. Overview of Material Poverty in 1999-2006 by Gender, Age and Social Groups

106. The picture of 1999-2005 poverty dynamics in terms of gender and age groups looks like the territorial poverty dynamics picture: fast reduction of poor and very poor in the groups mentioned in Table 2.9. as well as equalization of poverty levels, which is proven by substantial reduction of indicators describing the average quintile deviation. Such equalization of poverty levels is the result of the application of constant poverty line. Like in case of marz poverty, the differences of gender and age group poverty levels in the future will also be eliminated.

Table 2.9. Dynamics of poverty levels by gender and age groups, 1999-2006

Indicators	1999		2004		2005		2006		2006/1999*	
	Poor	Very poor	Poor	Very poor	Poor	Very poor	Poor	Very poor	<i>Poor</i>	<i>Very poor</i>
Women	56.3	21.1	34.3	6.4	29.7	4.6	26.6	4.2	52.8	80.1
Men	55.9	20.9	35.0	6.4	30.1	4.5	26.3	4.0	53.0	80.9
Children										
0-5 years old	63.3	24.1	41.9	8.0	34.9	5.1	35.3	5.6	44.7	77.2

6-14 years old	51.6	17.1	36.6	7.2	32.0	5.3	26.5	4.3	48.6	74.9
15-17 years old	52.9	18.4	35.7	6.4	31.2	4.7	27.8	4.8	47.4	73.9
Adults										
18-25 years old	59.7	25.8	35.3	6.3	29.2	5.4	27.0	3.7	54.8	85.7
26-45 years old	54.6	19.9	35.7	6.7	30.3	4.5	26.2	4.0	52.0	79.9
46-60 years old	56.6	22	29.8	5.4	27.2	4.1	23.0	3.2	59.4	85.5
Aged population	58.3	22.5	31.2	5.5	27.9	3.5	24.6	4.1	57.8	81.8
Average in Armenia	56.1	21	34.6	6.4	29.8	4.6	26.5	4.1	52.8	80.5
Average quintile deviation	3.5	2.7	3.4	0.8	2.3	0.6	3.3	0.7		

* Shows the amount of reduction of poor and very poor (percentage point) in 1999 as compared with the relevant level.

107. Table 2.10 shows that the picture is different when the level of poverty depends on the size of the family. During 1999-2005, the poverty reduction in the households with 1-4 members was faster, than average reduction in Armenia. Thus, in the households with 1 member the poverty reduction rate is higher almost 1.3 times than the national average; in the households with 2 members it is higher about 1.2 times; in the households with 3 members - around 1.3 times and in the households with 4 members - 1.1 times. From the other hand, in multi-member (5 and more) households the poverty reduction is lower than the national average rate. As a result, the differences in poverty levels of small and multi-member households have substantially increased. Thus, in 2006 the poverty risk in the households with 7 and more members was higher around 2.5 times than in the households with 1 member; around 2 times higher than in the households with 2-3 members; and around 1.6 times higher than in the households with 4 members. In 1999, these indicators were 1.46, 1.28, 1.3 and 1.27, respectively.

Table 2.10. Dynamics of poverty level by household size, 1999-2005

Indicators	1999		2004		2005		2006		2006/1999*	
	<i>Poor</i>	Very poor	Poor	Very poor	Poor	Very poor	Poor	Very poor	Poor	<i>Very poor</i>
Number of household members										
1	43.7	6.8	13.2	1.6	15.7	1.9	14.1	4.1	67.7	39.7
2	49.8	16.5	20.3	3.9	18.7	2.1	18.5	2.6	62.9	84.2
3	49.0	14.8	25.3	3.8	18.9	3.2	17.1	2	65.1	86.5
4	50.1	17.0	28.5	5.3	25	4	22.1	2.7	55.9	84.1
5	54.1	17.7	36.3	5.2	34.8	4.7	29.9	3.6	44.7	79.7
6	63.1	26.3	39.7	7.7	34	6.1	32.1	5.2	49.1	80.2
7 and more	63.8	29	52.8	11.9	46.8	7.2	36.1	7.9	43.4	72.8
Average in Armenia	56.1	21.0	34.6	6.4	29.8	4.6	26.5	4.1	52.8	80.5
Average quintile deviation	7.5	7.4	13.2	3.3	11.3	2.0	8.4	2.0		

* Shows the amount of reduction of poor and very poor (percentage point) in 1999 as compared with the relevant level.

108. On the other hand, as a result of aiming the social assistance policy at multi-member households the number of very poor multi-member households reduced around 4 times, which is consistent with the average nationwide rate of poverty reduction.

109. During the upcoming 10-15 years, the reduction of poverty levels of small and multi-member households will require further increase of purposefulness of family benefit system and orientation towards the multi-member families, as well as introduction of elements for the family reinforcement policy, which is missing now.

110. As Table 2.11. shows, depending on the number of children in the family the 2004 and 2005 poverty risk picture differs from that of 1999. In 1999, the system poverty conditions caused a situation when the poverty level was approximately the same in all types of families, except for the households with women heads and children, the poverty risk of which was the highest. In 2004 and 2005 the poverty risk differences in the mentioned groups substantially grew up: in 2005 the poverty risk of the families with 4 and more children was around 2 times; in the families with 3 children around 1.7 times, and in women headed families with children around 1.8 times more, than in families without children, as compared with 1.04, 0.99 and 1.12 respective differences in 1999.

Table 2.11. Dynamics of poverty level by the number of children and elderly in a household, 1999-2005*

Indicators	1999		2004		2005		2005/1999*	
	Poor	Very poor	Poor	Very poor	Poor	Very poor	Poor	Very poor
Number of children								
Without child	54.2	20	24.0	40	22.2	2.9	59.0	85.5
Woman household head without child	58.3	20.5	23.5	5.6	24.8	3.8	57.5	62.4
Woman household head with child	63.2	21.6	41.3	8.3	40.3	6.5	36.2	69.9
1 child	55.6	23.6	34.5	5.5	29.6	4.5	46.8	80.9
2 children	56.9	20	36.2	7.4	32.1	5.4	43.6	73.0
3 children	55.8	21.2	41.1	5.9	37.4	4.9	33.0	62.7
4 children and more	58.5	21.4	53.1	14.7	43.9	8.3	24.8	61.2
Number of elders								
Without elders	52.9	18.2	33.3	6	27.6	4.7	47.8	74.2
1 elder	60.4	22.9	34.4	7	32.8	5.2	45.7	77.3
2 and more elder	61	28.3	39.6	6.7	32.8	3.2	46.2	88.7
Single elders	50.7	12.2	19	2.5	19.4	2	61.7	83.6
Average in Armenia	56.1	21	34.6	6.4	29.8	4.6	46.9	78.1
Average quintile deviation – presence of children	3.1	1.2	9.8	3.7	8.1	2.4		
Average quintile deviation – presence of elders	4.5	6.0	8.2	2.0	5.7	1.5		

* The above data is impossible to compare with the 2006 statistical data as the latter is missing. The assessment recently conducted by NSA is based of a new methodology.

* Shows the reduction of poor and very poor (in percentage points) as compared with 1999 respective level.

111. The poverty risk depending on the number of elders in the family has been substantially reduced during the period of 1999-2005. The poverty level of the families made exclusively of elders, having been reduced by 2.6 times, is essentially lower than average.

112. As of the poverty risk depending on the employment status in the economy (Table 2.12), the greatest risk is the unemployment, which in 2006 was 1.6 times higher than the average as compared with 1.23 in 1999. The fast reduction of poverty level of retired and other unemployed in 1999-2005 has substantially reduced the poverty risk of the mentioned groups, which in 2006 was practically identical to the average.

113. Depending on the education level in 1999-2006, there has been a fast reduction in the poverty risk among people with higher education (around 3 times) and middle vocational education (around 3 times), as well as people with vocational education (around 1.7 times). However, the poverty risk is 1.4 times higher that the average among people with elementary and incomplete secondary education.

Table 2.12. Dynamics of poverty level depending on employment status and education level (for the population above 16) in 1999-2006

Indicators	1999		2004		2005		2006		2006/1999*	
	Poor	Very poor	Poor	Very poor						
Employment status										
Employee	48.7	15.0	27.5	4.4	22.7	3.0	21.3	2.2	56.3	85.3
Self-employed	48.6	13.4	31.0	4.3	27.3	3.2	23.9	2.8	50.8	79.1
Unemployed	69.5	35.1	45.9	11.4	46.9	10.0	41.2	8.7	40.7	75.2
Retired	64.0	25.4	33.2	6.2	30.0	3.9	26.5	4.6	58.6	81.9
Students	49.1	15.1	22.8	3.1	14.8	2.1	14.8	3.0	69.9	80.1
Other unemployed	60.3	27.4	40.6	8.2	29.9	4.7	26.1	3.4	56.7	87.6
Education level										
Elementary and lower	62.3	23.7	37.4	7.2	29.9	4.6	37.3	8.6	40.1	63.7
Incomplete secondary	63.3	27.8	42.6	8.7	37.0	6.7	36.4	8.3	42.5	70.1
Secondary general	58.9	24.0	38.2	7.2	34.4	5.3	29.9	4.4	49.2	81.7
Secondary vocational	55.6	19.4	31.9	5.6	26.1	3.8	22.3	2.4	59.9	87.6
Higher	44.9	13.4	19.5	2.6	15.4	1.9	14.3	1.9	68.2	85.8
Average in Armenia										
Average (for a population over 16)	56.5	21.7	33.5	6.1	28.9	3.8	25.6	4.1	53.1	81.1
Average quintile deviation – employment	9.1	8.8	8.5	3.1	10.6	2.8	8.7	2.4		
Average quintile deviation – education level	7.4	5.5	8.9	2.3	8.5	1.8	9.8	3.2		

* Shows the reduction of poor and very poor (in percentage points) as compared with 1999 respective level.

Table 2.13. Dynamics of poverty level for the most needy groups of the population in 1999-2006

Indicators	1999		2005		2006	
	<i>Poor</i>	<i>Very poor</i>	<i>Poor</i>	<i>Very poor</i>	<i>Poor</i>	<i>Very poor</i>
	<i>percentage</i>					
Families with 7 and more members	63.8	29.0	46.8	7.2	36.1	7.9
Headed by women – with child	63.2	21.6	40.3	6.5	32.4	4.0
Families with 3 children	55.8	21.2	37.4	4.9	32.1	6.5
Families with 4 children	58.5	21.4	43.9	8.3	30.2	7.2
Unemployed*	69.5	35.1	46.9	10.0	41.2	8.7
Persons with incomplete secondary education *	63.3	27.8	37.0	6.7	36.4	8.3
	<i>% as compared with average poverty level</i>					
Families with 7 and more members	113.7	138.1	157.0	156.5	136.2	192.7
Headed by women – with child	112.7	102.9	135.2	141.3	122.3	97.6
Families with 3 children	99.5	101.0	125.5	106.5	121.1	158.5
Families with 4 children	104.3	101.9	147.3	180.4	114.0	175.6
Unemployed*	123.2	161.8	162.3	227.3	155.5	212.2
Persons with incomplete secondary education *	112.2	128.1	128.0	152.3	137.4	202.4

- *The unemployment rate has been calculated for the population over 16.*

114. Thus, the analysis of poverty dynamics by population groups based on the data concerning the 1999-2006 period of time makes it possible to identify the groups of population to the utmost subjected to poverty risk³⁴. Table 2.13, which estimates their risk to face poverty and extreme poverty, shows that economic growth of the country have not been sufficient for these groups to exceed the poverty threshold; the results of the social policy have been less effective for them, than for other groups. As a result, the poverty reduction in these groups have been slower and the difference of poverty levels between them and other abovementioned groups of population has substantially increased during 1999-2006.

2.4. *Rural Poverty Reduction Factors and Peculiarities in Armenia in 1999-2006*

115. Sustainable economic growth of the country in recent years had its impact on the welfare level of the rural population. One of the major factors conditioning the differences of the rural poverty levels is the agriculture conditions, which are well identified by the altitude from the sea level of the settlement³⁵.

116. Although in 1999-2006 the general picture has not been changed – the poverty level increases together with the altitude; however, as one can see from Table 2.14 the

³⁴ They include groups, where poverty risk is more than 25 and more percentage.

³⁵ With this indicator two major rural manufacturing determinants are identified, i.e. productivity conditioned by land quality and distance from the major consumption markets and increase of value added conditioned by their accessibility.

poverty levels in 2005 have been considerably approximated and the steep decrease of average quintile deviation comes to witness it.

Table 2.14. Dependence of the level of the rural poverty on the altitude above sea level, 1999-2006

Indicators	2006		2005		1999	
	Poor	Very poor	Poor	Very poor	Poor	Very poor
Altitude less than 1300m	22.1	2.6	26.9	4.3	39.9	8.4
1300 – 1700m	19.0	2.9	26.7	4.2	55	21.9
More than 1700m	21.6	1.7	30.3	1.3	53.7	16.3
Total	21.0	2.4	28.3	3.2	48.2	14.1
Average quintile deviation	1.66	0.62	2.02	1.70	8.37	6.78

117. It is mainly conditioned by the fact that in rural areas poorer people have gained more from the economic growth, which from the viewpoint of geographical location is relevant to rural settlements located at 1300-1700 and more than 1700m above sea level.

118. Like in case of reducing the territorial rural disproportions it is conditioned by nonlinear nature of link between economic growth and poverty reduction, constant nature of poverty line, as well as difference in poverty start-up positions.

Table 2.15. Dependence of the level of rural poverty on the size of the owned land, 1999-2006

Indicators	2006		2005		1999		2006/1999	
	Poor	Very poor	Poor	Very poor	Poor	Very poor	<i>Poor</i>	<i>Very poor</i>
No land	41.9	4.8	33.0	11.2	65.4	39.1	1.6	8.1
Up to 0.2 ha	24.9	3.7	35.0	6.0	55.7	23.3	2.2	6.3
0.2 - 0.5 ha	18.4	1.5	28.3	1.5	51.2	11.9	2.8	7.9
0.5 - 1 ha	22.7	2.4	26.1	3.7	55.1	15.5	2.4	6.5
1 ha and more	24.4	2.2	26.7	1.7	39.6	10.4	1.6	4.7
Total	23.4	2.4	28.3	3.2	48.2	14.1	2.1	5.9
Average quintile deviation	9.0	1.3	4.0	4.0	9.3	11.8		

119. Similar developments took place concerning the impact on the poverty of another important factor conditioning the difference of rural poverty levels, i.e. the size of managed land plot, which, according to available data, has been substantially reduced. Apart from the aforementioned factors the new non-agricultural activities that took place in rural areas in 1999-2006³⁶ played a significant role.

³⁶ According to “Avag Solutions” Inc. estimates, in rural areas the share of non-agricultural activities in added value in 2005 was 32.5% as compared with 27.6% in 1999 – by increasing 1.86 times in absolute magnitude, in case, when the agriculture value added in the same period grew up by 1.58.

120. During 2002-2006, as shown in Table 2.16, a certain increase in possibilities of formal lending to rural households was registered, which; however, is still very limited. At the same time a reduction of those farms, which borrowed from informal sources took place. Thus, the number of farms that borrowed from bank or other formal entities in 2005, as compared with 2002 grew up by 2.9 times (in non-poor farms by 4.2 times, in poor farms by around 5.4 times)

121. Thus, the analysis of the peculiarities of rural poverty comes to show that under the conditions of economic growth aimed at the reduction of constant poverty line and poverty, the differences in the poverty levels, which are conditioned by rural peculiarities, tended to reduce during 1999-2006; the problem of extreme poverty in the rural areas can be considered as basically solved and the poverty reduction targets in the rural areas in medium and long-term perspective will not substantially differ from the respective targets of urban areas.

Table 2.16. Borrowing capacity of farms and poverty level in 2002-2006

Indicators	2006	2005	2004	2003	2002
	<i>percentage, if other notes are missing</i>				
Non-poor					
We did not borrow	91.1	92.8	89.5	97.8	96.3
We borrowed, including:	8.9	7.2	10.5	2.2	3.7
From formal sources (bank, micro-credits: international projects)	5.9	4.8	6.8	1.2	1.4
From informal sources (parents, friends, relatives, other sources)	3.0	2.4	3.7	1.0	2.3
Poor					
We did not borrow	93.2	91.8	92.2	98.4	97.5
We borrowed, including:	6.8	8.2	7.8	1.6	2.5
From formal sources (bank, micro-credits: international projects)	2.8	2.8	3.6	0.4	0.5
From informal sources (parents, friends, relatives, other sources)	4.0	5.4	4.2	1.2	1.9
Very poor					
We did not borrow	95.3	97.3	92.3	99.76	99.44
We borrowed, including:	4.7	2.7	7.7	0.24	0.56
From formal sources (bank, micro-credits: international projects)	2.61	0	3.85	0.07	0.06
From informal sources (parents, friends, relatives, other sources)	2.08	2.7	3.85	0.17	0.5
Total					
We did not borrow	90.30	92.43	90.02	96	93.3
We borrowed, including:	9.70	7.57	9.98	4	6.7
From formal sources (bank, micro-credits: international projects)	5.83	4.24	5.96	1.6	2.0
From informal sources (parents, friends, relatives, other sources)	3.87	3.33	4.02	2.4	4.7

Average size of bank lending, thousand drams	...	786.3	426.6	1,507.8	1,163.3
Volumes of rural lending, million drams	...	11,304	8,611	8,152	7,787
Number of farms, thousands	...	339.2	338.5	337.9	334.7
Number of entities borrowed from formal sources, thousand drams	...	14.4	20.2	5.4	6.7

2.5. Social Policy and Poverty Reduction in Armenia in 1999-2006

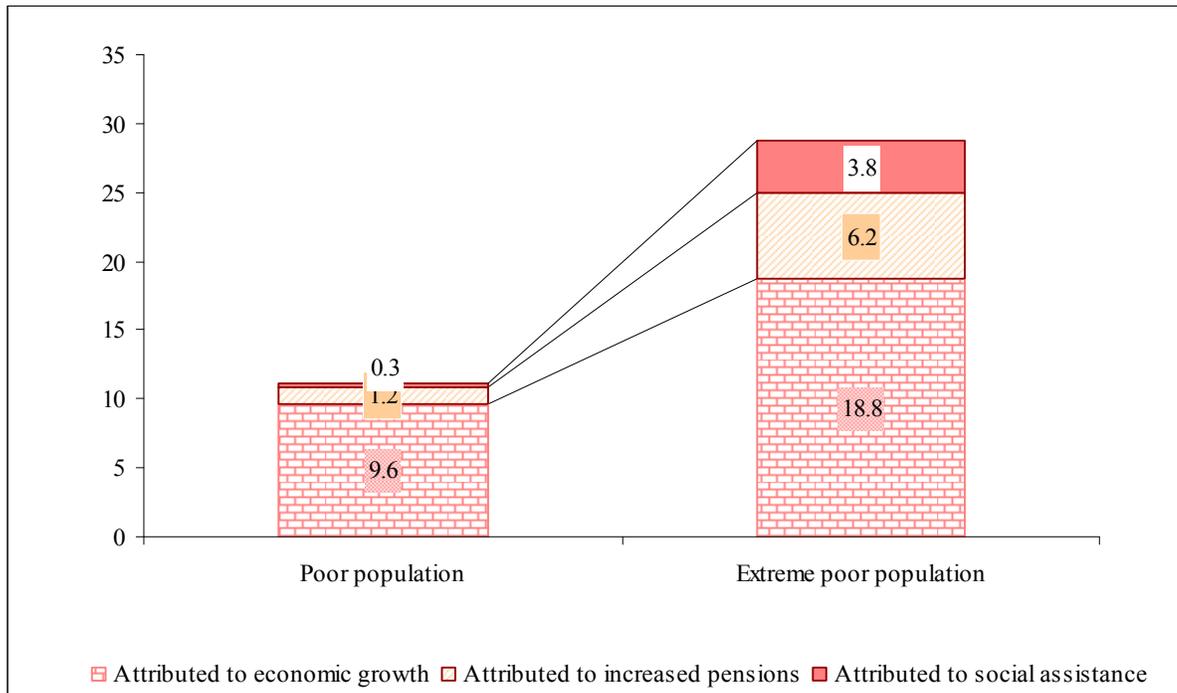
122. The biggest and most important components of social policy are social payments to the population, which are performed in the form of pensions and benefits. The most significant component of benefits is the family benefit system, which was introduced in 1999 to provide social assistance to the needy families. Table 2.17 and Figure 2.6 show that the social payments have considerably high impact on reducing the extreme poverty. Thus, in 1999-2005 the extreme poverty reduction annual average rate was 34.8%, with 65.2% of economic growth. As of the overall poverty reduction rate, the share of social payments was only 13.4% (of which the share of social pensions was 10.8% and the share of social assistance, including the annual poverty benefits, was 2.6%), with 86.6% of economic growth. The aforementioned difference is explained by considerably lower participation of very poor in the economic life, which limits their possibility to receive labor and other non-payment incomes, as well as by the circumstance that the family benefit system is still aimed at getting people out of extreme poverty, and the present sizes of the benefits, as a rule do not allow many beneficiaries to overcome the overall poverty line.

Table 2.17. Impact of social payments on the levels of poverty and extreme poverty in 1999-2006

Indicators	1999	2004	2005	2006	2006/ 1999*
<i>Poor</i>					
Post-payment level of poverty, %	56.1	34.6	29.8	26.5	10.2
Poverty level without social payments	69.1	44.8	39.8	32.8	10.1
Poverty level without pensions	64.2	42.7	38.1	31.0	9.9
Poverty level without social assistance	59	37.2	31.9	28.0	10.1
<i>Very poor</i>					
Post-payment level of poverty, %	21.0	6.4	4.6	4.1	20.8
Poverty level without social payments	38.2	15.4	13.6	12.1	15.1
Poverty level without pensions	31.0	12.3	10.6	8.2	17.3
Poverty level without social assistance	28.2	8.7	7.4	7.2	17.7

*Average annual rate of poverty reduction, %.

Figure 2.6. Impact of economic growth and social transfers on the poverty and extreme poverty reduction in 1999-2005, %



123. As regards the territorial aspect of the impact of social payments on the poverty reduction, their estimates for 2005 (Table 2.18.) show that the territorial picture for poor population is actually the same. This means that as concerns the poverty reduction, the present social policy is quite efficient and in case of fast poverty reduction its further territorial differentiation is not appropriate.

Table 2.18 Impact of social payments on the levels of poverty and extreme poverty in 2005, by regions

Indicators	Armenia	Yerevan	Other towns	Rural areas
Poverty level	<i>percentage</i>			
Total	29.8	23.9	37.8	28.3
Without benefits	31.9	25.0	40.4	30.2
Without pensions	38.1	30.6	46.0	38.1
Without social payments	39.8	31.7	48.6	40.0
Extreme poverty level	<i>percentage</i>			
Total	4.6	3.6	7.2	3.2
Without benefits	7.4	5.2	12.9	5.5
Without pensions	10.6	8.4	15.8	8.4
Without social payments	13.6	10.0	21.5	10.7
Poverty level	<i>% as compared with poverty level</i>			
Total	100	100	100	100
Without benefits	107.0	104.6	106.9	106.7
Without pensions	127.9	128.0	121.7	134.6
Without social payments	133.6	132.6	128.6	141.3
Extreme poverty level	<i>% as compared with extreme poverty level</i>			
Total	100	100	100	100
Without benefits	160.9	144.4	179.2	171.9

Without pensions	230.4	233.3	219.4	262.5
Without social payments	295.7	277.8	298.6	334.4

124. Nevertheless, the data presented in the table show that both in Yerevan and other towns the termination of social payments will lead to steep increase of very poor. Moreover, in rural areas that growth will be higher. Thus, in the entire Armenia and in particular, in the urban-rural context in 1999-2005, the social payments have considerably contributed to the reduction of extreme poverty, while concerning the poverty reduction that contribution was more modest. Under the conditions of very fast reduction of extreme poverty in the medium-term it will stop being a serious social issue and therefore, the major aim of social transfers will become reduction of general poverty.

125. The efficiency of the social assistance policy is directly conditioned by the degree of its purposefulness, which, as shown in Table 2.19., has substantially grown in 1999-2005. Thus, the volume of the benefits channeled to the poorest 10% of population grew up 5.66 times; the volume of benefits channeled to the poor population (income 2-4 deciles) grew up 2.23 times; and the volume of non-poor (income 5-10 deciles) - 1.77 times. Moreover, in 2005 as compared with 2001 the volumes of family benefits allocated to non-poor population reduced by 31.1%. In this regard, the Armenian family benefit system is evaluated as quite efficient. As shown in Table 2.19. and Figure 2.7, during the period of 2001-2005 the share of poor and very poor population (income first 4 deciles) in the system of family benefit has grown from 35.6% up to 54.4%, i.e. the degree of purposefulness has grown³⁷ around 1.5 times. Nevertheless, 45.6% of family benefits in 2005 were channeled to non-poor part of population.

Table 2.19. Per capita distribution of social payments by income deciles in 1999-2005*

Indicators	1999	2001	2005			
			Armenia	Yerevan	Other towns	Rural areas
<i>in current prices, dram, monthly</i>						
Very poor (1st income decile)						
Total	554.2	853.0	1519.0	2138.2	1268.7	1106.4
Pensions	471.7	580.1	1051.6	1408.6	886.6	888.1
Benefits	82.5	272.9	467.3	729.5	382.1	218.4
of which family benefits		251.1	389.7	538.1	314.2	175.1
Pot (2-4 income deciles)						
Total	903.2	1635.6	2288.3	2321.9	2342.7	2098.2
Pensions	612.8	1242.6	1638.9	1986.1	1474.7	1440.3

³⁷ Here the efficiency of poverty family benefits was evaluated by the deciles formed on the basis of HS income distribution data (current monetary incomes). The estimates of benefit distribution calculated by decile groups formed on the basis of consumption aggregates (the data and analysis are presented in the section of the document concerning the social protection) differ from those made on the basis of income distribution; however, the efficiency change and general and territorial directions in both cases are identical.

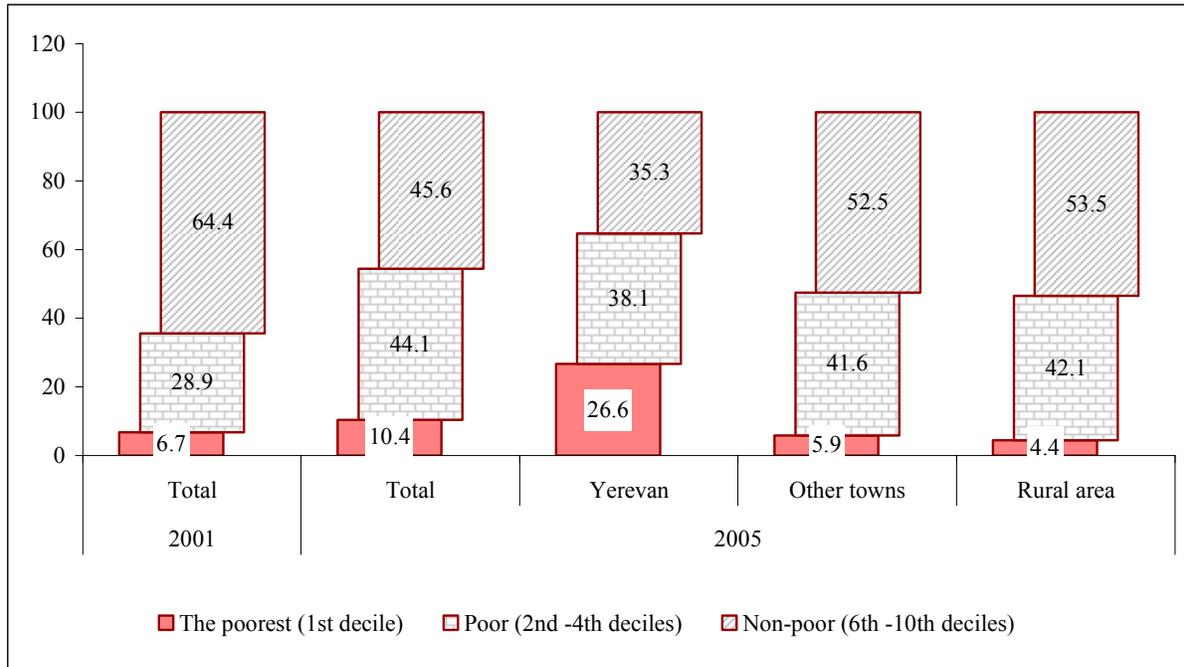
Benefits	290.5	393.0	649.4	335.8	868.0	658.0
of which family benefits		356.8	567.8	254.6	772.2	536.8
<i>Non-poor (5-10-income deciles)</i>						
Total	792.6	1783.0	2321.5	1752.0	2613.3	2697.4
Pensions	604.5	1344.4	1987.2	1600.6	2068.2	2280.7
Benefits	188.1	438.6	334.4	151.4	545.1	416.8
of which family benefits		404.5	278.5	119.6	455.3	363.7
<i>Average</i>						
Total	801.9	1645.8	2231.3	1961.6	2397.6	2358.6
Pensions	593.7	1237.4	1789.1	1697.1	1772.0	1889.3
Benefits	208.2	408.3	442.2	264.5	625.6	469.3
of which family benefits		374.9	376.4	201.9	536.2	396.8
<i>% to average</i>						
<i>Very poor (1st income decile)</i>						
Total	69.1	51.8	68.1	109.0	52.9	46.9
Pensions	79.4	46.9	58.8	83.0	50.0	47.0
Benefits	39.6	66.8	105.7	275.8	61.1	46.5
of which family benefits		67.0	66.7	266.5	58.6	44.1
<i>Poor (2-4 income deciles)</i>						
Total	112.6	99.4	102.6	118.4	97.7	89.0
Pensions	103.2	100.4	91.6	117.0	83.2	76.2
Benefits	139.5	96.2	146.9	127.0	138.7	140.2
of which family benefits		95.2	150.8	126.1	144.0	135.3
<i>Non-poor (5-10-income deciles)</i>						
Total	98.8	108.3	104.0	89.3	109.0	114.4
Pensions	101.8	108.6	111.1	94.3	116.7	120.7
Benefits	90.3	107.4	75.6	57.2	87.1	88.8
of which family benefits		107.9	74.0	59.2	84.9	91.7

* Calculated by deciles formed on the basis of HS monetary income data.

126. In 2005, the level of purposefulness of family benefits and consequently, their efficiency was the highest³⁸ in Yerevan, where the share of top 6 deciles in 2005 was 35.3% (national average 45.9%), while in other towns and rural areas the degree of purposefulness of the system was substantially lower than in Yerevan.

³⁸ Deciles are formed on the basis of HS income data.

Figure 2.7. Distribution of the family benefits among poor and non-poor population in 2001-2005, % (as by income deciles)



127. Table 2.20 shows the distribution of the poverty family benefits by decile groups of population formed on the basis of consumption aggregate. Here the degree of purposefulness (orientation towards the poor and very poor population) is substantially higher than in the previous case, especially for very poor population; however, the main regularities are the same: the system of benefits in Yerevan was the most efficient, where the very poor population received 41.7% of overall benefits – in case of 30.9% for rural areas and 31.4% for urban areas; while the non-poor population received 22.9% of overall benefits – in case of 38.3% for rural areas and 31.3% for urban areas. This means that inclusion and exclusion errors were the smallest in Yerevan and the biggest in rural areas.

128. According to 2005 data, the expediency of the benefit system calculated from the fact of being registered in the system (according to the existing order only the households registered in the benefits system are entitled to receive family benefits, whereas the registration is voluntary) for very poor families (before they received benefits) was 91.6%, for poor families - 79.9% and for non-poor families - 67.2%. It should be mentioned that in 2005, the benefits system involved 60.7% of very poor families, 39.1% of poor families and 18.8% of non-poor families (Figure 2.8).

Table 2.20. Distribution of family benefits by decile groups formed on the basis of consumption aggregate in 2005*

Indicators	Beneficiaries, decile as compared with population, %	As compared with total beneficiaries, %	Amount of benefit, million drams	% as compared with total
Armenia				
Very poor (1 income decile)	42.0	31.7	490.5	33.0
Poor (2-4 income deciles)	16.5	36.2	511.1	34.4
Non-poor (5-10 income deciles)	7.3	32.1	484.1	32.6
Yerevan				
Very poor (1 income decile)	26.3	36.6	107.4	41.7
Poor (2-4 income deciles)	16.2	40.2	90.9	35.3
Non-poor (5-10 income deciles)	2.8	23.2	59.0	22.9
Other towns				
Very poor (1 income decile)	55.5	30.4	203.7	31.4
Poor (2-4 income deciles)	17.4	38.1	241.2	37.2
Non-poor (5-10 income deciles)	9.6	31.5	203.0	31.3
Rural areas				
Very poor (1 income decile)	44.5	29.8	179.4	30.9
Poor (2-4 income deciles)	16.2	32.5	178.9	30.8
Non-poor (5-10 income deciles)	9.4	37.7	222.2	38.3

* First, the population is being classified according to consumption aggregate sizes of adult equivalent, and then the respective incomes are being considered.

Figure 2.8. Number of the households registered in the family benefit system in 2005 (by poverty level)

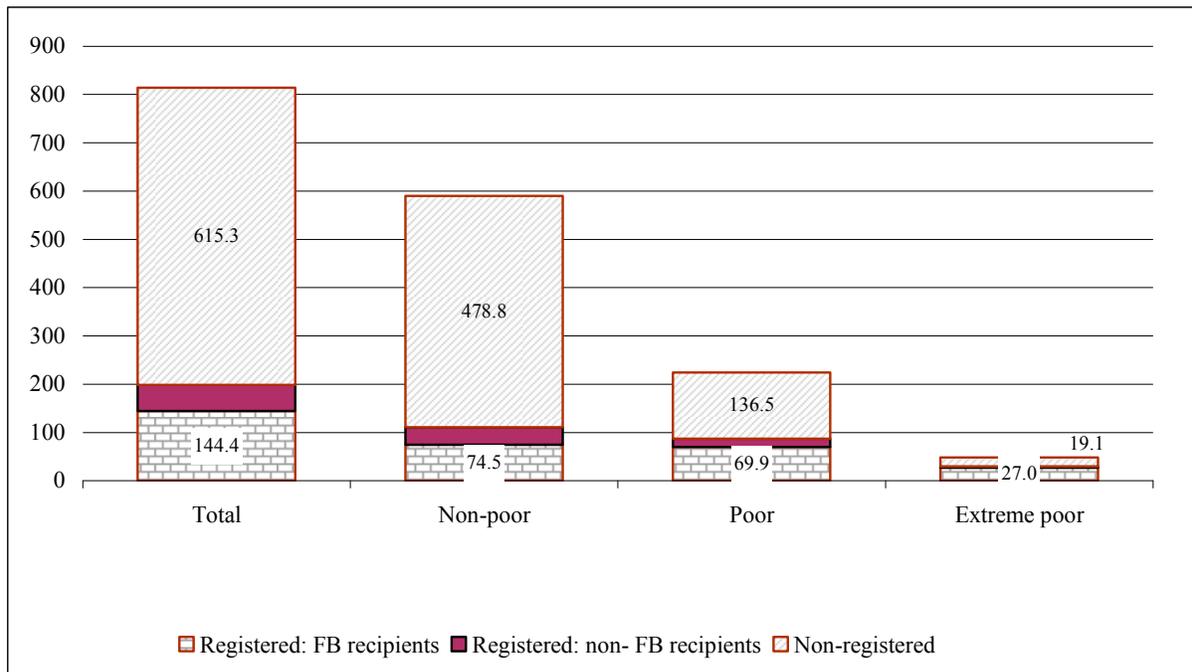
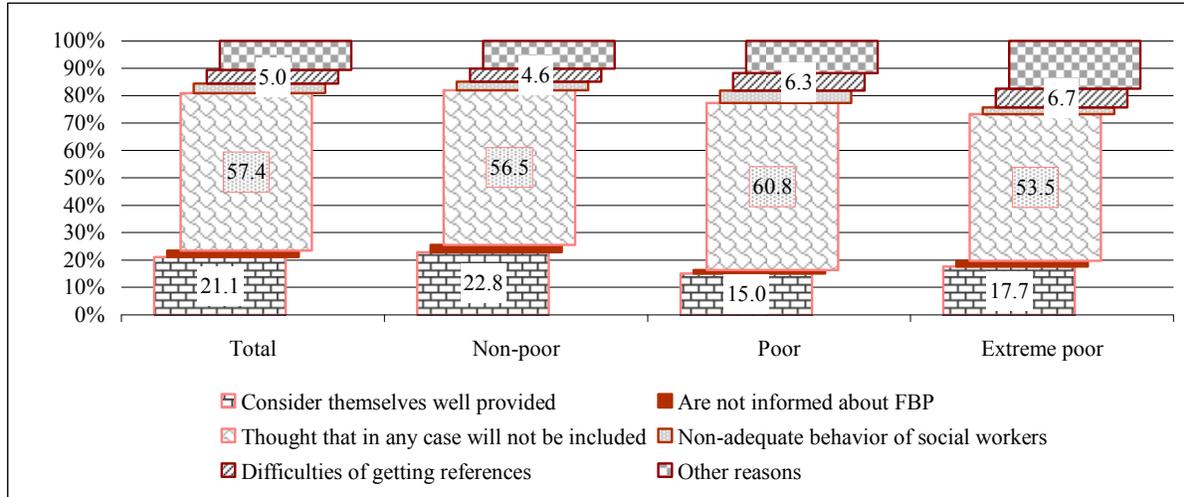


Figure 2.9. Major reasons for exclusion from the family benefits system by poverty levels



129. From the aforementioned two major issues stem for the further development of the family benefit system:

- the targeted transition from extreme poor population to poor population as a major goal of the benefit system and
- the increase of the system's purposefulness degree through the improvement of social services and involvement of non-registered poor and very poor families in the system.

2.6. *Employment and Reduction of Poverty in Armenia*

130. The labor income is a decisive factor conditioning the welfare level and poverty reduction of the households. The impact of this factor is expressed by the growth of the population's employment, as well as by the income of each employed person. According to HS data, as a result of economic growth in Armenia in 1999-2004³⁹ two factors have contributed to the poverty reduction.

131. As shown the indicators presented in Table 2.21 in contrast to official statistical data⁴⁰, in that period, the number of employees in Armenia grew up by 117.8 or 13.4%. The increase in employment was registered in the towns of the country; in Yerevan it made 30.9%; in other towns - 52.1%, while in the rural areas the employment decreased

³⁹ Selection of the data obtained in 2004 is conditioned by the fact that in 2005 HS required questions concerning the employment issues are missing.

⁴⁰ According to official statistics, in 1999-2004 the employment went down by 16.8 thousand or 16.7%. The difference of the data is explained by different calculation methodologies. However, one shall mention that the difference of employment between official and HS data has been reduced: the official estimate in 1999 was 1298 and in 2004 it made 1081.7 thousand people and, according to HS, respectively 882 thousand and 999.8 thousand people.

by 21.7%. As shown in Tables 2.20 and 2.21, the employment increased in the income groups of poor and non-poor (except for rural areas) and decreased among very poor population (except for rural areas). In rural areas, based on the peculiarities of rural activities in Armenia (small farm sizes; prevalence of natural economy and low productivity of labor, work that is done exclusively by own strength, etc.) the employment degree does not have a significant impact on the poverty level. In urban areas there is a substantial negative link between poverty and employment level: the employment level of the poor population is substantially lower, than that of non-poor. Despite the employment increase among poor population in 1999-2004, the employment of non-poor population grew faster, and the breach of employment levels among poor and non-poor population increased as the employment of very poor decreased both in Yerevan and other towns.

Table 2.21 Population employment and per capita monthly incomes in 1999- 2004 (in current prices, dram)*

Indicators	1999				2004			
	Armenia	Yerevan	Other towns	Rural areas	Armenia	Yerevan	Other towns	Rural areas
Adult population employment, % as compared with the general								
Very poor (1 decile)	45.5	18.3	23.7	64.3	42.8	10.5	22.4	61.8
Poor (2-4 deciles)	40.8	19.5	26.3	64.3	44.5	21.0	29.5	64.9
Non poor (5-10 deciles)	45.7	29.7	26.3	71.6	50.9	41.3	45.7	69.6
Total	44.3	27.8	28.9	68.2	48.2	32.2	38.5	67.4
Per employee monthly incomes conditioned by economic growth in Armenia (from labor and sale of agriculture products), dram								
Very poor (1 decile)	565.3	2,234.1	463.6	259.7	1,843.5	21,963.7	3,468.4	984.9
Poor (2-4 deciles)	3,623.0	13,461.6	7,525.0	2,233.5	10,865.6	53,504.5	16,210.9	4,567.8
Non poor (5-10 deciles)	33,533.3	35,610.9	35,765.7	30,661.9	44,815.9	63,436.1	37,610.2	24,853.0
Total	21,263.4	25,628.4	24,003.2	19,093.1	30,333.6	59,144.1	30,354.5	14,942.4
Number of employed, thousand people								
Very poor (1 decile)	90.7	12.6	14.3	63.9	88.9	7.5	13.9	67.5
Poor (2-4 deciles)	244.2	40.1	47.5	156.5	277.3	44.9	54.9	177.4
Non poor (5-10 deciles)	547.1	122.3	95.1	329.6	633.6	176.5	169.9	287.2
Total	882.0	175.0	157.0	550.1	999.8	229.0	238.7	532.1

* For 16-63 years old population.

132. The employment increase reduced the unemployment level both in Yerevan and other towns. The breach between the unemployment levels calculated on HS data and officially registered (Table 2.23) reduced as well. The unemployment level in the rural areas is the lowest due to the peculiarities of the rural life.

133. Together with the creation of new jobs and employment growth there has been a fast growth of the labor incomes of the employees with the incomes of poor and very poor growing faster. In this regard, the reduction of working poor, which took place in Yerevan and at lower degree in other towns of the republic, is substantial. In rural

areas,⁴¹ where the financial relations are of less prevalence, the monetary incomes of the employees grew slower, than in urban areas.

Table 2.22. Monthly income growth per employee in 2004 (in percentage as compared with 1999, Index=100)

Indicators	Armenia	Yerevan	Other towns	Rural areas
Employment				
Very poor (1 decile)	98.0	59.7	97.4	105.6
Poor (2-4 deciles)	113.6	112.1	115.5	113.3
Non poor (5-10 deciles)	115.8	144.3	178.5	87.1
Total	113.4	130.9	152.1	96.7
Per one employee incomes conditioned by the economic growth in Armenia (labor and sales of agriculture products), dram				
Very poor (1 decile)	326.1	983.1	748.1	379.3
Poor (2-4 deciles)	299.9	397.5	215.4	204.5
Non poor (5-10 deciles)	133.6	178.1	105.2	81.1
Total	142.7	230.8	126.5	78.3

Table 2.23. Employment and unemployment level or population in 1999- 2004

Indicators	1999				2004			
	Armenia	Yerevan	Other towns	Rural areas	Armenia	Yerevan	Other towns	Rural areas
Economically active population , % to total population								
Total	63.0	55.0	57.6	72.7	61.4	52.9	53.8	72.0
Employed population % to economically active population								
Very poor (1 decile)	45.5	18.3	23.7	64.3	42.8	10.5	22.4	61.8
Poor (2-4 deciles)	40.8	19.5	26.3	64.3	44.5	21.0	29.5	64.9
Non poor (5-10 deciles)	45.7	29.7	26.3	71.6	50.9	41.3	45.7	69.6
Total	44.3	27.8	28.9	68.2	48.2	32.2	38.5	67.4
Unemployment level cording to HS, % to economically active population								
Very poor (1 decile)	17.5	36.7	33.9	8.4	18.6	42.3	31.4	10.2
Poor (2-4 deciles)	22.2	35.5	31.3	8.4	16.9	31.8	24.3	7.1
Non poor (5-10 deciles)	17.3	25.3	31.3	1.1	10.5	11.6	8.1	2.4
Total	18.7	27.2	28.7	4.5	13.2	20.7	15.3	4.6
Number of officially registered unemployed, % to economically active population								
	11.2	11.0	31.9	1.6	9.6	8.7	24.0	1.3

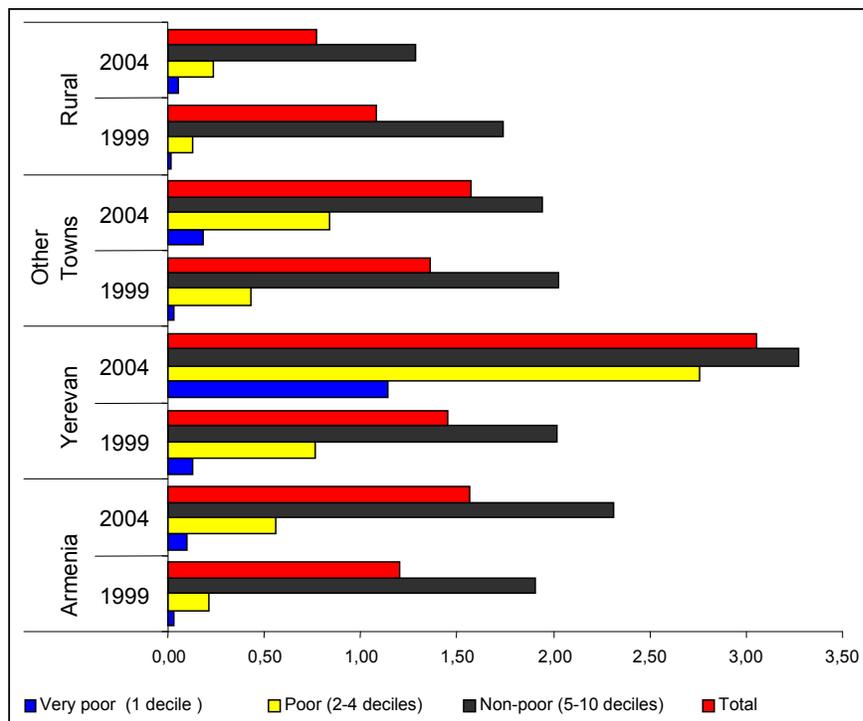
134. Figure 2.10 comes to witness the substantial increase in labor cost. The problem of the “working poor” in Yerevan can be deemed as solved in 2004. Thus, the income of one employee belonging to very poor group constituted 113% of poverty line instead of 13 in 1999. As regards the income of the employees belonging to the poor group, it made 276% of poverty line instead of 76% in 1999.

⁴¹ The income reduction of rural non-poor population calculated according to HS data does not comply with the official statistics data and is conditioned by steep decrease of income from the sale of agricultural products in the highest 9th and 10th deciles as compared with 1999, which most likely does not comply with reality and is conditioned by the peculiarities of family formulation.

135. In other towns, irrespective of per employee income progressive growth the problem of “working poor” has not been solved. Thus, the income of employee belonging to poor group in 2004 made 84% of poverty line or almost 2 times more than in 1999. This comes to explain high percentage of registered unemployed in other towns of Armenia, as compared with Yerevan.

136. Table 2.21 shows that the economic life is getting more and more concentrated in the capital. Thus, in 1999 the difference of the employees’ incomes between Yerevan and other towns of Armenia was only 6.8%, while in 2004 already around 2 times more. This is relevant to per capita GDP proportion of Yerevan and other towns, which was around 250%.

Figure 2.10. Comparison of income growth due to economic growth and poverty line, 1999 and 2004



137. Thus, the link between employment and poverty in Armenia, which in 1999 had approximately the same nature in Yerevan, other towns and rural areas, at present, is substantially different. In Yerevan, where the problem of “working poor” is mostly solved, the major reason for poverty is unemployment, the level of which is about 3.6 times (for very poor population) and around 2.7 times (for poor population) more, than that of non-poor and therefore, the economic policy should be channeled towards the creation of new jobs and ensuring of more favorable conditions.

138. As of the other towns of the republic, the unemployment as the major reason for poverty is still accompanied by low working incomes and therefore, the economic policy should be aimed at the promotion of not merely jobs, but also jobs ensuring high value added production.

139. In the rural areas, a major issue still remains the increase of productivity degree and increased opportunities for non-agricultural employment and therefore, the economic policy should be aimed at the solution of the mentioned issues.

2.7. *Alternative estimates of poverty*

140. Table 2.24 shows the alternative estimates of poverty for 1999-2005. During the mentioned period Armenia eliminated the extreme poverty measured according to internationally recognized indicators (1\$ and 2.15\$ per day) that are used for developing countries.⁴² As regards the poverty line used to estimate the top threshold of neediness for the countries of lower middle group of Eastern Europe and CIS (4.30\$ per day), in the period of 1999-2005 it reduced by about 4 times, and by 2005 it was already lower than the poverty measured by national poverty line.

Table 2.24. Alternative estimates of poverty in 1999- 2005

Indicators	1999*	2001*	2004	2005
	<i>% to number of existing population</i>			
Less than 1\$ per day	7.54	3.4	0.1	0.0
Less than 2.15\$ per day	43.5	36.1	1.8	0.8
Less than 4.30\$ per day	86.2	81.8	34.4	23.2
Less than 11\$ per day				85.6
Less than minimal food basket				6.9
Less than minimal consumption basket				41.2
<i>Memorandum articles</i>				
Purchasing parity of 1\$	3.26	3.38	3.61	3.08
National food poverty line in \$ - per capita a day	2.27	2.27	2.81	2.98
National poverty line in \$ - per capita a day	3.58	3.58	4.36	4.56
Minimal consumption food basket, dram per month				17,870
Minimal consumption basket, dram per month				29,843

* For 1999 and 2001 2\$ and 4\$.

141. In case of applying in Armenia the 11\$ per day poverty line used for the comparison of the poverty levels in the developed countries (in 2005 monetary terms it was monthly 48 972 dram per capita) the poverty level would be 85.6%.

142. In 2005, the extreme poverty level was 7.2 % with the minimal food basket t used as food poverty line⁴³, and the poverty level was 41.2% with the minimal consumption basket used as general poverty line⁴⁴, which is consistent with 2003 poverty level.

⁴² 1\$ per day poverty line is used by the World Bank and Millennium Development Goals in order to estimate the poverty level in the developing countries of Africa and Southern Asia, and 2.15\$ per day poverty line is used to estimate the extreme poverty level in CIS countries.

⁴³ Estimated by the NSS on the basis of the list, structure and nutritious facts of the food products elaborated by the RA MoH (2,412 kilo calories per day) which constituted 17870 AMD per capita for 2005

143. The fast reduction of poverty level (including the extreme poverty), which according to SDP forecasts will continue also in medium term perspective, will make it possible to use the minimal food and minimal consumption baskets as extreme and general poverty lines during the SDP implementation.

⁴⁴ In 2005, the minimal consumption basket assessed by NSS of Armenia on the basis of the list, structure and nutritious facts of the food products developed by the RA MoH and it cost 29843 per capita.

3. *Material Poverty Reduction goals under the SDP*

144. Thanks to sustainable economic development relevant to the PRSP macroeconomic framework, as well as to the measures undertaken to ensure progressive growth of public resources directed to the social policy and increase of its purposefulness, it is envisaged to reduce the share of poor population to 14.0% in 2012; to 10.1% in 2015; and to 6.8% in 2021 instead of 26.0% in 2006. The poverty will be substantially reduced in all marzes of Armenia: both in urban and rural areas,

145. Thus, in Yerevan the share of poor population will be respectively 8.7% in 2012; 5.4% in 2015, and 3.2% in 2021 instead of 19.6% in 2006 and the poverty⁴⁵ will stop being a dramatic social issue already since 2015. Such nature of poverty reduction is conditioned mostly by the forecast that in Yerevan the economic growth rate is expected to be higher, than in other urban and rural areas of the country, which in its turn can be explained by the concentration of the most rapidly growing sectors of the economy mainly in Yerevan, as well as by the higher degree of purposefulness of allocating the social assistance, which will also be maintained during the SDP implementation.

146. The share of poor population in other towns of the country will constitute respectively 18.5% in 2012; 13.1% in 2015 and 8.4% in 2021 instead of 34% in 2006 or will be reduced by more than five times. In order to achieve such reduction, one needs substantial acceleration of economic growth rate, to which the measures aimed at the mitigation of territorial development disproportions will contribute.

147. With regard to the rural poverty, the share of the poor population will make 14.9% in 2012; 11.6% in 2015, and 9.1% in 2021 instead of 26.6% in 2006. The reduction of rural poverty will be slower than in Yerevan and other towns of the country because of a slower growth of the major agricultural sectors in rural areas.

148. The extreme poverty per se will be eliminated by 2015, when according to SDP forecasts, it will make 1.6% on average, of which in Yerevan 0.8%, in other towns of the country 2.2% and in rural areas 1.8% instead of the average of 4.2% in 2006, where the share of Yerevan was 2.7%, of urban areas 6.4% and of rural areas 3.0%.

149. The major factors conditioning such poverty reduction will be the progressive growth of the poor population's labor incomes and employment level, as well as the progressive growth of the pensions and increase of purposefulness of the benefit system.

150. In parallel with the envisaged rapid poverty reduction, starting from 2018, SDP envisages to switch to the minimal consumption basket as a new poverty threshold and to the minimal food basket as a new extreme poverty threshold.

151. The major indicators concerning the poverty reduction are shown in Table 3.1.

⁴⁵ Measured by present poverty line.

Table 3.1 The PRSP main target indicators for poverty reduction

Indicators	2006	2012	2015	2018	2021
<i>Armenia</i>					
Poor, % of population	26.0%	14.0%	10.1%	8.4%	6.8%
Poor, thousand people	839	459	335	283	230
Extreme poor, % of population	4.2%	2.1%	1.6%	1.4%	1.2%
Extreme poor, thousand people	134	69	53	47	41
Poverty threshold, per month, dram	21 555	28707	31366	34280	37455
Extreme poverty threshold, monthly dram	14300	19045	20809	22742	24848
<i>Yerevan</i>					
Poor, % of population	19.6%	8.7%	5.4%	4.3%	3.2 %
Poor, thousand people	216	98	62	50	37
Extreme poor, % of population	2.7%	1.1%	0.8%	0.6%	0.4%
Extreme poor, thousand people	30	12	9	7	5
<i>Other towns</i>					
Poor, % of population	34.0%	18.5%	13.1%	10.6%	8.1%
Poor, thousand people	327	182	131	107	82
Extreme poor, % of population	6.4%	2.9%	2.2%	1.9%	1.5%
Extreme poor, thousand people	62	29	22	19	15
<i>Rural areas</i>					
Poor, % of population	26.6%	14.9%	11.6%	10.3%	9.1%
Poor, thousand people	309	177	139	126	111
Extreme poor, % of population	3.0%	2.3%	1.8%	1.7%	1.6%
Extreme poor, thousand people	35	27	22	21	19
Poverty calculated by MCB					
Poor, % or population	39.8%	24.8%	19.3%	15.3%	11.4%
Poor, thousand people	1283	812	640	515	385
Minimal consumption basket, monthly dram	31 961	42 566	46 509	50 829	55 537

***by the average prices for the third quarter**

152. The PRSP targets concerning the poverty level of particular groups of population are shown in Table 3.2, which demonstrates that the poverty levels are significantly reduced among all groups of population. The table 3.2 also shows the substantial impact of public policy ensuring progressive growth of pensions adopted within the SDP framework on the reduction of poverty rate of pensioners and disabled.

153. The most salient manifestation of the mentioned policy is the probable elimination of the poverty among the single pensioners since 2015, which will be mostly conditioned by the progressive increase of the pensions and by the policy aimed at ensuring the correspondence of the main pension size to the minimal poverty threshold. This growth also conditions faster than the nationwide average reduction of poverty level for the social groups receiving pensions, including disabled and those disabled from childhood⁴⁶.

⁴⁶ For the latter the poverty level in 2021 will be reduced by around 12 times, from 48.3% in 2006 to 3.9% in 2021.

Table 3.2. The PRSP main target indicators for poverty reduction by particular groups of population

Indicators	2005		2006		2012		2015		2021	
	Actual		SDP forecasts							
	Poor	Very poor	Poor	Very poor	Poor	Very poor	Poor	Very poor	Poor	Very poor
Children aged 5-16	33.1	5.2	26.5	4.3	12.6	1.8	8.7	1.4	6.8	1.1
Children up to 5 years old	34.9	5.1	35.3	5.6	12.9	1.9	9.6	1.4	6.7	1.2
Retired	30.0	3.9	26.5	4.6	5.8	0.6	3.2	0.3	1.0	0.1
Sole retired	20.0	0.0	19.2	0.0	8.0	0.0	0.0	0.0	0.0	0.0
75 years old and above	30.5	5.2	29.5	4.9	3.6	0.4	2.9	0.2	0.5	0.1
1 st class disabled	27.3	1.9	27.2	1.5	9.0	1.6	6.5	1.0	2.2	0.6
2 nd class disabled	33.1	4.2	31.6	4.1	10.4	1.1	6.0	0.6	2.6	0.5
3 rd class disabled	36.2	7.7	35.8	7.9	12.8	2.0	8.2	1.4	4.2	0.8
Disabled at birth	51.9	10.6	48.3	11.2	13.7	1.7	7.8	0.6	3.9	0.5
Employees	22.7	3.0	21.3	2.2	3.6	0.3	2.4	0.2	1.5	0.1
Self-employed	27.3	3.2	23.9	2.8	14.1	2.1	11.2	1.7	7.5	1.4

154. As for the children, the reduction of their poverty level will be conditioned by the economic growth, the impact of which will be expressed in the income growth of employees, which are already the main sources of income of the households⁴⁷, as well as the social assistance policy, where the main target group receiving the family benefits will continue to remain poor households with children.

⁴⁷ According to 2005 HS data, the incomes received from employment constituted 53% of the overall monetary incomes. According to SDP forecasts, it is envisaged that the share of income from the employment in the overall income picture in 2008-2012 will be kept at around 52-53%.

4. Macroeconomic framework

4.1. *Main macroeconomic developments in 2003-2007*

155. Although the actual move of macroeconomic indicators, in particular the economic growth rate are somewhat deviated from macroeconomic indicators projected by the PRSP scenario; however, in general the trends envisaged by PRSP remain the same.

4.1.1. Real sector

156. The economic growth recorded in Armenia in 2003-2007 was 13.1% on average instead 6.2% envisaged by PRSP. Such a higher than planned economic growth was achieved with the participation of almost all economic sectors. It should be mentioned that at the same time, a considerable increase of the role of non-export section of the economy was recorded in GDP structure. This means that the demand driven economic growth continued and deepened.

157. Thus, in **construction** sector the annual economic growth in 2003-2007 was 28.5% instead of planned 9.9%, as a result of which the share of the sector in GDP increased and in 2007 instead of the envisaged 15.7% it was 24.7%. The annual growth rate in construction sector constituted 45.5% in 2003; 15.3% in 2004; 27.9% in 2005; 37.7% in 2006, and 18.6% in 2007. The unprecedented growth of the construction sector is mostly conditioned by private investments, including the growth of the housing. The major reasons for the latter were foreign remittances and higher than in previous years savings of the population.

158. The income growth also determined the high demand for **services**. In 2003-2007, the average growth rate of the services constituted 13.5%, instead of the envisaged 7%, as a result of which the share of the sector in GDP in 2007 was 33.2%.

159. The growth in industry was lower than expected. The growth in **industry** was mostly conditioned by the increase in volumes of metal raw material production and metal processing since 2002-2003. In 2003-2007, the average growth of the sector constituted 4.6% instead of expected 6.6%. This was mainly conditioned by the decline of industry in 2006 (by 2.5% as compared to 2005) the main reason for which was the reduction of the volume of chemical industry, diamond cutting and tobacco industry in 2006. The industry growth rate was: in 2003 15.6%; in 2004 2.2% and in 2005 5.6%. In 2007 the growth rate in this sector was 3.1%. In addition, substantial foreign investments contributed to the increase of overall investment level on the one hand and to the increase in growth rate, on the other.

160. **The agriculture** growth was mainly conditioned by the favorable climate conditions and increase of arable land. In 2003-2007, the average annual growth of the sector was 8.0% instead of the planned 2.4%, with the main deviation recorded in 2004-2005, when the actual growth constituted respectively 14.2% and 11.2%.

161. However, the progressive growth of the construction sector and high start-up share of the service sector in GDP led to the reduction of industry and agriculture share in GDP

162. In 2003-2007, certain moves were recorded also in the relations between the economy's **consumption and savings** sectors. Conditioned by high economic growth and large-scale foreign inflows, the considerable part of increased national savings mostly bypassed the financial sector and turned into investments, and especially private investments, particularly in the housing construction. Thus, the share of investments in GDP in 2007 was around 16.3 percent point higher than envisaged – making it 37.3%, while the share of the national savings was 32% - surpassing the envisaged level by 16 percentage points⁴⁸.

163. Conditioned by the aforementioned trends of the economic development in 2003-2007 there was a substantial increase in per capita GDP. Thus, in 2007 per capita GDP in dollar denomination was \$2.853 against \$740 in 2002.

4.1.2. Prices

The growth of consumption prices in 2003-2007 was on average annual 4.4 % instead of envisaged 3.0%⁴⁹. One should take into account the fact that such high inflation in 2003 (8.6%) was mostly conditioned by the unprecedented price increase of one commodity in the consumption basket, i.e. grain products, which in its turn was impacted by more than 30% international price increase of grain. It should be mentioned that in 2007 unpredictable changes took place both in product and financial world markets (decline of real estate markets, fall in dollar exchange, substantial increase in provisions and raw materials prices, etc.), which for the most part determined the pricing policy in Armenia. In 2007 the prices in Armenia increased by 6.6% (as compared with 2006), of which 5.2 percentage points were conditioned by unprecedented increase in global market prices.

4.1.3. Developments of external sector

164. In 2004-2007, the external sector of the economy demonstrated certain deterioration trends in Armenia's trade and current account balances conditioned by decrease in export growth rates and more rapid growth of import capacities, with the latter being conditioned by the fact that starting from the third quarter of 2003, the nominal currency was appreciated. The mentioned negative trends were somewhat mitigated due to a higher than expected rate of incomes and official transfers (in 2004-2007 the average annual actual growth constituted 40.7%), as well as to a higher than expected economic growth rate (average growth rate in 2003-2007 was 13.1% instead of the planned 6.2%). As a result, the negative balance of the current account (as compared with GDP) in 2004-2007 had a negative trend: from 0.55% in 2004 it reached 6.4% in

⁴⁸ The national savings are calculated as the difference between the GNI and final consumption.

⁴⁹ In 2007 the CBA reconsidered the price increase targets fixing it for 4% (+/-1.5%) instead of 3% initially fixed % (+/-1.5%)`

2007. Within the mentioned period of time the average value of the indicator constituted 2.5% instead of planned 5.4%.

4.1.4. Public finances

165. In absolute terms, the indicators of consolidated budgets considerably grew up in 2003-2007; however, they were inferior to GDP growth rate. In 2003-2007, the average incomes and expenditures of the consolidated budget (as compared with GDP) were less than both actual indicators recorded in 2002 and those planned for 2003-2007. In particular, the average ratio of 2003-2007 actual incomes/GDP as compared with the respective indicators of 2002 decreased by 1.6 %, while the average ratio actual expenditures/GDP reduced by 1% making 20.8% and 22.3% instead of the envisaged 22.2% and 24.4 % respectively. Like in previous years this year as well the lion share of the budget incomes was provided by the tax incomes. Among the major changes in the structure of budgetary expenditures, in particular, the increase of the social sector expenditures should be mentioned.

166. Such a higher GDP growth was not accompanied by a similar growth of **tax revenues**. In 2003-2007, the tax-GDP ratio was 17.8% on average - by 0.2 percentage points remaining almost unchanged as compared to 2002 indicator and by 1.5 percentage points being inferior to the indicator envisaged for that period by the PRSP. This has been mostly conditioned by the GDP twice higher growth than the projected, the taxing capacities of which could not be immediately adapted. In addition, a considerable part of the economic growth was conditioned by the construction growth, a part of which is tax-free and the other part is hard to tax. Under such conditions, in the medium term perspective one of the most important sources of tax revenues for the Armenian Government will become sustainable and continuous improvement of tax administration.

167. As a result of developments in public financing sector in 2003-2007, there has been a considerable improvement of the **budget balance** – the deficit/GDP ratio, reducing from 2.6% in 2002 constituted around 1.5% in 2007, and in 2003-2007 it varied within 3-1.8%.

4.2. *2008-2021 macroeconomic framework projections*

168. The projections made within the SDP framework took into account main directions and targets of the policy adopted by the government of Armenia, particularly those concerning the improvement of the pension system. At the same time, the indicators and other quotients reflected both in the mentioned programs and in 2009-2011 MTEF were unified.

169. The major precondition ensuring the poverty reduction and income distribution will continue to remain the provision of long-term economic growth. The economic growth, on the one hand, mediated by the employment increase, will lead to the increase of employment incomes and on the other hand, contributing to the increase of

the income basis of the state budget, will expand the opportunities of income distribution policy conducted by the state.

170. Taking into account the economic developments of the previous years, the behavior of the factor conditioning them, as well as the rate of reforms aimed at the reinforcement of the economy's institutional basis, it is envisaged that during the forthcoming fifteen years Armenian economy will continue to grow at sustainable rate – with average 7% percent of annual growth.

171. Starting from 1994 until now the Armenian economy has permanently grown with average annual rate of almost 9.7%. In last five years, the accelerated economic development constituted an average annual growth of 13.1%. Although in 2008-2012 the GDP growth is expected to be less than that of the recent five years; however, quite high indicators will still characterize it. In the context of the aforementioned developments in 2007, the real GDP growth was tripled (as compared with 1994) thus surpassing the 1990 level by around 55%. At the same time, as a result of average annual nominal GDP growth of 10.8%, in 2021 (as compared with 2007) the per capita GDP will be almost four times more.

172. With regard to the major macroeconomic indicators the following developments are envisaged (see Table 4.1.):

- (i) **Real sector.** In the anticipated period, the GDP will trend to grow. Although until 2011 the rate of GDP growth will reduce (as compared with 2007), it will continue to remain high making average 9% per annum. The 2012-2021 economic growth rates will be relatively stable and make around 6%. These developments will take place as a result of presently formed real GDP growth rate (which is quite high), as well as due to the following envisaged changes in GDP sector structure: up to 2011 in GDP sector structural, conditioned by the growing demand factors, the non-export sector of the economy, in particular the capital construction and service sectors will continue to remain the driving force of the economic growth. Starting from 2012, the driving force of the economic development will be gradually shifted to the sectors of the economy based on increase of capital and scientific potential. In other words, during forthcoming 5-6 years the economic growth will be demand driven; and after that the high productivity sectors will step by step occupy leading positions⁵⁰.

⁵⁰ As the world economic experience shows, the developing countries usually undergo a number of transformations. The first transformation concerns the development of import substitutes; then comes the export growth on the basis of labor-intensive sectors (salaries with low competitive characteristics). Later on the economic transformations include development of capital-intensive branches. Finally, the economic development comes up to the introduction of high technologies. This is a knowledge-based, science intensive economy. This scenario underlies the SDP macroeconomic projections, i.e. a gradual transformation from labor intensive branches of the economy to capital intensive and then science intensive branches.

-
- (ii) **Consumer prices** Taking into account the recent developments in world markets (decline of real estate markets, fall in dollar exchange, substantial increase in provisions and raw materials prices, increase in prices conditioned by the supply factor, slow growth rate of global economy, etc.), as well as consequent increase in prices in domestic markets, it is envisaged that in upcoming years the price increase will exceed the RA CB 4+/-1.5% target. Nevertheless, as the pricing, which is mainly conditioned by supply factors (by increase of imported products prices), will tend to change its behavior, the long-term price increase targeting will comprise annual average 3+/-1.5%⁵¹. This will be achieved due to the RA CB new inflation targeted strategy, which in inflation management process, as compared with the previous strategy, is more flexible, as well as due to effective coordination of fiscal and credit policy. Starting from 2011 the GDP deflator is expected to be higher than CPI thus reflecting the process of transformation of the RA economy to the high value added production.
- (iii) **In GDP expenditure structure** the share of investments during forthcoming 14 years will remain at a high level - 29-37%. At the same time, it is envisaged that in medium-term perspective in the structure of the investments non-industrial capital construction will dominate (especially housing construction) – reflecting the aforementioned trend of GDP sector developments. In such a situation the share of investments in GDP will remain at an extremely high level comprising 37.8% of GDP in 2008-2012. However, starting from 2010 the share of investments in GDP will tend to decrease, and in 2021 it will make 29.1%. In perspective, in the structure of the investments there will be a gradual increase of industrial capital investments and the state participation to the capital construction will be gradually decreased – then remaining on quite high level.
- (iv) **The main benchmark for the forecast of indicators of the fiscal sector** has been the need to keep the inflation around 3+/-1.5 %, as well as meeting the money demand stemming from the other sectors of the economy. Under these circumstances, a certain increase of financial mediation is envisaged, which will lead to slowing down the money circulation and increase of monetization level. It is expected that in case of presently ongoing phenomenon of economy's monetization, existence of various monetary tools in money markets, as well as introduction of new pension system the demand for monetary share will have a progressive growth. On the other hand, it is expected that in parallel with the development of banking technologies and growth of formal transactions the demand for non-cash settlements will demonstrate progressive growth. As a result, the share of cash flow in monetary supply will gradually reduce. In 2021 it will make 17%, while the monetization indicator will reach 52.8%.
- (v) **The developments of the external sector** will be mostly impacted by the internal economy's developments and structural moves, as well as the process of integration

⁵¹ The mentioned situation will be ensured by a moderate fiscal and credit policy, which will exclude using increase of demand to meet price increase expectations.

of the Armenian economy into the global one. In this context, it is envisaged that the external openness of the country, calculated as relation between goods and services circulation in GDP (aggregate export and import) in the forecast period will have a growing trend – from the envisaged 58.3% in 2007 up to 101% in 2021 thus preconditioning the process of integration of the RA economy in global economic system. At the same time, in the forthcoming 2-3 years the negative balance of the goods and services as compared with GDP up to 2009 (as compared with 2007) will get a bit deeper (by around 5% points) and will make 25%. These developments will be conditioned by a high increase of the population’s incomes and high demand for the investment products. In the period of 2012- 2021 the aforementioned indicator will improve from year to year (in 2021 it will make 13.5%) thus reflecting the impact of high growth rate of the economy’s most productive sectors and consequently, the import of competitive goods and services. It is envisaged that the current account/GDP ratio will have approximately the same behavior, which will be characteristic to goods and services balance indicator. This means that up to 2009 as compared with 2007, the current balance will worsen, and in 2009 will make 9.6% of GDP. Then the balance will continuously improve and in 2021 it will constitute 4.4% of GDP.

Table 4.1. SDP macroeconomic framework: forecast of key indicators

Indicators	2007	2008	2009	2010	2011	2015	2018	2021
	<i>Actual</i>	<i>Forecast</i>						
	<i>% as compared with GDP, if nothing else is mentioned</i>							
<u>National income and prices</u>								
Real GDP, % change as compared with the previous year	13.8	10.4	9.2	8.5	8.0	6.3	5.7	5.1
GDP, billion dram	3,148.7	3,671.7	4,169.3	4,703.2	5,280.7	7,837.7	10,228.3	13,114.6
GDP million US dollar	9204	12022	13651	15399	17290	25662	33490	42939
Per capita GDP, US dollar	2853	3718.0	4210.0	4734.6	5297.2	7724.9	9944.9	12618.1
CPI (average), % change as compared with the previous year	4.4	8.9	6.1	3.8	3.4	3.0	3.0	3.0
Exchange rate (average), dram/US dollar	342.0	305.4	305.4	305.4	305.4	305.4	305.4	305.4
<u>Investments and savings</u>								
Investments	37.2	37.6	38.2	37.9	37.5	34.2	31.4	29.1
Consolidated budget	6.5	5.5	5.2	5.0	4.9	4.6	4.6	4.6
Other	30.7	32.1	33.1	32.9	32.6	29.6	26.8	24.5
National savings	32.0	30.1	30.4	31.2	32.3	30.1	27.1	24.7
Consolidated budget	4.7	3.8	4.1	3.7	3.6	3.2	3.1	2.9
Other	27.3	26.4	26.4	27.5	28.7	26.9	24.1	21.8
<u>Tax-budgetary section</u>								
Consolidated budget								
Total incomes and grants	22.4	21.6	22.1	22.1	22.4	24.2	25.7	26.7
Of which tax revenues	19.3	20.8	20.8	21.2	21.6	23.5	24.6	25.6

Indicators	2007	2008	2009	2010	2011	2015	2018	2021
	<i>Actual</i>	<i>Forecast</i>						
Grants	0.8	1.0	0.9	0.5	0.3	0.1	0.1	0.1
Total expenditure ⁵²	23.9	24.1	24.2	24.4	24.7	26.8	28.2	29.2
Current expenditure	16.7	17.9	18.1	18.6	19.0	21.5	23.0	24.2
Capital expenditure ⁵³	6.5	5.5	5.2	5.0	4.9	4.6	4.6	4.6
Net crediting	0.7	0.7	0.8	0.8	0.8	0.7	0.6	0.4
Balance excluding cumulative system)	-1.5	-2.4	-1.9	-2.1	-2.1	-2.1	-2.1	-2.1
Balance (including cumulative system)	-1.5	-2.4	-1.9	-2.3	-2.3	-2.4	-2.5	-2.5
Public debt								
Internal debt	2.0	2.4	2.7	3.2	3.7	5.3	6.6	8.0
External debt	15.7	13.5	13.2	13.2	13.3	14.5	15.3	15.9
Total debt	17.8	16.0	15.9	16.4	17.0	19.8	21.9	23.9
External sector								
Export	19.3	15.9	15.8	16.8	18.1	27.0	35.6	43.8
Import	39.0	38.4	40.5	42.3	43.9	48.9	53.3	57.3
Current account	-6.4	-9.0	-9.6	-9.3	-8.8	-7.0	-5.9	-4.4

⁵² Include expenses concerning credit and cumulative systems

⁵³ Do not include crediting expenditures

173. **The economic forecasts** have been done by provisionally dividing the period of 2008-2021 into two parts, considering that in that time the sector developments would have different directions. At the same time it should be mentioned that in the entire forecast period the GDP structure will substantially change. Thus, in 2008-2011 the GDP growth conditioned by growth of demand specific to present developments of RA economy will continue. In this case in the sector structure of the economy the construction and services sectors will be dominant, the supply growth of which mostly responds to the developing demands of the economy, while the productiveness growth of the latter in the long-term perspective is limited⁵⁴.

174. In 2011-2021 the aforementioned trends will somehow change conditioned by a number of structural factors. First, the high growth rate of construction and services sectors will be constrained due to limited nature of productivity growth in the mentioned sectors. Second, their growth will lead to salary level increase in Armenia, in which case one can expect the return of Armenian citizens that had left for seasonal work. This in turn will have an impact on foreign transfer's volumes (it should be mentioned here that 30.6% of persons transferring money to Armenia are seasonal workers⁵⁵). On the other hand, the capital investments of industrial significance made in previous years will gradually return the costs made through growth of productivity, as a result of which there will be a gradual acceleration of economy's, especially industry's, as well as capital sectors' development. Together with the abovementioned, conditioned by the demand growth for the services, as well as complication of the latter in parallel with the economy, the high rate of value added of the services will continue. In the light of the latter the following developments are envisaged:

- (i) In 2008-2011 the average growth rate of value added **of industry** will concede the GDP growth rate and will be quite low - 6.9% per annum. As a result, the share of the sector's value added in GDP will remain at the level of 13.5%. Then, in 2011-2021 the growth of this sector will accelerate and in the perspective it will surpass the average annual GDP growth. These trends will reveal themselves as a result of investments made in the sector – in parallel with fast growth of productivity. The average indicator of the latter will be more progressive than the average indicators of the productivity change in other sectors of economy and will make around 10.4%.
- (ii) Taking into account **the agriculture** peculiarities, high rate of agriculture growth is not expected during the entire predicted period – in 2008-2021 the value added of the sector will constitute annually 3.3% on average.

⁵⁴ The estimates of the regression analysis come to witness it, according to which the construction and services sectors are mostly conditioned by the volumes of foreign remittances (private remittances).

⁵⁵ Source statistical department of RA CB "Summary and analysis of survey results to estimate the real volumes of monetary remittances received by the Armenian households in 2005".

- (iii) In 2008-2011, the value added growth in **the construction** sector will be make around 11% per annum, while the share of the sector in GDP will be around 27%. Starting from 2011 and until 2015 the growth rate of the sector will substantially slow down making on average 2.8%, and starting in 2015 the sector will have almost zero growth rate. Thus the share of the sector in GDP in 2021 will constitute around 16%.
- (iv) In 2008-2021, the value added of the **services** will continue growing at high rate, which will make about annual 9% on average. As a result, the share of this sector in GDP in 2021 as compared with 2008 will grow by around 13% points and will make around 43.9%.

Maintenance of such a high economic growth rate cannot be of inertia nature. It will definitely be conditioned by implementation of a range of structural measures aimed at the reinforcement of institutional basis and fundamental quality like, in particular, improvement of business environment, efficiency increase of investment policy; actions aimed at the productivity increase in export sectors and consequently competitiveness, as well as institutional developments of this sector aimed at the increase of education and science potential. The developments envisaged by the program macroeconomic framework for **the major sectors of economy** are presented in Table 4.2.

Table 4.2. Projections of key indicators for the development of economy sectors

Indicators	2007	2008	2009	2010	2011	2015	2018	2021
	<i>Actual</i>	<i>Forecast</i>						
GDP sector structure	<i>In current prices: billion dram</i>							
Industry	471.9	504.6	556.2	625.9	719.3	1284.0	1888.1	2578.0
Agriculture	568.5	603.1	648.5	697.5	750.0	981.4	1171.8	1378.9
Construction	777.5	987.5	1161.2	1322.4	1460.6	1799.9	1970.5	2153.2
Services	1015.4	1169.8	1321.2	1505.8	1725.1	2884.5	4128.6	5756.3
Net indirect taxes	315.4	406.9	482.2	551.6	625.7	888.0	1069.4	1248.1
GDP	3148.7	3671.7	4169.3	4703.2	5280.7	7837.7	10228.4	13114.6
GDP sector structure	<i>% to GDP</i>							
Industry	15.0	13.7	13.3	13.3	13.6	16.4	18.5	19.7
Agriculture	18.1	16.4	15.6	14.8	14.2	12.5	11.5	10.5
Construction	24.7	26.9	27.9	28.1	27.7	23.0	19.3	16.4
Services	32.2	31.9	31.7	32.0	32.7	36.8	40.4	43.9
Net indirect taxes	10.0	11.1	11.6	11.7	11.8	11.3	10.5	9.5
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Growth by main sectors	<i>Change as compared with the previous year: %</i>							
Industry	3.1	3.0	6.0	8.2	10.5	12.0	8.2	7.0
Agriculture	10.2	4.0	4.4	4.1	4.0	3.0	3.0	2.5
Construction	18.6	16.3	12.0	9.5	6.2	1.0	0.0	0.0
Services	13.4	9.0	8.6	9.4	9.6	8.6	8.8	7.5
Net indirect taxes	32.1	23.0	15.5	10.0	10.0	6.0	4.0	3.0
GDP	13.8	10.4	9.2	8.5	8.0	6.3	5.7	5.1

5. Economic Development Strategy

5.1. *Key priorities of the Government's economic development policy and priority directions of economic reforms*

175. The continuation of stable and high rate economic growth during 2008-2021⁵⁶ together with constant improvement of its quality is the key objective of the Government's economic policy. To achieve that objective the Government will continue and deepen the liberalization of the economy at the same time maintaining the achieved macroeconomic stability.

176. To ensure the high rate of economic growth and permanent increase of its quality during 2008-2021 Government's economic policy will include the following main priorities: of the be:

- Ensuring freedom for economic activities and equal conditions for economic competition - through a respective anti-monopoly and competitive fostering policy, as well as a policy aimed at the institutional modernization of the country;
- Ensuring the progressive development of the economy's private sector, especially of SME and micro-business businesses which serve as a basic means of self-employment for the socially insecure groups - through the policy aimed at the permanent improvement of business environment quality and SME advanced development;
- Promoting progressive growth of internal and external investment volumes and structural diversification – through a policy aimed at the permanent improvement of investment climate;
- Promoting efficiency and access to loan resources for the purposes of economic growth of internal and external savings – through a policy aimed at advanced development of the financial sector of the economy (including banking);
- Ensuring permanent increase of the Armenia's international competitiveness – through progressive growth of labor productivity and promotion of stable low cost of labor unit;
- Permanently increasing the integration of the Armenian economy into the global economy – through implementation of a policy aimed at export promotion, facilitation of external trade and reduction of transport costs;
- Improving the of economic development – through a policy of introduction of “knowledge” based economy's major structures, which will be aimed at the

⁵⁶ According to SDP forecasts, in 2008-2021 it is envisaged to ensure average annual 6.9% of economic growth, of which the average annual economic growth rate of 2008-2015 should be 7.9 %, while in 2016-2021 it should make 5.6%.

promotion and ensuring of advanced development of information and communication technologies, as well as vocational education.

177. For the implementation of the aforementioned priorities the permanent growth of the quality and opportunities of economic and public institutions, their modernization and relevance to the standards and requirements of the developed countries or in other words securing of the permanent process of the country's institutional modernization is of vital importance. The basis for this process will be created in 2008-2021, through a step by step adaptation of the Armenian legal framework, as well as economic and public institutions to the EU requirements and standards within ENP⁵⁷ framework, which is also one of the priorities of the Government's economic policy for 2008-2021.

Table 5.1. EBRD transitional status assessments in 2001 and 2006

Indicators	2001					2006				
	Armenia	CIS	Europe	Average	Maximum	Armenia	CIS	Europe	Average	Maximum
Privatization	3.00	2.47	3.10	2.84	4.00	3.67	2.61	3.50	3.14	4.00
"Small" privatization	3.67	3.39	3.87	3.67	4.33	4.00	3.58	4.02	3.84	4.33
Enterprise restructuring	2.00	1.78	2.46	2.16	3.33	2.33	1.83	2.92	2.45	3.67
Price liberalization	4.33	3.70	4.17	3.98	4.33	4.33	3.72	4.23	4.02	4.33
Trade and currency exchange liberalization	4.00	3.14	4.02	3.65	4.33	4.33	3.39	4.16	3.85	4.33
Competition policy	2.00	1.92	2.27	2.11	3.00	2.33	1.92	2.58	2.30	3.67
Banking reforms	2.33	1.83	2.92	2.45	4.00	2.67	2.31	3.38	2.91	4.00
Securities market and non-banking financial institutions	2.00	1.78	2.27	2.06	3.67	2.00	2.31	2.73	2.38	4.00
General infrastructure reforms	2.33	1.78	2.65	2.28	3.67	2.33	1.94	2.85	2.46	3.67
Telecommunication	2.33	2.14	3.10	2.68	4.00	2.67	2.42	3.35	2.94	4.33
Railway	2.00	1.92	2.73	2.37	4.00	2.00	2.00	2.94	2.52	4.33
Power sector	3.33	2.17	2.81	2.56	4.00	3.33	2.44	3.19	2.88	4.00
Road sector	2.33	1.67	2.48	2.14	3.33	2.33	1.69	2.60	2.22	4.00
Water and water removal	2.00	1.53	2.87	2.29	4.00	2.00	1.67	3.00	2.41	4.00
Aggregate reforms	2.69	2.23	2.98	2.66	3.86	2.88	2.42	3.25	2.88	4.05

Source: Transition Report, EBRD 2006: CIS without Armenia and including Mongolia.

Table 5.2. EBRD assessments of "first" and "second" generations of reforms in 2001 and 2006

Countries	General			First generation reforms			Second generation reforms		
	2001	2006	2006-2001	2001	2006	2006-2001	2001	2006	2006-2001
Hungary	3.81	3.90	0.10	4.25	4.25	0.00	3.63	3.77	0.13
Estonia	3.67	3.81	0.14	4.25	4.25	0.00	3.43	3.63	0.20
Check Republic	3.50	3.71	0.21	4.25	4.25	0.00	3.20	3.50	0.30
Poland	3.62	3.67	0.05	4.08	4.08	0.00	3.43	3.50	0.07

⁵⁷ European Neighborhood Policy, where Armenia has been included since June 2004 together with other South Caucasus Republics. In November 2006 the 2007-2012 action plan within ENP was approved, and in May 2006 - the National Program for 2006-2009 aimed at EU integration was approved.

Countries	General			First generation reforms			Second generation reforms		
	2001	2006	2006-2001	2001	2006	2006-2001	2001	2006	2006-2001
Slovak Republic	3.12	3.57	0.45	4.17	4.25	0.08	2.70	3.30	0.60
Latvia	3.19	3.43	0.24	4.00	4.17	0.17	2.87	3.13	0.27
Lithuania	3.19	3.43	0.24	4.00	4.25	0.25	2.87	3.10	0.23
Bulgaria	3.12	3.38	0.26	4.00	4.17	0.17	2.77	3.07	0.30
Croatia	3.09	3.36	0.26	3.92	4.00	0.08	2.77	3.10	0.34
Romania	3.12	3.33	0.21	3.92	4.00	0.09	2.80	3.07	0.27
Slovenia	3.24	3.26	0.02	3.92	3.92	0.00	2.97	3.00	0.03
Russian Federation	2.57	2.90	0.33	3.50	3.58	0.08	2.20	2.63	0.43
FUR Macedonia	2.62	2.90	0.29	3.75	4.00	0.25	2.17	2.47	0.30
Kazakhstan	2.67	2.88	0.22	3.58	3.67	0.09	2.30	2.57	0.27
Armenia	2.69	2.88	0.19	3.75	4.08	0.33	2.27	2.40	0.13
Georgia	2.78	2.86	0.07	4.00	4.08	0.08	2.30	2.37	0.07
Ukraine	2.50	2.74	0.24	3.33	3.67	0.34	2.17	2.37	0.20
Moldova	2.64	2.71	0.07	3.67	3.75	0.08	2.23	2.30	0.07
Albania	2.55	2.69	0.14	3.92	3.92	0.00	2.00	2.20	0.20
Mongolia	2.43	2.67	0.24	3.58	3.92	0.33	1.97	2.17	0.20
Bosnia and Herzegovina	2.21	2.57	0.36	3.00	3.34	0.34	1.90	2.27	0.37
Serbia	1.91	2.55	0.64	2.67	3.42	0.75	1.60	2.20	0.60
Kyrgyzstan	2.33	2.52	0.19	3.92	4.08	0.17	1.70	1.90	0.20
Azerbaijan	2.24	2.43	0.19	3.17	3.42	0.25	1.87	2.03	0.17
Montenegro	1.74	2.38	0.64	2.59	3.42	0.83	1.40	1.97	0.57
Uzbekistan	1.98	2.07	0.09	2.50	2.67	0.17	1.77	1.84	0.07
Tajikistan	1.83	2.05	0.21	3.25	3.33	0.08	1.27	1.53	0.27
Belarus	1.57	1.67	0.10	1.92	2.08	0.17	1.43	1.50	0.07
Turkmenistan	1.19	1.19	0.00	1.67	1.67	0.00	1.00	1.00	0.00
CIS Average	2.23	2.39	0.16	3.17	3.33	0.15	1.85	2.02	0.17
Average of European Countries	2.98	3.25	0.27	3.79	3.98	0.19	2.66	2.95	0.29
Average of Countries in Transition	2.66	2.88	0.22	3.53	3.71	0.18	2.31	2.55	0.24

Source: Transition Report, EBRD 2006: CIS without Armenia and including Mongolia.

178. One of the preconditions for 1994-2007 and especially 2001-2007⁵⁸ fast growth of Armenia is the successful implementation of so called “first generation” reforms⁵⁹. As shown in Table 5.1, Armenia according to EBRD reforms implementation assessment, both in 2001 and in 2006 was consistent with the average of the assessed 29 transition countries.

⁵⁸ As a result of 1994-2006 permanent economic growth GDP in 2006 was 136.6 % of 1990 against 46.8% in 1993, i.e. during 13 years it grew up around 2.9 times. In 1994-2006 the average economic growth was 8.5%, of which in 1994-2000 it made 5.4% and in 2001-2006 it was 12.3%, which ensured by GDP doubling during 6 years.

⁵⁹ According to EBRD, the “first generation” of reforms includes privatization and “small-scale” privatization. Which in transition countries were the main sources of creation of the private sector; liberalization of prices, external trade and currency exchange rate, which are the basis of the modern market economy (see Transition Report, EBRD 2006).

179. At the same time the distances⁶⁰ between Armenia and European countries in 2006 as compared with 2001 grew up from 0.29 up to 0.37. This is explained by slower rate of “second generation” reforms⁶¹ in the discussed period, than in European transition and a range of CIS countries.

180. Table 5.2 shows that although with regard to the “first generation” reforms Armenia in 2006 was comparable with EU-10⁶² countries’ average; was among the leaders in CIS and was exceeded the average European level (all the European countries in transition) by 0.10 points, the “second generation” reforms in 2001-2006 were slower in comparison with not only European countries, but also with a number of CIS countries, as a result of which in this sector at present Armenia is conceding all EU-10 countries, as well as the Russian Federation and Kazakhstan⁶³.

181. Non-achievements of a range of economic reforms benchmarks envisaged by PRSP 2006 come to witness slower than envisaged implementation of the “second generation” of reforms⁶⁴. In particular, the PRSP for 2006 envisaged the following benchmarks: enterprise restructuring: 3 (the actual being 2.33); competition policy: 2.4 (the actual being 2.33); banking reforms: 3 (the actual being 2.67); financial market and non-banking financial institutions reforms: 2.5 (the actual being 2.0); and infrastructure reforms: 3 (the actual being 2.33).

182. The Government realizes that at the present phase of the country’s development the sustainable economic growth in the long-term perspective and institutional modernization of the country is mostly conditioned by substantial acceleration of the “second generation” reforms and their successful introduction, as a result of which the Government envisages (Table 5.3 to surpass in 2010 the average level of European countries in transition registered in 2006; in 2015 to surpass the present level of Poland and in 2021 the present level of Hungary).

⁶⁰ Measured as the difference of the reform’s aggregate (the table shows the average numeric of the estimates).

⁶¹ According to EBRD the “second generation” of reforms include restructuring of the enterprises; competition promotion policy; financial sector reforms (including banking); infrastructure sectors’ reforms (including telecommunication, railway, power sector, and road and water sectors).

⁶² New EU member states.

⁶³ At the same time the Government considers that EBRD assessment of Armenia’s “second generation” reforms, particularly in power and water sectors, especially for 2006 are lower than should be, taking into account the broad scale of reforms in the power and irrigation sectors, which took place during 2001-2006. During the SDP implementation the Government will use EBRD reforms assessment methodology to calculate the respective assessments, which will be the major benchmarks for the implementation of SDP economic policy priorities.

⁶⁴ See PRSP, Yerevan 2003, Table 6.8.

Table 5.3. “First” and “second” generations reforms implementation benchmarks

Indicators	2006	2010	2015	2021
Privatization	3.67	4.00	4.00	4.00
“Small” privatization	4.00	4.33	4.33	4.33
Enterprise restructuring	2.33	3.00	3.67	4.00
Price liberalization	4.33	4.33	4.33	4.33
Trade and currency exchange liberalization	4.33	4.33	4.33	4.33
Competition policy	2.33	2.67	3.00	3.67
Banking reforms	2.67	3.00	3.67	4.00
Equity market and non-banking financial institutions	2.00	2.67	3.33	4.00
General infrastructure reforms	2.33	2.67	3.33	4.00
Telecommunication	2.67	3.00	3.67	4.33
Railway	2.00	2.67	3.33	4.00
Power sector	3.33	3.67	4.00	4.33
Road sector	2.33	2.67	3.33	4.00
Water and water removal	2.00	2.67	3.33	4.00
Aggregate reforms	2.88	3.26	3.69	4.09

5.2. *Ensuring equal conditions for economic competition*

183. The surveys of the Armenian economy⁶⁵ identify that in the medium and long term perspective the present incomplete and weak system of the competition protection can be one of the obstacles of the country’s development and pro-poor economic growth. The provision and keeping up of equal conditions for economic competition according to the standards of the developed countries, as the international experience shows (in particular EU-10 countries) is a complicated, multi-element and long term process and will be conditioned by a number of the “second generation” reforms implementation.

184. The reforms will first of all concern the sector of regulating the monopolies and keeping up with competition, where the Government envisages to:

- correlate the law on competition with EU standards, especially specifying the provisions concerning the mergers and acquisitions, as well as financial groups with interconnected ownership;
- substantially reinforce the institutional capacities and possibilities of Economic Competition State Commission (ECSC), in particular in regard of commodity market survey; determination of dominant position; identification of mergers and acquisitions limiting the competition;
- substantially facilitate, accelerate and specify the process of cases filed by ECSC.

185. As regards the promotion of competition and ensuring of equal conditions, it is important to ensure an unstoppable access of new players to presently monopolized sectors of economy. The respective reforms will come to contribute to them, which will

⁶⁵ The Caucasian Tiger: Sustaining Economic Growth in Armenia. The World Bank, 2007 Ch.2 and 3.

be aimed at the overall institutional modernization of the country, as well as elimination of entry access in individual sectors of economy and rehabilitation of free competition.

186. The first group of reforms includes:

- qualitative improvement of public governance, including transparency increase of administration and simplification of administration procedures, the result of which shall be step- by- step improvement of indicators characterizing them – according to the respective benchmarks of SDP⁶⁶;
- constant improvement of business and investment climate⁶⁷;
- step-by-step reduction of the shadow economy, which as a result of a range of reforms will be the policy aimed at specification and simplification of legal regulation of transactions, including SME development, deepening of financial mediation and reduction of loan costs, introduction of the modern corporate governance standards.

187. The second group of reforms is aimed at those sectors of economy, where at present, for a number of reasons the access of new players is limited, and has an objective to substantially encourage the competition through elimination of the access obstacles and introduction of free market. These reforms are also divided into the following two groups:

- substantial limitation of the monopolies and introduction of free competition in the state regulated industrial infrastructure sectors, including telecommunication, power sector, railway and aviation⁶⁸;
- the elimination of access restraints and formation of free market in the areas of import of certain commodities and wholesale, which are not regulated by the state and which at present are under the control of one or several interconnected companies (in particular the petrol; aviation fuel; sugar; wheat import and wholesale

⁶⁶ For public administration quality reforms assessment in SDP will be used the World Bank developed (see Kauffmann, Kray & Mastruzzi, “Governance Matters III: Governance Indicators for 1996-2002. The World Bank, 2003) quantitative assessment of public administration quality for around 200 countries of the world. To promote competition and restrain anti-competition behavior 3 decisive indicators should be considered: political stability, efficiency of administration and quality of regulation.

⁶⁷ For the assessment of the policy aimed at the improvement of business environment, the SDP will use as relevant benchmarks the World Bank developed and regularly published business environment indicators (Doing Business: Annual Reports) for the qualification of state regulation, as well as qualitative indicators characterizing some transaction costs. The indicators characterizing the business environment express the degree of business, including access to the respective markers; formal mechanisms (stipulated by law) and relatively favorable degree of transaction costs. In contrast to them the investment climate of the country or indicators describing the climate, which for the developing and transition countries are jointly developed and published by the World Bank and EBRD (BEEPS surveys), express the generalized viewpoint of the studied enterprises about the major obstacles to make investments in that country (political, legislative, public administration, including tax and customs regimes and administration, infrastructure, etc.), as well as about the conditions of activities of enterprises in various sectors.

⁶⁸ For details see the respective section of PRSP-2.

sectors)⁶⁹ mainly through the improvement of tax and customs administration; limitation and elimination of different types of public entities sponsorship; promotion of entry of well-known transnational companies in that sector and capacity building of ECSC.

5.3. *Improvement of business environment*

188. In recent years, a quite favorable business environment in created in Armenia. As shown in Table 5.4. in 2006 Armenia by the quality of the entire business environment was 39th in the world, 6th in ECA transition countries. As for the easiness of title registration, Armenia was 1st in ECA countries and 4th in the world.

Table 5.4. Assessment of the quality of Armenia's business environment in comparison with the assessments of other transition countries' business environment in 2006

Countries	Total	1	2	3	4	5	6	7	8	9	10
Estonia	17	20	14	156	21	48	33	31	7	29	50
Georgia	18	10	11	4	11	48	33	102	64	42	105
Latvia	22	30	82	96	85	13	51	20	19	3	64
Lithuania	26	57	57	124	4	36	83	71	23	18	31
Slovakia	32	72	50	75	5	7	98	122	90	50	36
Armenia	39	47	73	48	2	36	83	143	118	64	42
Hungary	45	67	87	81	96	26	107	127	45	12	53
Bulgaria	46	100	103	57	62	13	33	88	89	90	72
Romania	48	26	90	145	123	13	33	134	38	37	81
Mongolia	52	62	43	64	18	68	19	90	168	27	115
Slovenia	55	120	62	166	99	68	19	63	69	79	34
Check Republic	56	91	83	55	54	26	83	113	30	97	108
Kazakhstan	71	57	173	22	72	48	51	44	178	28	100
Poland	74	129	156	78	81	68	33	125	40	68	88
FUR Macedonia	75	21	76	128	91	48	83	104	72	84	127
Montenegro	81	98	113	98	103	84	19	129	113	131	41
Serbia	86	90	149	110	115	13	64	121	58	101	103
Moldova	92	81	153	93	46	97	98	111	122	17	82
Kyrgyz	94	49	152	74	16	68	33	152	177	32	128
Azerbaijan	96	64	159	80	56	26	107	141	173	30	75
Croatia	97	93	162	139	99	48	122	43	96	45	78
Bosnia and Herzegovina	105	150	150	114	144	13	83	142	53	126	61
Russian Federation	106	50	177	101	45	156	83	130	155	19	80
Belarus	110	119	94	43	94	115	98	178	137	16	69
Albania	136	123	168	109	82	48	165	118	70	74	178
Uzbekistan	138	54	145	67	119	170	107	159	165	48	119
Ukraine	139	109	174	102	138	68	141	177	120	46	140
Tajikistan	153	161	166	125	43	135	176	155	176	23	99
Place of Armenia	6	6	7	4	1	10	12	23	18	19	5

The respective figures characterize the respective quality of business environment (place of country among the surveyed 178 countries) in the following areas: 1 – creation of new enterprises (companies); 2 – licensing processes;

⁶⁹ See the *Caucasian Tiger: Sustaining Economic Growth in Armenia*. The World Bank, 2007 Ch.10:

3 – employment regulation; 4 – title registration; 5 – access to credits; 6 – protection of investors; 7 – payment of taxes; 8 – international trade operations; 9 – application of contracts and 10 – liquidation of the company.

Sources: “Doing Business – 2008”, WB, 2007:

189. At the same time in two most important areas, which characterize the easiness of external trade and especially tax payment, the business environment cannot be deemed as favorable. With regard to the mentioned indicators, Armenia was the 18th and 23rd among surveyed 28 ECA countries. Such situation is conditioned by insufficient level of customs and tax administration. The situation cannot be considered as good also in the sphere of contract enforcement, where Armenia is the 19th.

190. Understanding the significance of business environment for sustainable development of the private sector, investments’ attraction and step- by -step reduction of the shadow economy⁷⁰ the Government intends to substantially speed up the business environment reforms within the framework of the program particularly in 2008-2010, so that in 2010 Armenia be rated among top 10 countries with the most favorable business environment – further on keeping up and reinforcing its positions among top 10.

191. Table 5.5 shows the SDP benchmarks for business environment improvement in 2008-2021 taking into account all indicators of “Doing Business” last annual report. The benchmarks have been identified on the basis of the present situation in Armenia, as well as the experience of those ECA and OECD countries, which in 2006 were in leading positions in particular sectors reflecting the business environment⁷¹.

Table 5.5. The quality benchmarks for business environment

Indicators	2006	2010	2015	2021
Overall place* *	39	9	3	3
Creation of new businesses, place	47	3	3	2
Number of procedures	9	2	2	2
Duration, days	18	3	3	3
Cost, % per capita GDP	4.8	2	2	2
Statutory capital, % per capita GDP	3.1	0	0	0
Functions of providing permission for construction, place	73	7	8	7
Number of procedures	19	9	9	9
Duration, day	116	110	105	100
Cost, % per capita GDP	411.3	30	25	25
Employment regulation, place	48	7	4	4
Employing index	33.33	0	0	0
Working hours toughness index	40	20	0	0

⁷⁰ According to contemporary studies (Doing Business 2004-2008, The Caucasian Tiger: Sustaining Economic Growth in Armenia. The World Bank, 2007) the improvement of business environment through identification and simplification of state regulations substantially reduces operational costs of being in formal economy. At the same time the access to credits, ownership protection and easy and efficient mechanisms for enforcing the contracts substantially increase the degree of attraction of formal sector, which is one of the major preconditions of reducing the shadow economy.

⁷¹ The experience of ECA countries: Georgia; Slovakia; Mongolia; Latvia; Estonia and from OECD countries: Australia; New Zealand; USA; United Kingdom; Denmark; Luxemburg and Japan was largely used.

Indicators	2006	2010	2015	2021
Index of firing complexity	20	0	0	0
Employment toughness index	31	0	0	0
Cost of firing (salary, week)	13	4,3	4	4
Title registration, place	2	2	2	2
Number of procedures	3	2	2	3
Duration, day	4	2	2	4
Cost, as compared with title, %	0.4	0.3	0.3	0.3
Getting credits, place	36	13	3	3
Credit information index	5	7	7	7
Legal rights index	5	6	9	9
Credit registry coverage (for adult population %)	16.3	25	35	45
Investor protection, place	83	12	9	9
Identification index	5	8	9	9
Director responsibility index	2	6	8	8
Index of court cases filed by the shareholders	8	8	8	8
Investor protection index	5	7	8.33	8.33
Tax payments, place	143	80	70	50
Number of payments	50	29	25	20
Time spent, hour	1120	300	200	150
Cost, % per capita GDP	65.1	36,6	30,0	25
International trade, place	118	21	16	15
Export, number of documents *	7	3	3	3
Time required for export, days	30	5	5	5
Export cost (US \$ per container)	1165	1165	1000	1000
Import, number of documents *	8	3	3	3
Time required for import, days	24	5	5	5
Import cost (US \$ per container)	1335	1335	1200	1200
Enforcement of contracts, place	64	24	9	8
Number of procedures	50	36	27	25
Duration, days	285	285	195	170
Cost (% of demand)	19	19	19	19
Liquidation of enterprises, place	42	41	37	31
Cost, % per capita GDP	4	3	3	3
Time, year	1.9	1.6	1.5	1.4
Rate of return, %	42	42	45	50

** according to the methodology the indicators of 2006 reflecting the number of documents required for export and import and demanded by the Georgian customs service in the Georgian port is 2. Thus, the number of documents required by the RA Customs service for export and import is 5 and 6 respectively

* The comparative positions of Armenia from the viewpoint of overall quality of business environment, as well as of individual areas have been estimated by 2006 using the special program attached to the latest report of “Doing Business” (simulator, www.doingbusiness.org).

192. The framework of reforms, which during 2008-2021 should contribute to the substantial improvement of business environment, relates to a number of state regulation areas of economy including legislative, procedural and administrative areas, as well as the required changes in state-business community interaction. The reforms will be mainly aimed at:

- reduction and simplification of procedures;

- reduction of time and financial resources required for their implementation (operational costs);
- quality increase of business environment and elimination of legislation hampering the reduction of shadow economy;
- reduction of direct interaction between public officials and businessmen through introduction of one-stop shops, e-governance and transition of procedures to on-line regime.

The timing of the reforms takes into account the degree of their difficulty for given sectors, as well as the peculiarities of the present situation.

193. In 2006, 9 procedures were required to register a new business in Armenia (Limited Liability Company), it lasted 18 days, the cost of registration was 38.5 thousand dram or 4.8% of per capita GDP, the minimal statutory capital was 25 thousand dram or 3.1% of GDP per capita ⁷². In 2008-2010 the reforms in this area will be aimed at:

- elimination of overall requirement of the minimal statutory capital⁷³;
- gradual elimination of the obligatory requirement of having a stamp with the purpose of eliminating the latter by 2012;
- transfer of the state registration, receipt of taxpayer's registration number and registration at the statistics service procedures (Agency of State Registration of Juridical Persons of the RA Ministry of Justice will perform one stop shop role in registration procedures);
- creation of technical opportunities for the on-line system of documents registration, state registration and taxpayer's registration and their step by step implementation starting from Yerevan.

194. In 2006, the process of providing permit for construction (based on the example for building up an industrial warehouse in Yerevan) required 19 procedures, lasted on average 116 days and cost 3.3 million dram or per capita 411% of GDP⁷⁴. The reforms in this area will be aimed at the reduction of costs and number of procedures of providing permit for construction. Starting in 2010 they envisage having 9 procedures instead of

⁷² In 2006 in Australia, which was number one in the world and in Georgia (No.10 in the world and the best in ECA countries) the picture is respectively as follows – number of procedures 2 and 5; duration 2 and 11 days; cost per capita GDP 1 and 10%, the demand for minimal statutory capital – 0% in both of countries (in 2006 in 76 countries of the world it was not mandatory to have statutory capital at the registration of business). The data for Armenia 2006 for the aforementioned and further discussed sectors are taken from the World Bank report “Doing Business 2008. Armenia”. 2006 data about Georgia and Australia are taken from respective reports “Doing Business 2008. Australia” and “Doing Business 2008. Georgia”.

⁷³ The requirement for the minimal statutory capital will be protected by the state in the areas subject to special regulation (financial sector; industrial infrastructure and in other cases stipulated by law);

⁷⁴ In New Zealand which is No2 in the world in 2006 (the best in OECD countries) and in No10 Georgia (the best in ECA countries) the picture is respectively as follows: number of procedures 7 and 12; duration 65 and 113 days; cost per capita GDP 25% and 29%. (Source: “Doing Business 2008. New Zealand”). One shall mention that Armenia in 2005 in that sector was 36th with around 8 times less cost for the entire process, than in 2006.

presently functioning 19, in particular concentrating all allowances concerning construction activities within one body and reducing the period required for providing a permit for construction by 6 days.

195. The enforcement of the New Labor Code has clarified the regulation of the labor relations⁷⁵. However, taking into account the need for substantial increase of jobs in the formal economy, which is one of the priority of the economic policy of the Government, a range of extremely tough provisions of the Code should be amended – to maximum liberalize the labor market and encourage the transfer of the jobs from shadow part of the economy to its formal sector⁷⁶. By 2010 the following measures should be taken:

- The necessity to conclude contractual agreements and to meet the mandatory requirements concerning time constraints should be eliminated; and the legal entities should clarify working procedures and employment relationship;
- A more flexible procedure of discharging employees should be adopted;
- The time needed to notice the employee about his/her discharge as well as the amount of compensation should be reduced;
- The amount of remuneration for overtime work should be reduced and the labor time limitations should be mitigated;
- Restrictions concerning night and week-end work should be eliminated.

196. In 2006 Armenia was the 2nd in easiness of title registration after New Zealand⁷⁷. In this area the Government does not envisage a relative increase of quantity, time of procedures and relative cost of registration.

197. In 2006 in access to credits⁷⁸ Armenia was quite high – 36th. The reforms in that Area shall contribute to further development of credit registries and expansion of information. The changes in legislation concerning the bankruptcy, pledge and company liquidation will be aimed at the expansion of the list of property serving as collateral and rights of pledger⁷⁹. In particular it is envisaged to:

⁷⁵ In US that is No3 in the world in 2006 (the best in OECD countries) and in No4 Georgia (the best in ECA countries) the cost of first 4 indexes of the Table 5.5 is zero and the cost of firing from job was 0 and 4 weeks respectively (source “Doing Business 2008. USA”).

⁷⁶ The major reason for toughening the labor conditions by the enforcement of the New Labor Code (by terminology of “Doing Business” report – the employment index growth from 0 in 2004 up to 33.33 in 2006) was the relative worsening of the Armenia’s position in this area – from 22nd in 2004 to 48th in 2006.

⁷⁷ In 2006 in New Zealand the title registration included 2 procedures, lasted 2 days and was 0.1% of the registering property.

⁷⁸ The given sector is not about the overall volume and accessibility of the credit resources, in which Armenia is one of the last in the world (the volume of credits given to the economy in 2006 was only 9.17% of GDP), but characterizes the degree of legal protection of pledgers and pledges and volume and spread of information about debtors.

⁷⁹ In No1 in the world in 2006 UK and No 12 Slovakia (the best in ECA countries) the picture is respectively as follows – credit information index 6 and 4; index of legal rights 10 and 9; coverage of credit registries 84.6% and

-
- by 2010 to expand the scope of information provided by private credit registries, including the information about the credits by commercial and non-banking financial organizations, fees of the service providing companies;
 - by 2010 to set up a unified registry of the pledged mobile property and make its information available for all the banks and credit organizations.

198. The relatively weak level of the investors' protection in Armenia⁸⁰ is one of the major factors conditioning portfolio investments of minority (including foreign investments), as the present very low level of corporate management. Besides, the insufficient level of investor protection contributes to concentration of property and stops the development securities market. In order to keep with the high economic growth rate envisaged in SDP the promotion of the local and foreign investments (including the portfolio investments) and the progressive growth of their volumes is one of the top priorities of the Government's economic policy. In this regard the Government puts a special importance to the substantial increase of the investors' protection during forthcoming several years.

199. In particular, by 2010 the legislation concerning the companies will be amended: the obligation to disclose the transactions that represent potential conflict of interest will be made more tougher and the responsibility of the company manager to the owners in case of the contracts containing conflict of interest will increased. The mentioned amendments, together with the introduction of mechanisms for their efficient application, will make it possible to increase the investors' protect index cost from present 5 to 7.33 in 2010.

200. The main weakness of the Armenian business environment is the extremely high level of tax payment operational costs⁸¹. The latest surveys of the Armenian economy show that the present degree of tax payment complexity and low quality of tax

57.2% of adult population (source: "Doing Business 2008. United Kingdom" and "Doing Business 2008. Slovakia"). The respective indicators' cost in Armenia in 2006 was respectively 5,5% and 16.3%.

⁸⁰ This sector describes the level of the right to legally impact on the transactions conducted by the company management on behalf of minority shareholders (investors). In No1 in the world in 2006 New Zealand and No19 Mongolia (the best in ECA countries) the picture is respectively as follows: negative index 10 and 5; manager responsibility index 9 and 8; index of court cases filed by the shareholders 10 and 6; overall index of investors' protection (average arithmetical of the previous three) 9, 7 and 6, 3 (source: "Doing Business 2008. New Zealand" and "Doing Business 2008. Mongolia"). The respective indicators in Armenia in 2006 were 5, 2, 8 and 5 and it was 83rd in the world and was 12th among ECA countries.

⁸¹ In 2006 Armenia was 143rd by degree of easiness of tax payments and 23rd among 28 ECA countries. the taxes are paid by companies 50 times and for it 1120 hours or 140 man/day were required and the cost of tax payments was per capita GDP 65, 1%. In 2006 in No6 in the world Ireland (the best in OECD countries) and No20 Latvia (the best in ECA countries) the taxes were paid annually 9 and 7 times, for that 76 and 219 hours were required and the cost of tax payments were per capita GDP 3,6% and 10,3% (source: "Doing Business 2008. Ireland", "Doing Business 2008. Latvia"). The time and financial costs connected with the tax controls are not taken into account.

administration is one of the major factors conditioning high level of shadow economy and consequently lower level of tax collecting, than it would be possible⁸².

201. To facilitate the payment of taxes during the SDP implementation, the tax system reforms will be aimed at the reduction of tax payment frequency and time spent for it. It is envisaged in particular to step-by-step renounce the monthly payments of VAT, profit tax and income tax (prepayments) and switch to quarterly principle of tax payments. In addition, consistent with the technical facilities, a step-by-step transition to mostly on-line tax payment principle will be made.

202. In order to minimize the negative impact of unfavorable geographical location and consequent high transportation costs (absence of direct access to sea and two out of four land borders are closed for trade; the country is far from the major international markets) the highest possible liberalization of foreign commerce and elimination of obstacles (including technical) are regarded as issues of high importance for such a small and open economy as Armenia.. However, as regards the degree of external trade easiness, even taking into account the country's unfavorable geographical location and closed borders with Turkey and Azerbaijan, Armenia lags far behind other ECA countries⁸³.

203. The reforms in this area will be directed towards the reduction of the number of documents required for export and import; reduction of time for their preparation and receipt and land transportation cost cuts from the nearest port, so that by 2010 three documents be required for export and import.

204. The reduction of terms and cost required for export and import will be also conditioned by Armenian Railway reforms; technical modernization; substantial increase of railway transportation share in overall cargo transport.

205. In the sphere of contracts enforcement in 2006 Armenia was the 64th in world and 19th among 28 ECA countries. The reforms in this area will be concentrated on two directions: a/ legislative reforms, as a result of which the quantity and periods of procedures connected with the enforcement of the contracts will be reduced; and b/judicial reforms, which in this case will be aimed at the efficiency increase of civil cases' trials, which will also enable to reduce the periods connected with contract enforcement.

⁸² The Caucasian Tiger: Sustaining Economic Growth in Armenia. The World Bank, 2007:

⁸³ In this area in 2006 Armenia was 118th and among ECA countries 18th. As compared with Estonia (the best in ECA) and Denmark (the best in OECD countries) in 2006 in Armenia for export there were necessary 7 documents (in Estonia 3; in Denmark 4); the time required was 30 days (in Estonia and Denmark 5 days) and the cost of export of one standard container was \$1165 (in Estonia \$675; in Denmark \$540). For import 8 documents are required (in Estonia 4; in Denmark 3); it lasts 24 days (in Estonia and Denmark 5 days) and cost for one standard container \$1335 (in Estonia \$675; in Denmark \$540).

206. In the area of enterprise liquidation in 2006 Armenia was the 42nd and 5th among 28 ECA countries. The reforms in this area will be focused on two directions – legislative and judicial reforms, which will be directed towards the simplification of the procedures and increase of the rights of creditors in bankruptcy procedures, and which will make it possible to create opportunities for the reduction of overall terms and increase of rehabilitation provision; and increase of liquidation managers’ qualifications and responsibilities, which will also contribute to the increase of rehabilitation provision.

5.4. *Improvement of investment environment and investment promotion*

207. As mentioned above, the indicators describing the investment environment of the country (BEEPS⁸⁴) express the generalized opinion of the business communities of the given country about the major business and investment obstacles, as well as conditions of the enterprise activities in a range of economy sectors. The indicators describing the investment environment can contain useful information about legal regulations to be applied in real life, as well as to characterize the various business and investment obstacles in the country.

208. Unlike the business environment, where in 2006 among 28 ECA countries Armenia was 6th by the aggregate magnitude of the investment environment in 2005 Armenia was only the 18th among 26 ECA countries⁸⁵. The major peculiarities of the Armenian investment climate include its steep differences of favorable conditions – depending on the size of the enterprise: it is the least favorable for small enterprises and the most favorable for large enterprises. Thus, if we look at those enterprises one by one then by the quality of business environment for large enterprises among ECA countries Armenia is 6th, for medium enterprises 9th and for small enterprises it is 21st (see Table 5.6).

Table 5.6. Summary investment environment assessment in ECA countries, 2005

Countries	Aggregate, 2005	Per capita GDP, US dollar (2004)
Slovenia	19.02	14810
Slovakia	16.12	6480
Estonia	15.63	7010
Croatia	14.66	6590
Belarus	13.33	2120
Armenia: large enterprises	10.16	

⁸⁴ BEEPS – Business Environment and Enterprise Performance Survey. In this section the World Bank and EBRD survey results of 26 ECA countries’ investment environment describing the situation are used. (See www.enterprisesurveys.org).

⁸⁵ The summary aggregate of investment climate quality has been developed by us as an aggregate describing the constituent 7 sectors (state of infrastructure, enterprise funding, labor market, quality of corruption and state regulation; judicial system and crimes, information and technologies, external trade). The latter has been calculated as aggregate of indicators describing those sectors. The indicators’ values have been calculated as ECA countries’ average and the difference of that indicator related to ECA average. The negative value of the aggregate means that it is lower than average of ECA countries and the positive that it is higher (average values are equal to zero).

Latvia	9.63	5460
Hungary	8.44	8270
Lithuania	8.33	5740
Armenia: medium enterprises	5.04	
Bosnia and Herzegovina	3.70	2040
Uzbekistan	2.69	460
Poland	2.26	6090
Check Republic	1.57	9150
Romania	1.21	2920
Kazakhstan	0.92	2260
Moldova	-0.48	710
Russian Federation	-1.01	3410
Bulgaria	-1.72	2740
Armenia. Overall	-2.41	1120
FYR Macedonia	-2.71	2350
Azerbaijan	-3.25	950
Armenia: Small Enterprises	-5.17	
Ukraine	-5.52	1260
Tajikistan	-7.41	280
Serbia	-11.60	2620
Kyrgyzstan	-13.06	400
Georgia	-13.62	1040
Albania	-58.6	2080

Source: BEEPS 2005, The World Bank.

209. Such a difference of the aforementioned situation and business and investment climate, including the presence of different business conditions for small, medium and large business, are explained mostly by the following factors:

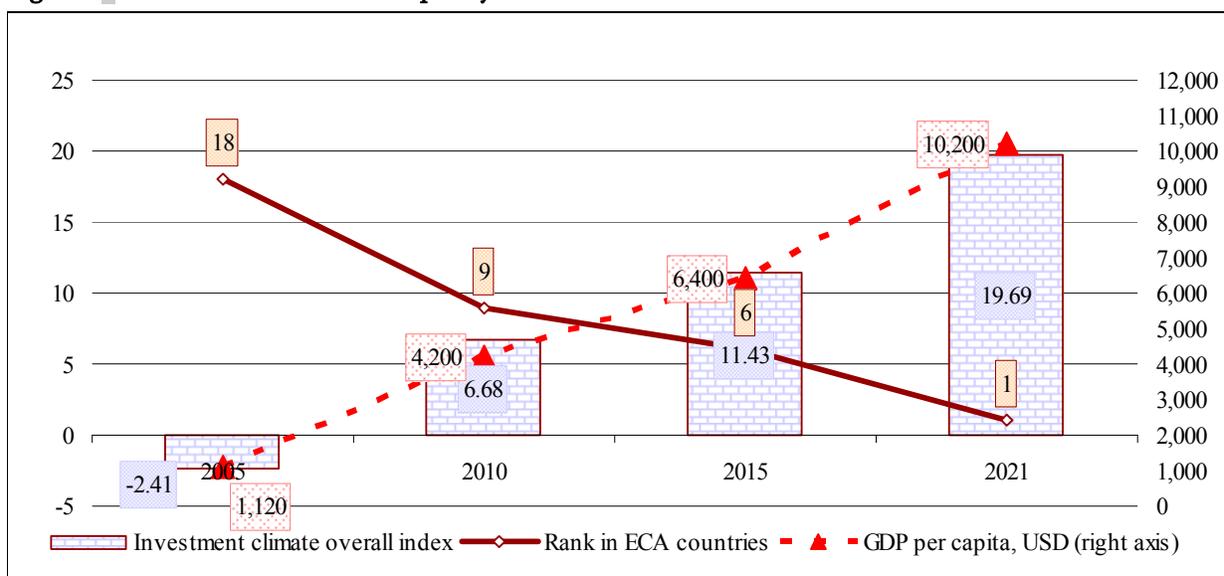
- the problem of real enforcement of quite advanced legislation regulating the business environment, which is mainly conditioned by the low efficiency of public administration and judicial system; high degree of corruption and sponsorship; lack of an efficient system able to restrict the monopolies and protect the competition; low level of tax and customs administration⁸⁶;
- the conditions of physical environment ensuring the business and investment activeness; in particular by the level of services provided by financial mediation, information and infrastructure systems and access to the external world.

210. Realizing the importance of the investment climate quality improvement for the development of the private sector and progressive growth of investments, which should predetermine the high rate of economic growth envisaged within SDP, the Government plans in 2010 to get the overall investment climate aggregate to the Lithuania's 2005 indicator; in 2010 to surpass the Latvian indicator and in 2021 the Slovenian level of

⁸⁶ Similar issues also exist in the neighboring Georgia, which in 2005 by the quality of business environment among 28 ECA countries was 6th and by the quality of investment climate it was last but one among 26 ECA countries.

2005 (Figure 5.1)⁸⁷ at the same time substantially adapting the working conditions for small, medium and large enterprises.

Figure 51. General estimate for the quality of the investment environment for 2005-2021



211. The general policy to achieve these objectives will contain a broad scope of interconnected areas, including the following major components:

- creation of efficient anti-monopoly and competition protection system;
- improvement of business environment and achievement of respective benchmarks;
- constant improvement of public administration quality and achievement of respective benchmarks;
- effective implementation of anti-corruption program and provision of efficient growth of judicial system;
- further deepening of financial mediation and ensuring of progressive growth of services;
- further liberalization of trade and elimination of technical obstacles;
- improvement of infrastructure quality; consideration of infrastructures as priority directions of the state investment programs; aviation and railway reforms and liberalization.

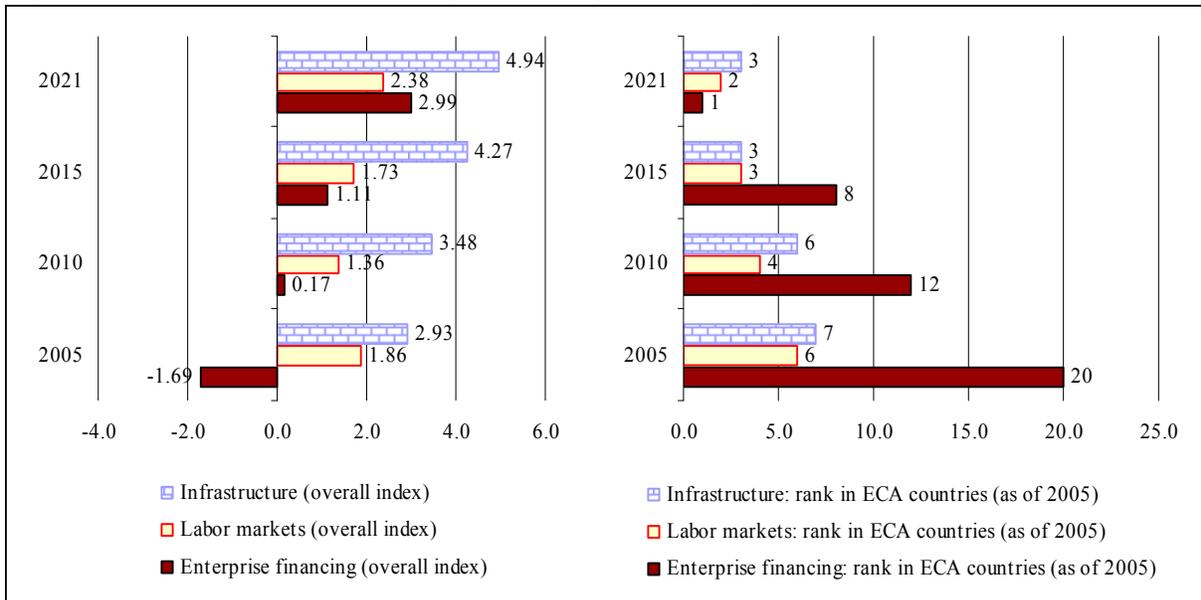
212. For constituent areas of investment climate the target benchmarks for SDP are presented below and calculated based on the situation of 2005; they take into account the reform timing envisaged for the respective areas. The benchmarks related to infrastructure, enterprise financing and labor market are presented in Figure 5.2 and the respective target indicators are presented in Table 5.7.

⁸⁷ The benchmarks are calculated based on the rate of economic growth envisaged in SDP and forecast per capita GDP and take into account the business environment quality benchmarks.

213. With regard to the infrastructure sector, by the overall quality estimate of which in 2005 Armenia was the 7th among the 26 ECA countries the major obstacle to investments is the transportation costs (23rd among ECA countries). Without taking into account the transportation costs Armenia is the 4th in ECA countries by the quality of infrastructure services. In the infrastructure area the program envisages:

- substantial decrease (from present 9.2% to 4% by 2021) in transportation costs and in the number of companies that consider the transportation costs as the major obstacle to development and investments
- step by step decrease in the number of power and water supply disruptions, as well as improvement of the quality of services - as a result of power, water supply and telecommunication sectors reforms.

Figure 5.2 Estimates of infrastructure quality, enterprise financing and labor markets for 2005-2021



214. In the sphere of enterprise financing, where Armenia in 2005 was the 20th among 26 ECA countries, the major problems are conditioned by low accessibility, financing and high collateral cost, as well as financing source structure of enterprises, where the financing volumes from informal sources or non-banking sources are extremely high.

215. To solve the aforementioned issues the priority direction of SDP will be the implementation of a policy aimed at the deepening of financial mediation, including the legislation amendments directed towards the simplification of the collateral system in the result of which it is expected that during 2015-2021 these measures will result in creation of a modern and efficient system of financial mediation and will make it possible for Armenia to reach in 2021 the present level of Croatia (the first in 2005).

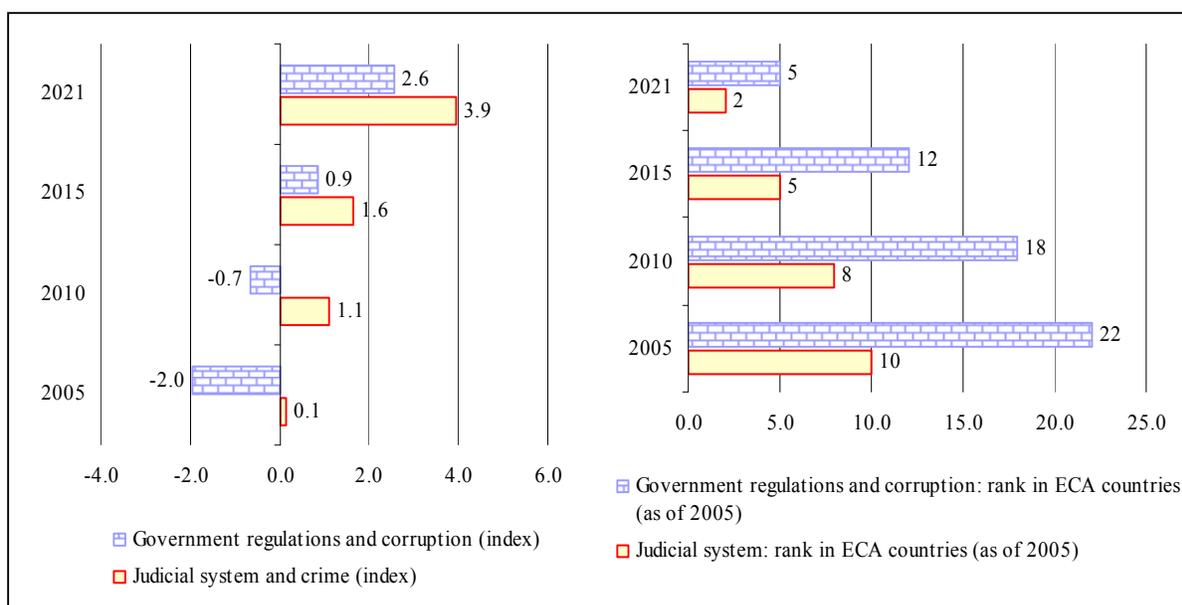
Table 5.7. Target indicators characterizing the infrastructure quality, enterprise funding and labor market 2005-2021

Indicators	2005		2010		2015		2021	
	Value	Place	Value	Place	Value	Place	Value	Place
Indicators describing the infrastructure quality								
Transportation costs as the major development obstacle (companies, %)	9.2	23	8	22	6	21	4	13
Energy supply as the major development obstacle (companies, %)	3.2	8	2.9	7	2	2	1.5	1
Energy supply disruptions (days – per year)	1.4	11	1.2	7	1	7	0.9	7
Losses due to energy supply disruptions (% of realization volumes)	2.5	13	2	9	1.5	6	1.3	3
Water supply disruptions (days – per year)	1	15	0.8	14	0.7	14	0.5	14
Duration to subscribe to electricity network (days – per year)	2.7	3	2.5	3	2.4	3	2.3	2
Duration to subscribe to telephone network (days – per year)	6.5	6	6	6	5	5	4	3
Indicators characterizing the enterprise financing								
Financing as the major development obstacle (companies, %)	18.1	17	16	13	12	12	6	4
Financing cost as the major development obstacle (companies, %)	22.6	14	20	14	15	10	10	8
Investments financed from internal sources, %	64.2	8	62.2	7	60	6	55	4
Investments financed from the banks, %	19.5	4	22.7	4	25	3	28	1
Investments financed from other formal sources, %	7.1	19	9.7	16	10	16	14	11
Investments financed from informal sources, %	9.2	26	5.3	22	5	19	3	14
Cost of collateral (% of credit amount)	177.7	19	170	17	150	15	130	4
Indicators characterizing the labor market								
Labor legislation as the major development obstacle (companies, %)	2.9	7	2.9	7	2.9	7	2.9	7
Lack of quality labor force as the major development obstacle (companies, %)	2.3	2	2.3	2	2.3	2	2.3	2
Companies that train labor force as the major development obstacle (companies, %)	64.8	21	70	19	85	12	90	8
Trained qualified labor force, %	16.5	19	20	16	30	8	45	4
Qualified labor force, % of overall labor force	43.2	17	46	11	48	9	48	9

Low quality labor force, % of general labor force	9.1	10	8	6	10	15	10	15
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216. In regard with the labor market, from the standpoint of the employers the situation can be considered as relatively good – taking into account the employment problem that Armenia currently faces (the 7th among the 26 ECA countries). The major issue in this area is the low investment level in enterprises for ensuring the labor force quality (the 21st by the number of training organizations and the 19th by the share indicator of trained labor force). In this connection, the labor market policy, together with liberalizing the labor regulations, will be directed towards the promotion of investments with the purpose to increase the labor force quality.

Figure 53. Estimates for the quality and corruption of public administration and judiciary and crimes for 2005-2021



217. In the area characterizing the public administration quality and spread of corruption the situation is one of the major factors threatening the further sustainable development of the country. In Armenia, the rate of unofficial payments to various public entities by companies is very high (the 20th and by the payments to tax inspectors the 25th among the 26 ECA countries).

218. The aforementioned issues, as well those presented in Table 5.8 will be solved within the framework of consistent implementation of a policy aimed at the permanent improvement of quality and efficiency of public administration, which is one of the public administration priorities of SDP, as well as Anti-Corruption Strategy adopted in 2003. The degree of the ensured target indicators presented in the Table 5.8, as well as other tables of this section will characterize the efficiency level of the respective public policy implementation.

Table 5.8. Target indicators characterizing the quality of public administration, the situation with corruption, the quality of the judicial system and the influence of crime, 2005-2021

Indicators	2005		2010		2015		2021	
	Value	Place	Value	Place	Value	Place	Value	Place
Indicators characterizing the public administration quality and corruption								
Corruption as the major development obstacle (companies, %)	19.8	17	15	11	12	9	8	5
Unofficial payments (% of realization volumes)	1.2	20	1	15	1	15	0.7	8
Companies making unofficial payments to tax inspectors, %	39.9	25	35	23	25	18	15	7
Companies making unofficial payments to get licenses, %	15.1	17	12	13	8	8	6	5
Companies making unofficial payments to get import licenses, %	23	24	20	23	15	20	10	15
Time spent by company management for public regulations (days per year)	4.2	11	4	8	3.5	6	3	3
Time spent to communicate with tax authorities (days per year)	2.6	13	2.4	12	2.2	10	2	10
Indicators characterizing the judiciary system and impact of crimes								
Judiciary system and dispute settlement as the major development obstacle (companies, %)	12	12	11	11	10	11	9	11
Crimes, thefts and lack of order as the major development obstacle (companies, %)	2.3	4	2.2	3	1.9	2	1.8	2
Companies that have unpaid mutual obligations with suppliers/buyers/consumers, %	18.8	25	25	24	30	24	35	20
Companies that settle the issues through the judicial system, %	7.6	26	15	24	20	24	30	19
Companies that trust the judiciary system in settling the contracts, %	52.5	11	56.5	10	60	10	65	5
Security protection cost (% of realization volumes)	0.7	18	0.6	13	0.5	11	0.4	9
Losses as a result of crimes (% of realization volumes)	0	1	0	1	0	1	0	1

219. The situation is relatively good in the area characterizing the judicial system (the 10th among the 26 ECA countries). There are two main problems in this area:

- Although the degree of trust of businessmen towards the judicial system in settling the contracts is high (52.5%, 11th among the 26 ECA countries); however, the

number of companies settling the disputes in legal form is the lowest among the ECA countries (7.6%⁸⁸, in 2005 Croatia was the first with 61.8%);

- The major reasons for such weak use of the judiciary system are beyond the judiciary and are mostly conditioned by very low level of unsolved mutual obligations of the companies⁸⁹.

220. Thus, the high participation level of the judiciary in the economic life is one of the policy priorities in this area, which will be ensured within the framework of general judiciary reforms, as well as investment climate quality improvements. The respective measures will be aimed at ensuring the growth of trust towards the judiciary system, as well as ensuring the growth of mutual trust within the business world, which is the major condition for reducing the number of non-official contracts.

221. The innovation and technology problems concerning the enterprises are mostly conditioned by relatively weak spread of modern Internet devices (e-mail and web pages) ensuring the efficient communication with consumers/suppliers and entrepreneurship. This is explained by insufficient level of official contracts (high degree of shadow economy), as well as by relatively low spread of internet, which in its turn is determined by existing competition constraints in telecommunication sector and by respective consequences, such as high service cost, low connection speed and relatively low accessibility.

222. Thus, the innovation and technology policy will be aimed at the development and application of mechanisms of efficient encouragement of the companies suggesting innovations; elimination of obstacles to efficient competition in telecommunication area and reduction of shadow economy. This will be done within the framework of precise and efficient introduction of major structures of knowledge-based economy.

⁸⁸ As a rule the large company do not use the judiciary system for dispute settlement at all; 5,6% of small companies do that and 20% of medium companies, which comes to witness one more time about different quality of investment quality – depending on the enterprise size.

⁸⁹ In 2005 only 18.8% of companies had unpaid obligations – the last but one place among ECA countries (of which the small companies - 19.5%; medium companies - 20% and large companies - 8.3%). Croatia's indicator is 72% and Lithuanian - 88.3%.

Figure 5.4. Estimates for innovation and technologies and external trade for 2005-2021

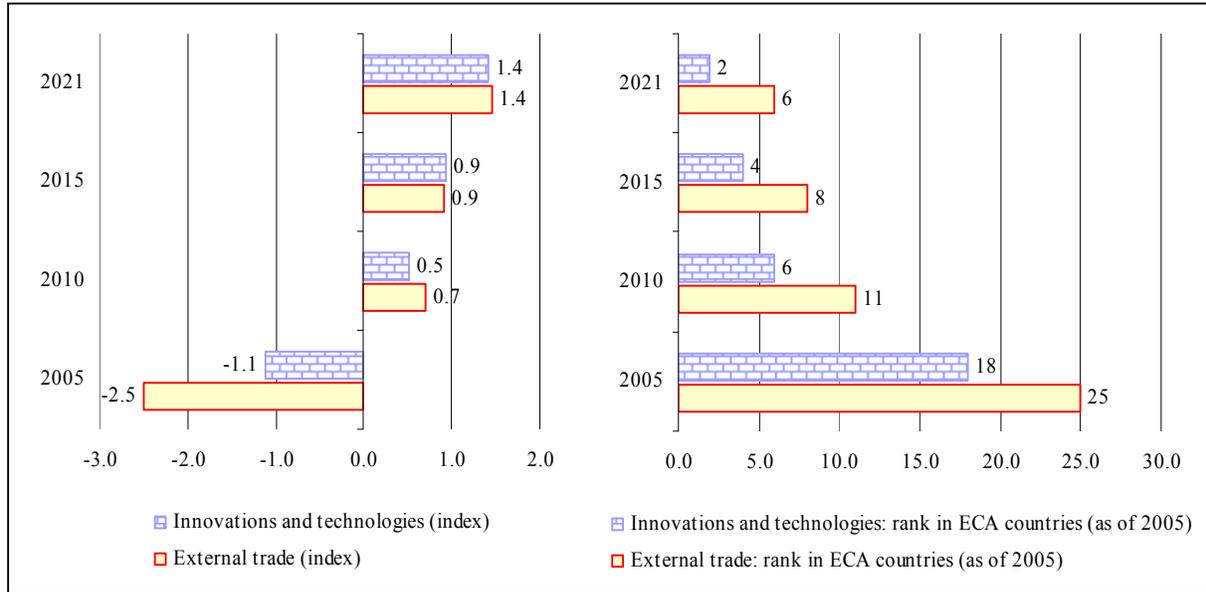


Table 5.9. Target indicators characterizing the innovation and technologies, and foreign commerce, 2005-2021

Indicators	2005		2010		2015		2021	
	Value	Place	Value	Place	Value	Place	Value	Place
Indicators characterizing the innovation and technologies								
Companies making innovations, %	71.8	11	80	3	80	3	80	3
Research and development costs expenses (% of realization volumes)	0.3	6	0.4	4	0.45	4	0.5	3
Companies using e-mail in communicating with suppliers/buyers/consumers, %	45.6	22	70	11	75	8	85	7
Companies using e-mail in communicating with suppliers/vendors/consumers, %	26.2	24	55	17	65	15	75	8
Indicators characterizing the external trade								
External trade regulation and customs regulation, as the major development obstacle (companies, %)	28.3	25	10	9	9	9	6	6
Time needed in customs service for customs registration of the imported lots, days	4	17	3	11	2.8	9	2.5	7
Time needed in customs service for customs registration of the exported lots, days	4.7	22	3	15	2.8	13	2.5	11
Companies making unofficial payments for getting a permit for import, %	23	24	10.2	16	9.9	15	8.2	10

223. In the foreign commerce domain the situation is very unsatisfactory (next to last among ECA countries in 2005). The major reason for that – in case of having quite liberal external trade regimes and actually lack of quantitative limits of trade – is the

present low level of customs administration and high level of sponsorship⁹⁰. Taking into account the importance of foreign commerce and especially the promotion of export for the stable high rate economic growth of the country the drastic improvement of customs administration within the policy aimed at the further liberalization of the foreign commerce and reduction of transportation costs is one of the priorities of the public economic policy.

224. The aforementioned reforms will be directed towards the achievement of investment volumes envisaged in Table 5.10, which in their turn are necessary to ensure GDP volumes forecast by SDP. Table 5.10 shows that during the SDP implementation it is necessary to keep up with high accumulation volumes, which depending on the envisaged rate of the economic growth will vary within 28-37% of GDP. The level of public investments will be quite stable and remain at the level of 4.6-5% to GDP.

225. Substantial increase of foreign direct investments (FDI) is expected – the accumulated volume of foreign investments during 2007-2021 is planned to increase by around 13 times, which assumes implementation of a policy aimed at FDI promotion, where decisive will be the active involvement of transnational companies that shall be one of the major instruments for technological modernization of the country.

Table 5.10. Investments in 2005-2021 (in prices of respective years)

Indicators	2005	2006	2010	2015	2021
Total investments, billion dram	683	954	1762	2653	3772
Of which – public	101	116	234	361	603
Private	583	838	1529	2292	3169
Foreign direct investments, million UD dollar	287.0	467.4	958,6	1468	2132
Accumulated foreign investments, million US dollar	1298.3	1774.4	5050	11362	22458
	<i>% as compared with GDP</i>				
Total investments	30,5	35.4	37.5	33,9	28.8
Of which – public	4,5	4.4	5.0	4.6	4,6
Private	26.0	31,0	32,5	29,3	24.2
Foreign direct investments	4,8	7.0	6,2	5,7	5,0
Local investments	21,2	23,0	26.3	23.6	19,2
Accumulated foreign investments	26.5	27.8	32,8	44,3	52,3

5.5 Policy aimed to ensure structural economic transformations and continuous growth of country's competitiveness

226. In 2003-2007 the growth rate of the economy was almost two times higher than that envisaged in PRSP. At the same time the economic development demonstrated a more and more deepening transformations: economic growth based on the development

⁹⁰ In 2005 36.2% of small enterprises, 25% of medium enterprises and 5.3% of large enterprises assessed the customs administration as the major obstacle to development and investment. By the magnitude of foreign commerce aggregate for small enterprises among ECA countries in 2005 Armenia was the last; for medium enterprises Armenia was the 23rd and for large enterprises Armenia was the 16th.

of import substitutes and progressive export growth, which was the economic policy priority in 2000-2003 began to transform into a demand-driven economic growth, with the construction and service sectors playing a leading role in this process. At the same time significantly decreased the contribution of industrial and export sectors to the process of economic development.

227. In 2003-2007 the annual average industrial growth rate comprised 5.6%, while beginning from 2006 a tangible decrease of industrial growth was registered (in 2003-2005 it averaged annually 8.3% as compared with 1.4% in 2006-2007)⁹¹ conditioned by the fact that in 2000-2004 the main factor of industrial development, i.e. the low value of labor force, was gradually lost. One of the reasons for such a rapid rise in labor force value is the appreciation of national currency, which took place in 2003⁹² and which resulted in the increase in the labor force value by 5.3 times in 2001-2007. By the end of 2007 the average monthly salary comprised 286 US dollars against 53.6 US dollars in 2001.

228. As a result of certain transformation that took place in the nature of economic development and decline of the industrial growth rate in 2003-2007 the foreign economic relations of the country were characterized as commercial. The export/GDP ratio in 2007 comprised 12.5%, which was almost two times lower than in 2003, while the import volumes remained at the same level⁹³.

229. On the other hand, beginning from 2004 the average annual growth rate of import was two times higher than the export growth rate. As a result, the trade deficit increased from 594 mln. US dollars in 2003 up to 2124 mln. US dollars in 2007⁹⁴. At the same time, the export stagnation and the present nature of economic growth have created a rather unfavorable situation for the country in terms of its integration in global economic system⁹⁵ (taking into account the decrease of GDP from 70 % in 2003 to 48% in 2007). The reasons are the same as in case of industrial decline: demand-driven economic growth, which is mainly financed from external sources. In addition, the Armenian drams appreciation against the US dollar together with rise of food and raw materials prices have lead to the progressive growth of import; and vice-versa – to the stagnation of import deriving from low labor force. Constatnly increasing deficit balance and current account deficit was mostly financed by capital transfers, foreign direct investments, and official external support. As a result, in 2003-2007 the country's

⁹¹ This tendency is typical also for 2008. According to the data concerning the first six months of 2008, a 0.2% decrease in volumes of industrial production (as compared with the previous year) was registered.

⁹² The nominal exchange rate in April 2008 comprised 309 AMD/US dollar against . 578.8 AMD/1US dollar in 2003.

⁹³ In 2003 the export volumes amounted to 396.8 bln. AMD against 394.2 bln. AMD in 2007, and this tendency is typical also for 2008. The data concerning the first six months of 2008 show that the export volumes decreased by 0.8% (as compared with the same period of previous year), while the import in the same period increased by 40.3%.

⁹⁴ It is obvious that such a rapid growth of import volumes is substantially conditioned by increase of fuel and food prices in world markets that took place in recent years.

⁹⁵ Turnover/GDP ratio.

dependence on external financing has tangibly increased. While in 2003-2007 the volumes of financial support made it possible for the country to fill the deficit gap and ensure substantial monetary reserves, according to data concerning the first six months of 2008, the increase in monetary reserves was not registered. This means that the volumes of external financing do not meet the requirements of demand-driven economic growth and that such economic system is insecure both in mid-term and long-term perspectives.

230. Taking into consideration current economic development trends the SDP assumes that in 2009-2011 the economic growth will be based on the same demand-driven principle, and the development of non-exporting sectors, particularly construction and service sectors, will remain the main driving force of economic activity. Nevertheless, beginning from 2012 the economic policy will switch to production investment and knowledge-based economy. This will require deep structural transformations as well as development and implementation of relevant economic policy.

Table 5.11. Projections of construction of the economy the structure according to the sectors (% to GDP)

	2003	2007	2010	2012	2015	2018	2021
Industry	19.3	15.0	13.3	14.1	16.4	18.5	19.7
Agriculture	21.5	18.1	14.8	13.8	12.5	11.5	10.5
Construction	15.7	24.7	28.1	26.7	23.0	19.3	16.4
Services	34.4	32.2	32.0	33.6	36.8	40.4	43.9
Net indirect taxes	9.1	10.0	11.7	11.8	11.3	10.5	9.5
Export	24.8	13.0	10.6	12.6	16.9	21.8	25.8
Import	-40.3	-30.4	-33.4	-35.4	-37.9	-40.5	-42.2
External trade	65.1	43.4	44.0	48.0	54.8	62.2	68.0

231. Beginning from 2012 the economic growth will be driven mainly by advanced development of industrial sector and services. It is envisaged that the share of construction and agriculture will significantly reduce (see Table 5.11). The mentioned structural transformations will require redirecting of investments to industrial and service sectors and extension of exportation volumes. The economic policy will serve to achieve this goal through the improvement of business and investment environment, enhancing competition in the economy, deepening financial mediation, ensuring SME development, creating relevant institutional capacities. At the same time strategic measures will be taken to develop industrial and service sectors and to advance export activities.

232. So far Armenia is lacking complex economic policies. However, realizing the urgency of structural reforms in economy the government will elaborate and launch relevant complex long-term programs in 2008-2009.

233. The long-term industrial program will be aimed at building a competitive and modern industrial complex. It will contain the following elements:

- relevant mechanisms required to export contemporary technological complexes;
- relevant conditions required to promote the entry of new companies, especially in the sphere of high technology, including creation of necessary infrastructure financed by public sector or in result of public-private cooperation;
- development of training and retraining institutions required to prepare relevant high-quality professionals (particularly in the sphere of knowledge engineering);
- promotion of systems required to ensure proper service and upgrading of high technologies;
- mechanism required to reveal production complexes in Armenia having potential for development, promoting the process of their upgrading and strengthening as well as the process of creation on their basis integrated regional clusters (including relevant research organizations); ensuring financial support of both public and private sectors;
- involvement of Diaspora’s investment and management capacities in the process of creation and development of modern production complexes (including establishment of various pan-Armenian informational portals and their further improvement with the purpose of involving the Diaspora in the investment projects of Armenia);
- mechanisms and means required to ensure creation of high technology systems in the long-term perspective.

234. From the economic development mid-term perspective, beginning from 2012 the main contribution to the economic growth will be ensured by service sector. It is expected that in 2021 the share of this sector in GDP will reach 44% in against 32.2% in 2007. Tthe growth will mostly take place in 2012-2021 ensured by progressive development of information technologies, financial mediation, services in the spheres of education, science and health as well as local and foreign tourism.

235. Development of information technologies is the necessary and basic precondition required for the creation of the knowledge-based economy in general and the “Electronic Armenia” system in particular (e-Governance, e-Eenterpreneurship, e-Education and other e-systems), especially in terms of both acquiring and creation of the new knowledge. In this respect, the Government will pay special attention to such issues as computarization of the population, large-scale application of the Internet and the quality, accessibility, and availability of high technologies.

Table 5.12. Key benchmarks for the development of information technologies

	2006	2010	2015	2018	2021
Share of home computers, %	10	25	40	50	75
Level of computerization of educational system ,	10	30	50	90	100
Use of the Internet by households	5	25	40	50	75

The level of computerization and use of the Internet in public administration system	10	50	90	95	100
Existence of functioning e-Governance websites in public and local administrative bodies		50	100	100	100

236. The main objective of state policies implemented in the sphere of tourism is to increase the input of the latter in the national revenues, balanced territorial development, improvement of the living conditions of the population and in poverty reduction. This will be conditioned by increase of tourists' visit, increase of profits and creation of new job places.

237. Development of tourism in marzes may be viewed as one of the main problems in this field. This will contribute to mitigation of regional development disparities between Yerevan and other regions of the country. Reconstruction of the airports of Gyumri and Vanadzor are very important in the context of regional development.

238. In the program implementation period steps aimed development of the following types of tourism which have a perspective in Armenia should be undertaken:

- Spa tourism
- Mountain-ski tourism
- Diamond cutting and jeweler's art centre,
- Tours around the vineyards, cognac and wine factories presenting the whole circle of the production

239. Basic outcome indicators of the tourism sector development are presented in the Table 5.13

Table 5.13 Basic outcome indicators of the Tourism Sector Development

Indicators	2006	2010	2020
Number of international tourists	510.2	600.0	1,500
Share of people employed in the sector of tourism among the total number of employed %.	1.7	1.8	1.9
Expenditures made by the tourists , mln dram	440	480	1,350
Number of inside tourists' visits (per thousand people)	369	500	1,000

240. The long-term development strategy of the government is aimed to ensure conditions, which would make it possible for Armenia to become a financial, health and educational regional centre. This will require substantial improvement of relevant services in order to bring them in line with international standards; extension of their export volumes and maintenance of their competitiveness in the world markets. In

order to achieve the mentioned goals the government is committed to develop long-term programs during the 2008-2009 period and launch them in 2009.

241. As for the export promotion, the policy in this sphere will contain both general and specific components.. It should be mentioned that export promotion, especially in such small countries as Armenia directly depends on the development of industry and agriculture. Nevertheless, the government will develop and beginning from 2009 will launch a long-term program, which along with other relevant measures will ensure:

- creation of relevant institutions for export financing (using credit insurance and loan guarantee tools);
- possible mitigation or elimination of trade restrictions;
- commercial activities based on free trade agreements (particularly with the EU and EU member states);
- assistance to exporters in the certification of their production in other countries, particularly in receiving ICO certificates;
- a set of measures aimed to enlarge the list of exported goods and their geographical coverage, as well as the share of high technologies in total export volumes;
- measures aimed to reduce transportation costs, including investment of public or joint public-private resources.

5.6. Monetary policy and deepening of financial mediation

242. In recent years, together with the accelerating economic growth and move from the restoration growth to that of based on investments, as well as in parallel with the process of the dram's stabilization the degree of economy's monetization began to significantly increase expressed by progressive growth of money base and money aggregates⁹⁶, by the rise of their ratio to GDP and by gradual reduction of the level of shading/dollarization of economy. The mentioned developments were conditioned by an impact of a number of internal and external factors.

243. The factors of internal nature include, in particular, the tight fiscal and budgetary, as well as monetary and credit policy adopted by the Government and CB of Armenia aimed to restrain budget deficit and price increase within 1.5 – 3% (of GDP) and 3-5%, respectively. The main external factors include substantially increased foreign currency inflows (through informal remittances) and continual increase in

⁹⁶ The terms monetary base and monetary aggregates are used for money aggregates and money base if there are no additional note

imported fuel, food and metal prices mainly determined by regularly growing global demand and expansionary monetary policy adopted by the USA in recent years.

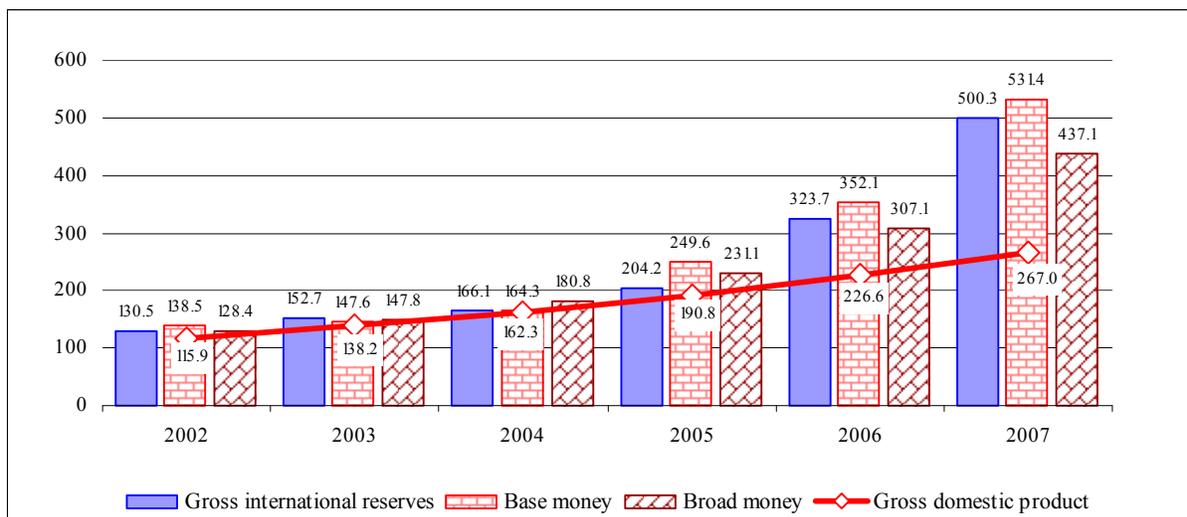
Table 5.14. Dynamics of main indicators characterizing the monetary policy in Armenia in 2001-2007

Indicators	2001	2002	2003	2004	2005	2006	2007
Gross foreign reserves	331.2	432.3	505.8	550	676.4	1072	1656.9
<i>% , to GDP</i>	<i>15.6</i>	<i>18.2</i>	<i>18.0</i>	<i>15.4</i>	<i>13.8</i>	<i>16.7</i>	<i>18.1</i>
<i>Import cover, month</i>	<i>4.5</i>	<i>5.3</i>	<i>4.7</i>	<i>4.9</i>	<i>4.5</i>	<i>5.9</i>	<i>6.1</i>
Money base, bln. drams	80.4	111.3	118.6	132.1	200.6	283.0	427.1
<i>% , to GDP</i>	<i>6.8</i>	<i>8.2</i>	<i>7.3</i>	<i>6.9</i>	<i>8.9</i>	<i>10.6</i>	<i>13.6</i>
Money aggregate, bln. drams	158.2	203.1	233.8	285.9	365.6	485.7	691.3
<i>% , to GDP</i>	<i>13.4</i>	<i>14.9</i>	<i>14.4</i>	<i>15.0</i>	<i>16.3</i>	<i>18.2</i>	<i>22.0</i>

Source: NSA of RA; CB of RA

244. The main growth of monetary policy indicators took place starting from 2004 and coincided with the process of appreciation of the dram, expansionary monetary policy of the USA, volumes of informal remittances, and abrupt increase in fuel and other natural products' prices (see Table 5.14 and Figure 5.5). Under these circumstances, to the nominal and real appreciation of the dram in terms of the floating- rate regime adopted by the CBA contributed the excess of foreign currency which the CBA did not sterilize reasoning from its basic priority of assuring stable and low prices.

Figure 5.5. Gross international reserves, base money, broad money and nominal GDP in 2002-2007 (index : 2001 = 100)



245. Nevertheless, as Figure 5.5 shows, beginning from 2005 even in case of partial neutralization of foreign currency inflow, which took place in the conditions of worsening trade balance⁹⁷, in 2007-2007 the county's Gross foreign reserves, money base

⁹⁷ In 2007 the trade balance deficit comprised 23.2% of GDP against 17.6% in 2004 2007.

and money aggregate increased by (annual average) 44.4, 47.9 and 34.2 percent, respectively, with 18.1% growth of nominal GDP, while in 2002-2004 the growth rate of mentioned indicators was equal to the GDP growth rate.

246. The process of appreciation of the dram accompanied by toughening of monetary conditions promoted the progressive growth of specific weight of transactions concluded in drams at the expense of those based on foreign currency, which – together with a number of measures aimed to regulate the dram circulation – significantly increased the degree of monetization and reduced the level of shading/dollarization of the economy.

247. On the other hand, as a result of the processes of appreciation of the dram in 2005-2007, the cost of living in Armenia estimated in foreign currency has increased almost twice, while the nominal wage (in US dollar terms) in 2001-2007 rose 5.13 times (or 3.16 times as compared with domestic currency terms⁹⁸. As a result, the temporary competitive advantage of low wages was quickly eliminated thus directly affecting the country's competitiveness. The appreciation of the dram has a negative impact on the export as well.⁹⁹ For instance, although in 2007 in terms of domestic currency the export volumes remained at the level of 2003, in terms of terms of US dollars they rose by 68 percent.

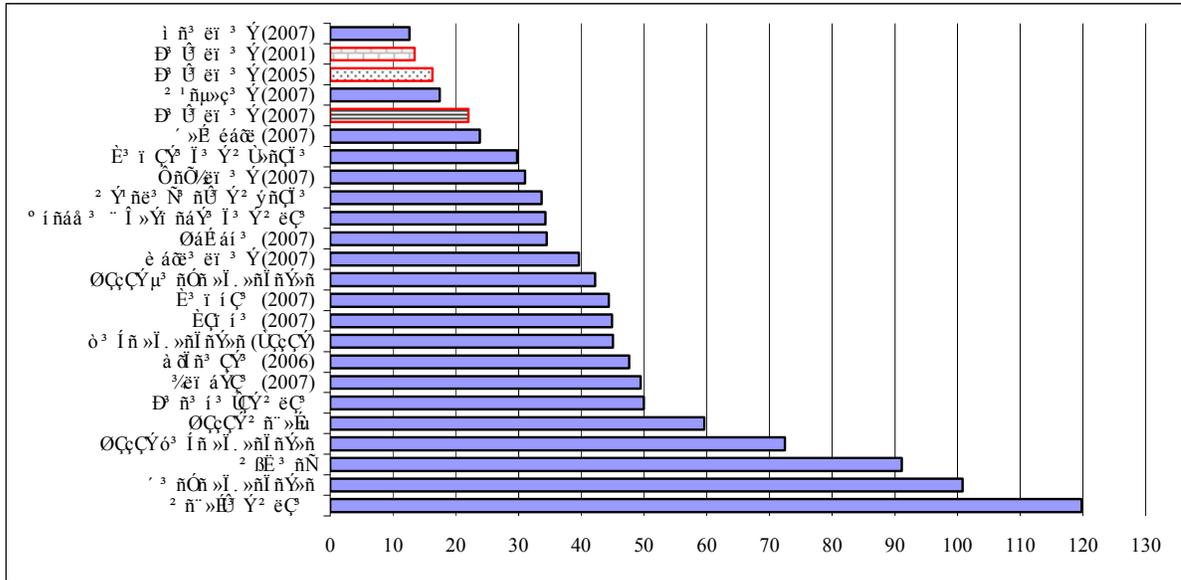
248. Nevertheless, the Government and CBA believe that the advantages of tight monetary and floating-rate policy, such as efficient and independent limits on increase in prices, the growth of dramization of economy, the conditions created to reduce dollarization and shadow in the economy both at present and during the SDP implementation period are more important than negative consequences of appreciation of the dram conditioned by external factors, including the increase in prices in the terms of exchange rate and the trend of export reduction based on temporarily competitive merits¹⁰⁰:

⁹⁸ In 2001 the average nominal salary in Armenia comprised 24.5 thousand dram or \$44.1 per month; in 2007 it was 77.5 thousand drams or \$226.5. In case the exchange rate remained the same it would comprise in 2007 139.6 US dollars or would be less by 62.3 percent.

⁹⁹ Given that it is being appreciated faster than the national currency of the main commercial partners. Actually this happens with almost all EU, Russian, as well Armenian big commercial partners.

¹⁰⁰ As the international experience shows, the opportunities for production and export based on the use of a relatively cheap labor force and requiring a relatively small amount of investments gradually decrease parallel to the country's development giving way to production and export based on high level of productivity and quality, as well as high technologies. At present, Armenia faces a period of transition from the first model of development to the second, or from i.e. from the restoration growth to that of based on investments, where a decisive role should play qualification and growth of productivity owing to attraction and promotion of investments rather than the labor force cost,

Figure 5.6 Money mass/GDP ratio international comparison , % (2003 if no additional)



249. Despite the significantly growing monetization of the economy during the last three year¹⁰¹, at present Armenia falls behind the majority of countries by mentioned indicators. Among the CIS countries, Armenia is one of the last leaving behind only the neighboring South Caucasian countries – Georgia and Azerbaijan (see Figure 5.6). Based on the abovementioned, as well as on the necessity to increase the degree of monetization (the latter being the main factor conditioning permanent reduction of dollarization and monetary circulation in the shadow economy), it will become one of the main priorities of the SDP monetary policy –together with ensuring the low level of rise in prices.

250. Along with the appreciation of the dram, high levels of monetization and reduction of dollarization became possible due to the CB policy aimed at regulation and supervision of foreign exchange internal operations. The next steps concerning the improvement of the level of monetization will include, in particular, measures directed towards limitation of cash turnover and abrupt increase of monetary circulation through non-cash banking system and electronic payments systems.

251. The SDP projections concerning the monetary policy agregates are based on the the following major assumptions:

¹⁰¹ Money aggregates/GDP ratio

- During the entire period of program implementation, the target of the rise in prices for 12 months should be 3 (+/-1.5) percent except for 2009-2010 when the target for the rise in prices should make 4 percent (+/- 1.5) percent)¹⁰².
- It is envisaged that the growth rate of informal private remittances become slower to some extent conditioned by the expected economic growth and subsequent improvement of living conditions, as well as by the expected decrease of the growth rate of global economic development (including the Russian Federation, which is the main source of informal remittances directed to Armenia).
- It is envisaged that beginning from 2009 a substantially toughening monetary policy of the USA will limit the foreign exchange supply thus counteracting the rise in fuel and other natural products' prices.
- It is envisaged that a gradual improvement of the country's negative trade balance/GDP ration will take place owing to the progressive growth of imports, which will limit to a certain extent the domestic demand for foreign currency required for import.

252. Based on the abovementioned assumptions, the gross foreign reserves and money aggregates forecasts are shown in Table 5.15. It is expected that in 2008-2021 the gross foreign reserves in nominal terms will grow by average annual 10.9 percent with the estimated average annual 11.6 percent of GDP growth (expressed in current dollars), whereas the gross foreign reserves in 2008-2012 will grow at a slower pace than GDP (9.4 percent and 15.4 percent, respectively),¹⁰³ while in 2013-2021 they will demonstrate a faster growth rate (11.8 percent and 9.3 percent, respectively): It should be mentioned that in 2001-2007 the annual average growth of gross foreign reserves comprised 30.8 percent, with the average annual 27.7 percent of GDP nominal growth (expressed in dollars)

Table 5.15. Gross foreign reserves and monetary aggregates forecasts for 2010-2021 (in current prices)

Indicators	2007	2010	2012	2015	2018	2021
	<i>Real</i>	<i>Forecasts</i>				
Gross foreign reserves, mln US dollars	1659.2	2058.8	2703.8	4303.3	6344.6	8348.5
<i>Percent to GDP</i>	<i>18.0</i>	<i>14.6</i>	<i>15.8</i>	<i>19.1</i>	<i>21.7</i>	<i>22.3</i>
<i>Import cover, month</i>	<i>6.1</i>	<i>4.6</i>	<i>4.9</i>	<i>5.6</i>	<i>6.2</i>	<i>6.1</i>
Monetary aggregates, bln. drams	691.3	1223.3	1650.9	2602.7	4226.1	7209.5
<i>Percent to GDP</i>	<i>22.0</i>	<i>26.5</i>	<i>29.4</i>	<i>35.3</i>	<i>44.1</i>	<i>58.8</i>

253. As regards the increase of money aggregates, the rate of their growth is expected to be considerably higher than the rate of GDP growth. During 2008-2021 the money aggregates will demonstrate an average annual growth of 18.8 percent, with the annual

¹⁰² Particularly with the view of the expected (in 2008-2009) rise in fuel (including the natural gas) import prices is partly taken into account.

¹⁰³ Shows the impact of estimated rise in fuel import prices on the behavior of foreign reserves.

average growth of GDP comprising 10.2 percentage points. In 2008-2012 the money aggregate will grow annually by 19 percent on average (the nominal GDP on average will grow by 12.3 percentage points per annum; and in 2013-2021 by 17.8 percentage points, or almost two times higher than nominal GDP). The mentioned growth will be ensured mainly by progressive development of financial sector, particularly the banking system, as well as by the Government and CB policy aimed to step by step deepen financial mediation; widen the national currency turnout and the application of electronic payments system; restrain the circulation of domestic and foreign cash.

254. The financial sector in Armenia started to develop immediately after declaring independence. At present, it is characterized by undoubted dominance of banking system over all other structures of the sector (see Table 5.16). In 2007 the specific weight of the banking system in the structure of entire sector comprised 93.7% against 96.6% in 2001. Apart from the banking system, lending agencies represent the only developing sector in financial system, which started functioning in 2003 and during 4 years increased its assets by about 19 times. As regards the insurance, it should be mentioned that this very important sphere of financial sector failed to develop in 2001-2007; although provided with required legal and institutional basis, corporate equity markets remain in embryonic state. Armenia is still missing such important elements of financial system as investment banks and funds, as well as private pension funds.

255. Based on international experience, due to which the role and relative interests (as compared with GDP) of financial sector steeply rise in parallel with economic development, as well as taking into account the transition to the investment-based economic growth (as planned within the SDP framework), which makes it possible for financial mediation to sharply increase its role as a main source ensuring domestic investments, securing substantial increase of the level of loan and credit accessibility becomes one of the main priorities of the SDP economic policy. This strategy will be achieved through deepening of financial mediation and ensuring progressive growth of financial sector's relative rates and variables.

Table 5.16. Armenia's financial system assets in 2001-2007 (bln drams in current prices)

Indicators	2001	2002	2003	2004	2005	2006	2007
Banking system assets	188.7	228.6	282.1	363.6	440.7	524.5	764.4
<i>% to GDP</i>	<i>16.1</i>	<i>16.8</i>	<i>17.4</i>	<i>19.1</i>	<i>19.6</i>	<i>19.7</i>	<i>24.3</i>
Financial organizations assets	...	...	...	2.3	7.9	20.6	43.4
<i>% to GDP</i>	...	...	...	<i>0.1</i>	<i>0.4</i>	<i>0.8</i>	<i>1.4</i>
Insurance sector assets	3.7	4.0	4.2	6.4	9.9	8.5	8.4
<i>% to GDP</i>	<i>0.32</i>	<i>0.29</i>	<i>0.26</i>	<i>0.33</i>	<i>0.44</i>	<i>0.32</i>	<i>0.27</i>
Equity market capitalization	2.8	5.9	15.9	...	13.9	...	...
<i>% to GDP</i>	<i>0.2</i>	<i>0.4</i>	<i>1.0</i>	...	<i>0.6</i>	...	...
Total assets	195.3	238.4	302.3	372.2	472.4	553.6	816.1
<i>% to GDP</i>	<i>16.6</i>	<i>17.5</i>	<i>18.6</i>	<i>19.5</i>	<i>21.1</i>	<i>20.8</i>	<i>26.0</i>

256. The Sustainable Development Program envisages that in foreseeable future the banking system will keep its dominant position in country's financial system advancing other elements required for effective development of financial sector.

Table 5.17 Structure of loan investments in 2001-2007, bln. drams

Indicators	2001	2002	2003	2004	2005	2006	2007
Total loan investments	86.6	90.5	110.0	159.3	215.3	276.9	464.9
Including: banks	86.6	90.5	107.6	155.7	208.1	259.3	426.2
Financial organizations	0.0	0.0	2.4	3.6	7.2	17.6	38.7
In drams	14.7	19.7	31.3	42.7	77.7	132.0	281.6
In foreign currency	71.9	70.8	78.7	116.6	137.6	145.0	183.2
To legal entities	68.2	64.9	74.0	102.3	138.8	156.4	216.9
To the population	18.4	25.7	36.0	57.0	76.5	120.5	248.0
Of which: consumer credits		12.8	23.4	39.3	52.4	71.4	123.6
Mortgage credits					11.8	25.4	53.4

257. As Table 5.17 shows, in 2001-2007 the volumes of bank loans in the economy sector has increased at a higher pace than GDP. In the mentioned period the average annual indicators of bank loans volumes comprised 32.3%, while the nominal GDP average growth made 17.8% per annum. 60.7% of accumulative growth of the loans volumes were secured at the expense of those provided for the population. As a result, in 2007 their specific weight in the total volumes comprised 53.3% against 21.3% in 2001. It should be emphasised that the progressive growth of loans provided in Armenian drams comprised average annual 63.3% in contrast to loans provided in foreign currency which made merely 16.9%. As a result, in 2007 the specific weight of loans provided in national currency comprised 60.6% of all loans against 17% in 2001. Despite significant increase in loan volumes which almost tripled during the last 4 years, the Armenian banking system¹⁰⁴ is still smaller than could be considering international regularities concerning domestic loan/GDP ratio¹⁰⁵:

¹⁰⁴ Expressed in economic terms of credit volumes/GDP ratio.

¹⁰⁵ Two regression equations have been formulated on the basis of “World Development Indicators-2006” and Actual data on domestic credit and GDP in Armenia in 2001-2007: the first one on the basis of data on ECA countries, and the second on the basis of data on all countries. The group of ECA countries is chosen because of the fact that in transition countries involved in the mentioned group (including Armenia) the volumes of banking system are substantially smaller than in other countries.

First equation (for ECA countries) reads as following:

$$\text{Ln(DC)} = -3.58 + 1.21 \text{ Ln (GDP)} \quad R(2) = 0.932, \text{ SE} = 0.638 \text{ F}=429.5 \text{ n}=33$$

(0.59) (0.06)

Second equation (for all countries) reads as following:

$$\text{Ln(DC)} = -3.86 + 1.27 \text{ Ln (GDP)} \quad R(2) = 0.917, \text{ SE} = 0.9 \quad \text{F}=1712 \text{ n}=155$$

(0.32) (0.03)

where DC – volumes of domestic credit in current mln. US dollars,

GDP – is expressed in current mln US dollars

R(2) – coefficient of determination, SE –standard deviation of equation,

Table 5.18 Actual and rated values of domestic loan/GDP ratio in 2001-2007

Indicators	2001	2002	2003	2004	2005	2006	2007
Domestic loan/GDP ratio, % (actual)	7.31	5.59	6.27	7.33	8.40	9.13	13.48
Domestic loan/GDP ratio, % (rated for ECA countries according to 1st equation)	14.13	14.48	15.00	15.79	16.88	17.87	19.28
Domestic loan/GDP ratio, % (rated for all countries according to 2nd equation)	16.37	16.88	17.65	18.83	20.50	22.02	24.25
Deviation of actual values from those rated (according to 1st equation)	-6.82	-8.88	-8.73	-8.46	-8.48	-8.73	-5.80
Deviation of actual values from those rated (according to 2nd equation)	-9.05	-11.28	-11.38	-11.51	-12.09	-12.88	-10.77

258. As Table 5.18 shows, despite noticeable improvement of banking system in recent years and certain reduction of respective deviations, in 2007 its volumes were by about 40% less than those rated for ECA countries and by almost 80% less than those rated for all countries (in case the domestic loan/GDP ratio works).

259. Based on the abovementioned and taking into consideration the existing banking development potential, as well as the perspectives of GDP growth, the SDP envisages to get the domestic loan/GDP ratio to 25.3% by 2012¹⁰⁶, and to 36% by 2021¹⁰⁷. Benchmarks required to achieve mentioned goals are presented in Table 5.19

Table 5.19 Domestic loan/GDP ratio benchmarks envisaged for 2007-2021

Indicators	2007	2010	2012	2015	2018	2021
Domestic loan, bln drams, in current prices	423.2	994	1485	2561	4129	6631
Domestic loan /GDP, %	13.5	21.2	25.3	32.7	40.4	50.6
Domestic loan annual average growth rate, %	30.4	32.9	22.2	19.9	17.3	17.1
<i>Mmemorandum article</i>						
Nominal GDP annual average growth rate, %	17.8	14.3	11.7	10.1	9.3	8.6

* Annual average growth rates are estimated for 2007 including the period 2001-2007 and for 2010 including the period 2008-2010.

260. To achieve the benchmark values presented in above Table, the domestic loan/GDP ratio should be kept at the level of 2001-2007; or the domestic loan increase rate should be by about 1.7-2.0% higher than the GDP nominal growth rate except for the period 2010-2012, when they should exceed GDP growth rate approximately 2.3-2.4 times.

261. Along with the strategy of increasing the access to loans, which are described in SDP sections dedicated to business and investment environments, policies aimed to achieve abovementioned benchmarks should include the following:

F –Fisher statistic value, n – number of observations

Enclosed in brackets are standards estimate deviations

¹⁰⁶ Comply with the GDP ratio estimated for Armenia-2012 on the basis of 1st equation (for ECA countries).

¹⁰⁷ Comply with the GDP ratio estimated for Armenia-2012 on the basis of 2nd equation (for all countries).

- increasing competitiveness and encouraging reputable foreign banks to enter the Armenian market (the only first-rate international bank functioning currently in Armenia is the HSBC Bank Armenia);
- increasing efficiency of bank operations and adopting a policy aimed to reduce expenses through introduction of new technology and banking instruments; integration of software programs and systems including substantial extension of mortgage able property;
- slightly deregulating the system and mitigating unduly strict standards thus making it possible for the bank assets to be used more effectively;
- consistently integrating contemporary principles of corporate governance; ensuring openness and transparency of banking system; promoting real shareholding;
- creating institutional basis for protection of borrowers (financial Ombudsman – following the United Kingdom example), taking into account progressive growth of both present and future (envisaged in SDP) consumer credit;
- creating devices required to form, put in use and safeguard mortgage bonds, which will make it possible to increase the number of households making use of mortgage lending; ensure sustainable improvement of this form of lending and reduce degree of its risks.

262. As a result of progressive advance of abovementioned and a number of other measures, the SDP plans to achieve the benchmarks defined in Table 5.19. Moreover, it is expected to reduce the borrowing costs by lowering lending-depositing spread on the one hand, and to reduce the extremely high capital-assets ratio, on the other hand.

263. The interest spread (see Table 5.20 characterizes both the weak competitive capacities and high credit risks as well as the capital/assets ratio¹⁰⁸, which in turn demonstrates the existence of rather strict normative standards and insufficient use of existing resources for the purposes of domestic loaning. Rated values of spread and capital/assets ratio are obtained on the basis of respective regression equations (World Bank, (World Development Indicators-2006)¹⁰⁹: The Table shows that the values of

¹⁰⁸ According to respective data, in 2004 bank capital ratio to bank assets in Armenia was the highest among those 88 countries about which respective information was available. (See World Bank, World Development Indicators - 2006):

¹⁰⁹ Two regression equations have been formulated on the basis of abovementioned and actual data on bank spread, bank capital/assets and domestic credit in Armenia in 2001-2007: the first one for dependent variables of spread, and the second for those of capital/assets.

First equation (for spread) reads as following:

$$\ln(SP) = 3.02 - 0.31 \ln(DC) \quad R(2) = 0.275, SE = 0.554 \quad F=46.25 \quad n=124$$

(0.17) (0.05)

Second equation (for capital/assets ration) reads as following:

bank spread and especially capital-to-assets ratio in Armenia are substantially higher than trends of respective indicators worldwide.

Table 5.20. Actual and rated values of bank spread and bank capital/bank assets ratio 2001-2007

Indicators	2001	2002	2003	2004	2005	2006	2007
Bank spread (actual) %	13.83	18.18	14.85	14.60	12.17	12.54	10.77
Bank spread (rated) %	11.03	11.99	11.57	11.02	10.56	10.29	9.11
Deviation of actual spread from rated %	2.80	6.19	3.27	3.57	1.61	2.25	1.66
Bank capital/bank assets ratio (actual), %	21.65	18.41	17.76	17.78	21.50	22.91	22.48
Bank capital/bank assets ratio (rated), %	13.75	14.67	14.27	13.74	13.29	13.02	11.85
Deviation of actual ratio from rated %	7.90	3.74	3.49	4.04	8.21	9.89	10.63

264. Considering the importance of two abovementioned indicators and in order to decrease values of credit resources and as a result to enhance the accessibility to credit, as well as to assume more efficient control of bank resources SDP uses them as key interim benchmarks to ensure anticipated loan volumes, which are presented in Table 5.21

265. As Table 5.21 shows, based on the results of mentioned strategic measures, the SDP envisages to reduce the interest rate spread in compliance with growth of domestic loan volumes ratio to GDP getting it to 6.7 percentage points against 10.7 in 2007. In addition, it is expected that slight deregulation of the system; mitigation of unduly strict standards, and adoption of principles aimed to increase competitiveness will lead to a sharp decline (more than twice) in bank capital-to-bank assets ratio in 2008-2010.

Table 5.21 Benchmarks for Interest rate spread and bank capital/bank assets ratio envisaged for banking system in Armenia in 2007-2021

Indicators	2007	2010	2012	2015	2018	2021
Domestic loan /GDP, %	13.5	21.2	25.3	32.7	40.4	50.6
Interest rate spread, %	10.8	8.4	7.8	7.4	7.1	6.7
Bank capital/bank assets ratio, %	22.5	11.1	10.5	10.1	9.7	9.3

266. Armenia is among the world countries ranking lowest in terms of equity market capitalisation, and lagging behind all those ECA countries (including CIS) about which

$$\ln(\text{CA}) = 3.1 - 0.24 \ln(\text{DC}) \quad R(2) = 0.294, \text{ SE} = 0.37 \quad F=39.75 \text{ n}=94$$

$$(0.15) \quad (0.03)$$

where: DC – domestic credit/GDP ratio, %

SP – interest rate spread, %

CA –bank capital/bank assets ratio, %

R(2) - coefficient of determination, SE – standard deviation of equation,

F –Fisher statistic value, n – number of observations

Enclosed in brackets are standards estimate deviations

respective publications have been available¹¹⁰. Despite the existence of sufficient legislative and institutional basis (including the Armenian stock exchange and the Central depository) as well as the existence of the regulatory body, i.e. the Central bank of Armenia¹¹¹, actual absence of such important system necessary for financing the economy and attracting investments¹¹² is conditioned by absence of both demand and supply.

267. As regards the supply issue, it should be mentioned that its lack is mainly conditioned by such factors as the way of business management (prevalence of single-owned or group-owned companies and enterprises unwilling to involve minor shareholders), as well as strict requirements concerning disclosure of corporate information. With the exception of banking system and a number of companies having branched infrastructure and foreign stakeholders, both management and communication systems (in terms of providing population with required information) adopted by existing open joint-stock companies do not meet contemporary standards of corporate governance.

268. Absence of demand from potential minor investors is mainly caused by lack of trustful information and by impossibility to effectively influence decisions made by the management of companies. That is the reason why in recent years minor investors prefer to direct their free financial resources towards real estate markets.

269. Nevertheless, based on international experience, including the experience of the member states of the European Union and the candidate countries, which shows that the development of banking system serves as a driving force for other branches of financial sector including corporate equity market, the SDP defines the following benchmarks for the development of equity market (see Table 5.22).¹¹³

¹¹⁰ See the World Bank's "World Development Indicators" published in 2005 and 2006.

¹¹¹ In 2005, the regulatory functions of equity market were delegated to the Armenian Central Bank. Heretofore, the mentioned functions have been performed by the RA Equity Committee, which was closed out when its responsibilities were transferred to CBA.

¹¹² The corporate equity market is underdeveloped in a number of CIS countries as well, with the exception of Russian and partly Ukraine. This can be explained by the real sector peculiarities of mentioned two countries (fuel exporting companies in Russia and metallurgical works in Ukraine) .

¹¹³ The benchmarks are estimated on the basis of World bank's "World Development Indicators-2006" statistical data concerning the ECA countries' equity market capitalization. The regression equations reads as follows:

$$\text{Ln(MC)} = -1.53 + 1.31 \text{ Ln (DC)} \quad R(2) = 0.963, \text{ SE} = 0.623 \text{ F}=555.6 \text{ n}=23$$

(0.16) (0.05)

where MC – equity market capitalization, mln US dollars,

DC – domestic credit, mln US dollars,

R(2) – coefficient of determination, SE –standard deviation of equation,

F –Fisher statistic value, n – number of observations

Table 5.22. Benchmarks defining equity market volumes (in current prices) and capitalization in 2010-2021

Indicators	2010	2012	2015	2018	2021
Domestic loan, bln drams	994	1485	2561	4129	6631
Equity market capitalisation, bln drams	237.3	419.1	725.7	1256.8	2176.5
Equity market capitalisation/GDP ratio, %	5.0	7.1	9.3	12.3	16.6
Equity market capitalisation, annual average growth rates, %*	...	32.9	20.1	20.1	20.1
<i>Memorandum article</i>					
Nominal GDP annual average growth rate, %*	14.3	11.7	10.1	9.3	8.6

*Annual average growth rates are estimated for 2012 including the 2010-2012 period of time; for 2015 - including 2012-2015, for 2018- including the period for 2012-2015. Growth rates for the period previous to 2010 are not estimated due to very small sizes of existing equity market:

270. The strategy aimed at creation of actual equity market will be comprised of the following components: applying principles of integration and technical promotion; promoting shares' circulation in the stock; implementing present-day standards of corporate governance. The integration component should make it possible to evaluate Armenian companies in order to sell their corporate shares in international stock markets, and *vice versa*: to make the shares circulating worldwide available for local population.¹¹⁴ Technical solutions include modernization of exchange trade systems, which should link the Armenian stock market to OMX and other markets and should be realized by OMX company.

271. Policy aimed at promoting shares' circulation in the stock market presupposes that considerable assistance be provided by the regulatory body to ensure initial public offering (IPO) process related to domestic companies' shares, which should include: selection of companies; execution of IPO file; public disclosure; introduction of contemporary standards of corporate governance, etc.

Poor development of insurance market of Armenia in recent years is conditioned by absence of relevant systems of obligatory insurance. In 2007, the total amount of insurance premiums comprised merely 4.8 bln drams, or 0.15% of GDP. As predicted by experts, in 2010 the insurance market of Armenia will substantially develop due to obligatory third party vehicle insurance against harm envisaged for 2009; and the overall amount will make 30 bln drams, or 0,65% of GDP¹¹⁵. It is also envisaged that beginning from 2010 creation of a contemporary voluntary medical insurance will be initiated whereupon the Government will discuss the possibility of its transformation into an obligatory system for government officials and some groups of budgetary employees (in particular, teachers). By 2015 the

Enclosed in brackets are standard estimate deviations

¹¹⁴ In January 2008 the Armenian stock market and Central Depository were sold to Swedish OMX, which owns an extensive stock network including transition countries, and which in 2007 was bought by NASDAQ – one of the largest American stock exchanges.

¹¹⁵ Calculated on the basis of collected insurance premiums.

total amount of insurance premiums will make at least 1.25% to GDP; by 2021 it will comprise 2.5 % as compared with GDP.

5.7. Tax policy and administration

272. Economic developments and significant changes in tax administration system that took place in Armenia after PRSP approval, have created a quite new situation. In recent years, two-digit indicators of economic growth were recorded; however, the tax base of Armenia has a huge unused potential in terms of increasing tax revenues and requires continuous reforms. In general, the amendments in the tax law were aimed to simplify and clarify taxation, to restrict and minimize tax evasion thus creating more favorable conditions for investments and economic activity of the population. The simplification of tax laws should be continued to ensure a faster growth of tax revenues and their positive impact on economic development.

273. With regard to the issues addressed within the framework of poverty reduction program, development of Tax Code was initiated in 2007, with the aim to group tax laws. In 2008 the development of special part of Tax Code will be completed, and in the mid-term perspective it will be applied based on the following priorities of the tax policy:

- (i) A simple tax system with a wider tax base should be established with the aim to equally distribute taxation burden. However, this should be done in a way that tax rates are not raised, existing tax privileges are eliminated and new tax privileges are excluded.
- (ii) Alternative taxation procedures once defined for particular activities should be transformed into a unified taxation method in order to completely switch to a taxation system depending on economic output.
- (iii) Taxation mechanisms should be improved through minimizing tax evasion, as well as simplifying and clarifying legislative provisions.

274. The main instrument to ensure the required taxes-to-GDP level should remain improvement of tax administration aimed at reduction and prevention of shadow activities. To this end highly prioritized is the implementation of activities envisaged by the RA Strategy for Tax Administration 2008-20011. Introduction of the principle of voluntary exercise of tax obligations as well as implementation of new tax control policies are fixed in the program core objectives with defined criteria timeframes. Toughening of the responsibility for disregard of tax duties is also viewed as an important measure to increase the discipline among the tax-payers.

275. Introduction of effective self-assessment system requires a long-term comprehensive program, which should embrace simplification and improvement of taxation procedures (including accounting); unification of taxpayers' registration in various state structures, improvement of tax services and appeals system functioning

within those structures. Introduction of effective system of self-evaluation will simplify the interrelations between tax authorities and taxpayers.

276. Improvement of tax administration requires introduction of the risk-based audit system, which will strengthen the tax oversight function and increase its efficiency. This will, in turn require collection and analysis of data on taxpayers which is needed for risk-based selection. Introduction of such system will make it possible to reduce the expenses for law-abiding taxpayers and direct them to reveal the issues causing tax evasion.

277. In the field of customs administration, relevant measures should undertaken to streamline and simplify customs legislation and procedures; to increase the efficiency of control in customs administration system; to introduce enhanced mechanisms of customs declarations, and to improve the accountability and oversight of customs regulation and administration system.

278. In this regard, special emphasis will be put to improving the technical conditions of tax and customs administration, as well as the mechanisms needed to ensure informational exchange between the two systems. This in turn, will contribute to improving the quality and efficiency of control over economic entities.

5.8. Institutional modernization of the country

279. Institutional modernization of the countries in line with the EU standards, which has demonstrated its efficiency in 10 new EU member states (EU-10), became the main basis on which the mentioned countries successfully realized the „second generation” reforms in 1999-2006. Therefore, it was decided that the following components of Armenia’s institutional modernization process be learned from the experience of EU-10: (i) adaptation of the RA legislation to corresponding EU legislation ¹¹⁶, (ii) institutional adaptation , i.e. formation or reformation of governmental, public and other institutions in compliance with the EU standards and requirements, which are necessary for effective adaptation to corresponding EU legislation; (iii) strengthening the institutional capacities in order to bring the capacities of newly formed or reformed institutions to those of the EU institutions.

280. Institutional modernization of the country is one of the government priorities. It should be realized in line within the European Neighborhood Policy (ENP) framework adopted by Armenia in 2003. The government intends to intensify the above mentioned processes of institutional modernization.

281. Particularly, it is expected that 30% of legislation will be adapted in 2010, 60% will be adapted in 2015, and the process of adaptation will be accomplished in 2018.

¹¹⁶ Corresponding EU legislation means the adaptation of those parts of the EU Acquis Communautaire, which concern the requirements to be met by the EU member states or candidates. However, it does not include the regulation of relations deriving from the EU membership.

Concrete fields of measures to be taken towards legislative and institutional adaptation and towards strengthening of institutional capacities will be identified based on the degree of the countries readiness to take those measures as well as on the goals defined for each period of time. This activities will be realized within the framework of National Program for institutional modernization, which will be elaborated in 2008-2009¹¹⁷ in line with the ENP Action plan approved for Armenia.

282. As for the institutional adaptation, it is expected that at the moment the relevant legislation is adopted corresponding institutions should be already introduced. This means that by 2018 the process of institutional adaptation will be accomplished as well.

283. Measures aimed to strengthen institutional capacities should be worked out so as to ensure by 2021 conditions equal to those in EU-10 countries.

¹¹⁷ The first Program of this kind – the Partnership and Cooperation Agreement between the EU and the Republic of Armenia has become out of date and requires substantial changes.

6. Employment, unemployment, labor productivity, population income and poverty reduction

6.1 *Correlation between employment and poverty*

284. The fundamental poverty reduction perspective through economic development is the expansion of “dignity employment”¹¹⁸. First of all the dignity employment assumes a minimal level of work remuneration, which will at least enable the worker and his/her family member to avoid the poverty. In this regard, despite some positive moves in recent years, in 2005 around 24% of employed people and their family members were considered as poor¹¹⁹. No doubt, when compared with the overall poverty level in the country, this indicator proves that the employment substantially reduces the poverty risk (in 2005 it was reduced almost by 10% points). This may be evidenced also by the comparison of the poverty level of those employed and unemployed. Nevertheless, the existence of considerable number of the employed poor (conditioned often by low level of productivity) is a problem the solution of which in the forthcoming future will become one of the priorities of poverty reduction strategy.

285. Along with the increase in employment and reduction of unemployment, the program will be also aimed to reduce the risk of being poor for employed people so that by 2015 the share of the employed poor constitutes no more than 5%. It is also expected that in 2021 the problem will be completely solved, as the minimal earning of one family member having full employment will be equal to poverty line of an average family.

286. The dignity employment is not limited to the remuneration level of labor; it also includes such important component as: working conditions; degree of formality and social security, especially minimal guarantees for provision of pension. In this regard, the increase of formal employment becomes of great importance, especially, when the matter concerns the non-agriculture employment. The program envisages that the formality degree of non-agricultural employees will grow by 2-3% per annum and in 2021 will constitute 85%.

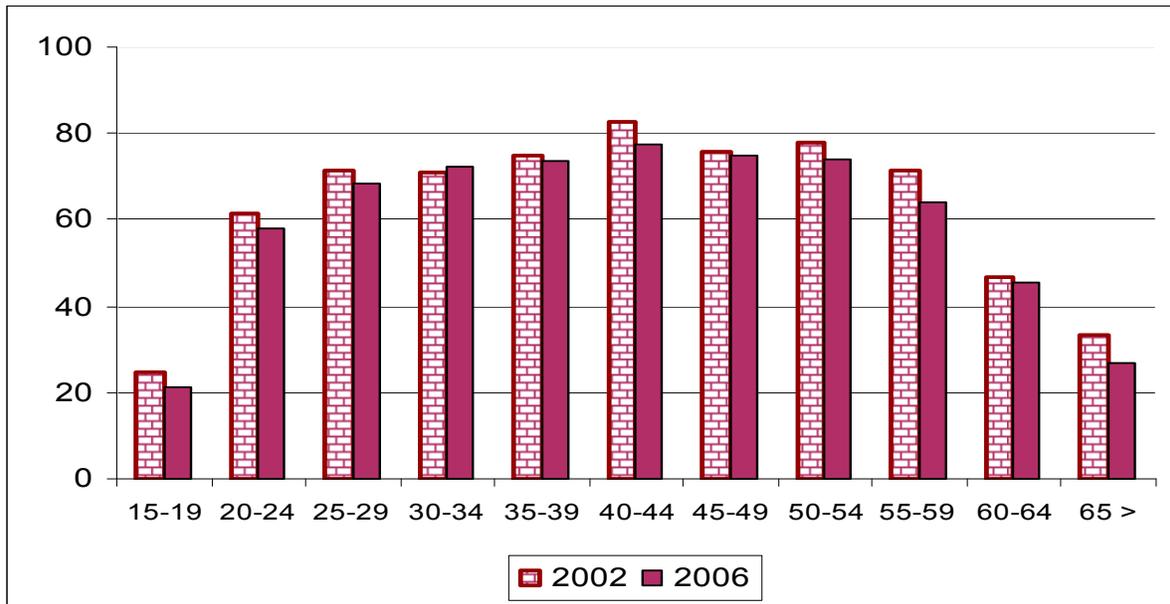
6.2 *Economic activity of population*

287. Over the last years, the reduction of the economic activity rate of population has been observed, which is specific for almost all the countries of former socialist sector including all countries of Eastern and Central Europe. According to labor force alternative survey findings, in 2002-2006 the economic activity level in Armenia decreased by around 4%, whereas the women’s economic activity rate decreased even further – by 4.7% and in 2006 reached 48.8% against 53.5% in 2002. In general, the economic activity level decreased in all age groups except for the 30-34 years olds. Among this group the economic activity level is slightly higher.

¹¹⁸ This concept was put into circulation in recent years by ILO:
<http://www.ilo.org/public/english/standards/realm/ilc/ilc91/pdf/rep-i-a.pdf>.

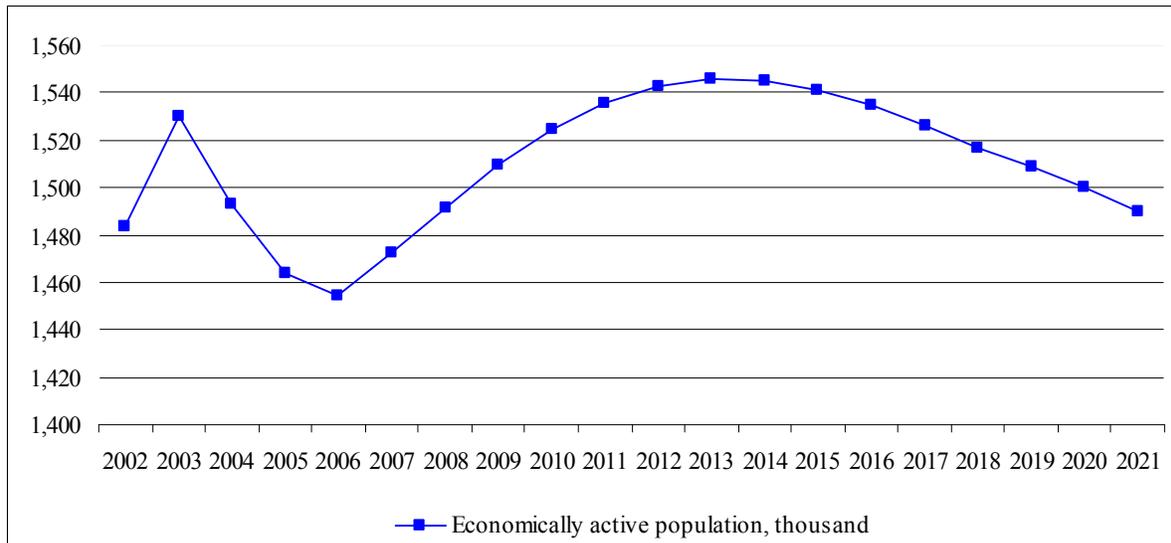
¹¹⁹ For comparison: in 1999 this indicator was around 49%.

Figure 6.1. The level of economic activity by age groups in 2002 and 2006, % of the relevant population group



288. The present level of economic activity (65% in the age group of 15-64) although yielding to the respective indicators of the developed countries (especially in regard of women's economic activity); is comparable with the indicators of Central and Eastern European countries. During forthcoming 10-15 years, the present level of the population's economic activity is likely to be maintained irrespective of possible variations and expected structural changes conditioned, in particular, by the growth of engagement in higher education and by increase of women's economic activity. At the same time, in case the constant economic activity level is ensured (as the demographic forecasts show), the labor force supply will tend to grow until 2015. However, later on it will decline supposedly due to the behavior of 15-64 years old age group.

Figure 6.2. Projections of the number of economically active population (assuming constant economic activity level at 65%)



6.3. Overall level of employment

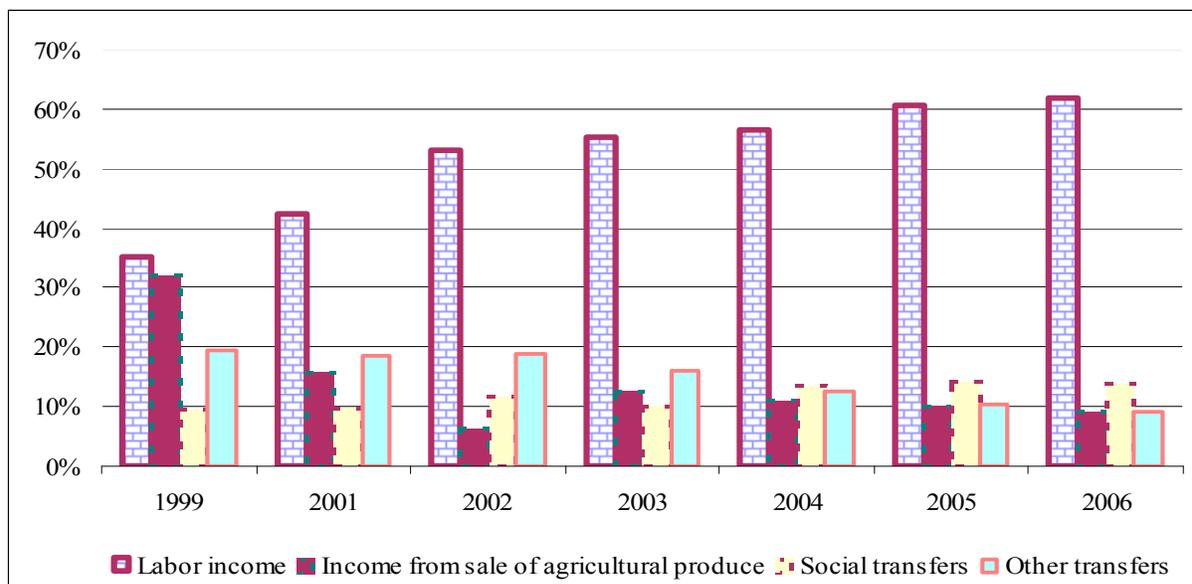
289. According to official statistics in Armenia the absolute, as well as relative employment level and its dynamics are somewhat contradicting. The absolute number of employed in 2006, according to the official statistics received from the organizations and farms was 1,092 thousand workers (thus recording a slight 1.27% of employed people as compared with 2002). Nevertheless, as the sample surveys of labor force show, the relative level of the employment, i.e. the share of the employed as compared with the population of the respective age (15-70 years old) for the same period has increased by around 2% making it 43.8% in 2006. Taking into account the fact that in the same period there has been increase of the number of population presenting the given age group one might come to a conclusion that in 2002-2006 an increase of employment took place. The approximate estimates show that the number of employed in that period increased by 120-150 thousand people or by around 15%. Thus, according to labor force sample surveys the economic growth of 2002-2006 for the first time in post-Soviet period has led to employment expansion. According to estimates in 2002-2006, the elasticity of employment as compared with the economic growth was 0.2%, meaning that 1% of economic growth expanded the employment by 0.2%¹²⁰.

¹²⁰ It should be mentioned that according to the existing PRSP forecasts the employment elasticity in medium term perspective was 0.17 and for 2002-2015 0.2% on average. Thus, one can say that from the standpoint of this indicator the actual results have not been deflected from PRSP-1 forecasts. At the same time one shall also mention that in this area the statistics needs to be considerably improved and the results presented shall be approached with certain reservations. Thus, the employment increase during 2002-2006 according to ILO is approximately all about 2002-2003, after which there has been actually no employment increase. Taking into account that the economic developments of those years have not been substantially different, one year vibration shall be ascribed to statistical deviations.

290. Thus, irrespective of the differences in employment estimates, during the last 5 years recorded positive results which witness that the economic growth was not accompanied by employment reduction, as it was permanently happening up to 1998-1999. Moreover, according to the labor force sample surveys, an increase of employment which was at the same time accompanied by high rate of labor productivity.

291. The unprecedented rate of economic growth under the circumstances of stable employment has led to substantial change of the population income structure for the benefit of incomes determined by employment. During the last 5 years the incomes from employment in the overall structure of population's monetary income grew up by around 11%, while as compared with 1999 the respective indicators were approximately doubled.

Figure 6.3. Structure of population income in 1999-2006, % of total income



6.4. *Level and structure of unemployment*

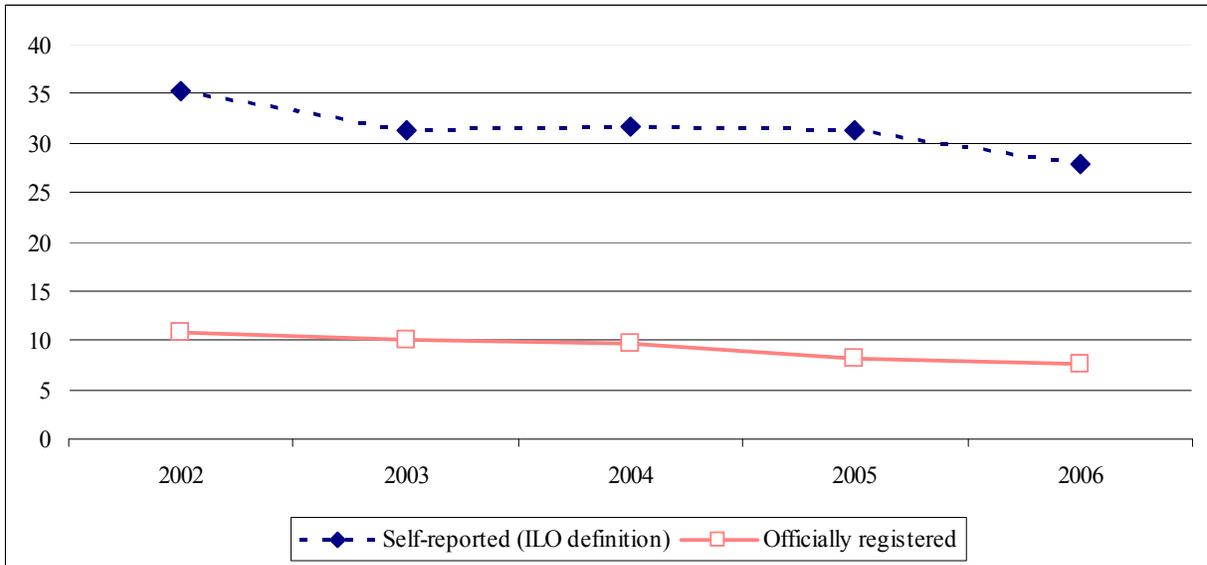
292. The other important characteristics of the labor market, which also have a special significance from the standpoint of developing an employment policy aimed at the poverty reduction, concern the unemployment level and structure. The fact of being an unemployed, according to the household survey results, continues to substantially increase the poverty risk. Thus, in 2005 the fact of being unemployed increased the poverty risks by around 60%.

293. At present, the unemployment level in the country is estimated in two different ways. The first one is the official unemployment, which concerns the unemployed people registered in the employment services. The second one is the real unemployment, which is obtained on the basis of sample surveys on labor market and is mostly consistent with ILO criteria. Although the unemployment levels revealed through the mentioned two ways substantially (around 20% points) differ from each other, nevertheless, a clear

reduction trend of registered as well as unregistered unemployment took place during last 5 years (see Figure 6.4).

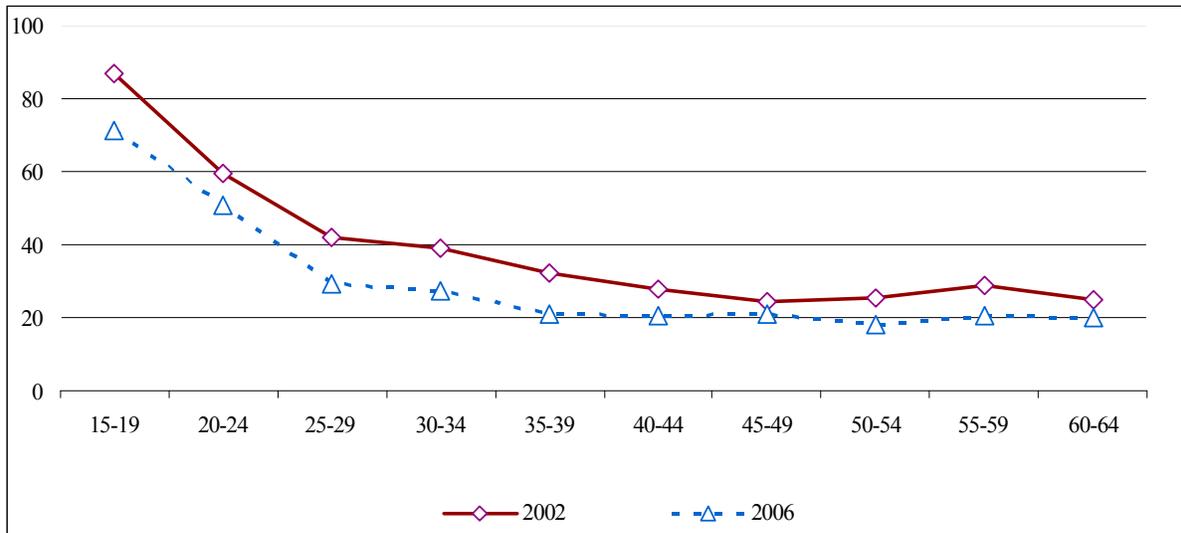
294. The unemployment level, irrespective of its substantial decrease, still remains very high as compared with any international data. The official (registered) unemployment level in 2006 was 7% or less than 4% as compared with 2002 indicator, and the level of real unemployment, according to labor force sample surveys, was 27% – having been reduced by 7% as compared with 2002.

Figure 6.4 Dynamics of registered and real (self-reported) unemployment rates in 2002-2006



295. The gender/age peculiarities have not been changed during PRSP period. According to labor force alternative surveys the women’s unemployment level continues to surpass the men’s unemployment level. As regards the age groups the real unemployment level continues to remain especially high among the youth – surpassing its average by around 2.5 times.

Figure 6.5. Level of the real (self-reported) unemployment by age groups in 2002-2006



296. In recent years, some positive moves in the dynamics of long-term unemployment took place as well. Thus, according to labor force surveys the share of unemployed people looking for a job for 12 months and more has decreased making it 39.7% in 2006 as compared with 51.3% in 2002. Nevertheless, taking into account the high unemployment rate, the fact that most of the unemployed are not registered and that the level of unemployment benefit is still low, the reduction of the number of unemployed looking for a job for more than a year will be of primary importance for the poverty risk reduction.

297. In general regarding the poverty reduction, as well as the previous program, a special importance should be put onto the level of real poverty, especially poverty reduction among youth and long-term structural unemployment, as well as efficiency and volume increase of the support provided to the unemployed. The SDP real unemployment level (the source of which will be the labor force selective surveys) mid-term target will be 15% by 2015 and in the long-term perspective it will constitute not more than 10%. As concerns the indicator of the registered unemployed people, it will not be considered a program target and its variations, as well as the possible increase of the registered unemployment level will not be regarded as deviation from the program.

298. To mitigate the unemployment impact on the poverty level, in the perspective an important value will be attached to the unemployment benefit system. At present, the unemployment benefits still continue to remain very low: the average unemployment benefit size in 2006 was not more than 50% of poverty line¹²¹: Considering that at

¹²¹ In December 2006 10,000 people received unemployment benefit (11.8% of registered unemployed) and the average unemployment benefits was 9,000 drams per month (around \$20). On average the benefit amount was 57% of minimal salary and 14% of average salary. Additionally 24,000 unemployed (2004) received monetary assistance – amounting 30% of the unemployment baseline benefit. The small number of the beneficiaries is mainly explained by the fact that most of the unemployed have used and lost their right to get unemployment benefit. In 2006 more than 73% of the registered unemployed did not have employment during last 12 months and additional

present only a limited number of unemployed receive unemployment benefits, it seems that the increase of the unemployment benefits will not play a serious role in the reduction of poverty risks among the unemployed. However, it should be taken into account that the low level of unemployment benefits is one of the reasons for the unemployed not to get registered. Thus, in the perspective the extremely modest unemployment benefits system will continually demonstrate significant differences between the real and registered unemployment levels. At the same time, this fact to a certain degree contradicts to the increase of formal employment – in regard of lack of pertinent incentives among informal employed, which in its turn leads to a vicious circle, as the informal employed cannot claim for unemployment benefits.

6.5. Employment in agriculture

299. In contrast to urban areas, the poverty level in the rural areas is mostly conditioned by low level of employment incomes rather than by the high unemployment level. According to various estimates the unemployment level in rural areas is considerably, (3-5 times) lower than the urban unemployment level. The difference becomes more tangible according to the official statistics: in 2006, only 7% of the registered unemployed were from rural areas.

300. At the same time in the sector providing the most of the rural employment, i.e. in agriculture, together with the low level of productivity the employment income distribution inequality coefficient is also considerably lower, as a result of which the overall level of the rural poverty and the poverty level of self-employed in the agriculture are approximately the same, or in other words the self-employment in the agriculture does not reduce the rural poverty risk¹²².

301. The issues concerning the rural population employment and in particular, the employment in agriculture are detailed in the agriculture section of the program.

6.6. The state and perspectives of non-agricultural employment

302. According to the data obtained by two major methods of employment assessment, i.e. the labor force sample survey and information provided by enterprises about employees, registered self-employed people, as well as about the rural population able to work in the farms, the share of non-agricultural employment in the overall employment in 2006 was respectively 76% and 54%. Such significant difference is explained by the fact that different methodologies were used to assess the employment in agricultural sector.

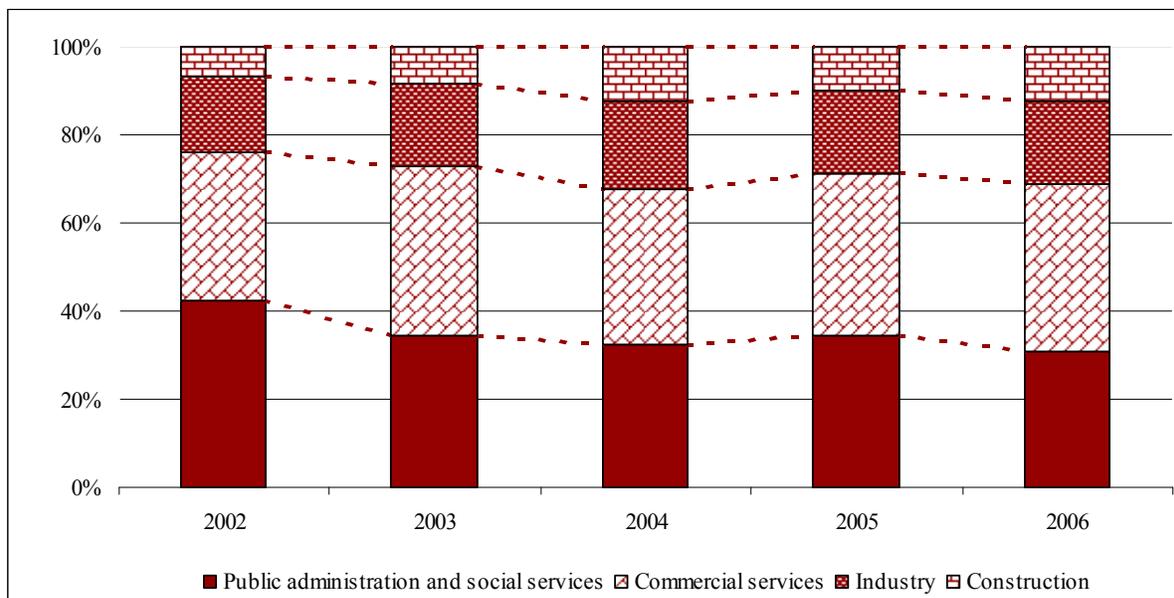
13% during 6-12 months. All these people lost their right to receive benefit, which is given for maximum six months (NSS 2006).

¹²² According to 2005 HS (Household Survey), the overall poverty level of the rural population was 28.3% and among the rural self-employed it constituted 27.2%.

303. According to regularly conducted labor force sample surveys in 2002-2006, certain trends were recorded in the structure of non-agricultural employment, which in general reflect the changes that took place in economy.

- The share of employed in the public administration and social services has considerably decreased, mostly conditioned by the continuous structural reforms in this area. In general in 2002-2006 the share of the employed in this area in the employment structure decreased by around 10% points. It is noteworthy that in parallel the remuneration of the people involved in the mentioned sector increased. In particular this concerns the public service, education and health sectors, where the salary growth rates surpassed the rate of average salary growth in the country.
- Under the conditions of continuous growth of the share of commercial (non-social) services in the employment structure in 2006, as compared with 2002 the indicator level increased by 4% points making it around 38% of non-agricultural employment in 2006.
- In contrast to continuous employment reduction in industry up to 2002 in 2002-2006, the share of the sector in the employment structure was quite stable constituting around 19%.
- And finally in 2002-2006, a considerable growth of the employment in the construction sector (around 70%) was registered, although mainly due to informal employment.

Figure 6.6. Non-agriculture employment trends by sector in 2002-2006



304. It is expected that in forthcoming 10-15 years the share of non-agricultural employment in the overall employment will continue to grow getting up to 80% in 2021 (by ILO methodology). This will take place because of the expected stable level of agriculture employment under the general employment expansion conditions. It is expected that apart from the construction, the share of which in medium term remaining stable in the perspective will somewhat go down getting reaching 7-9%, in

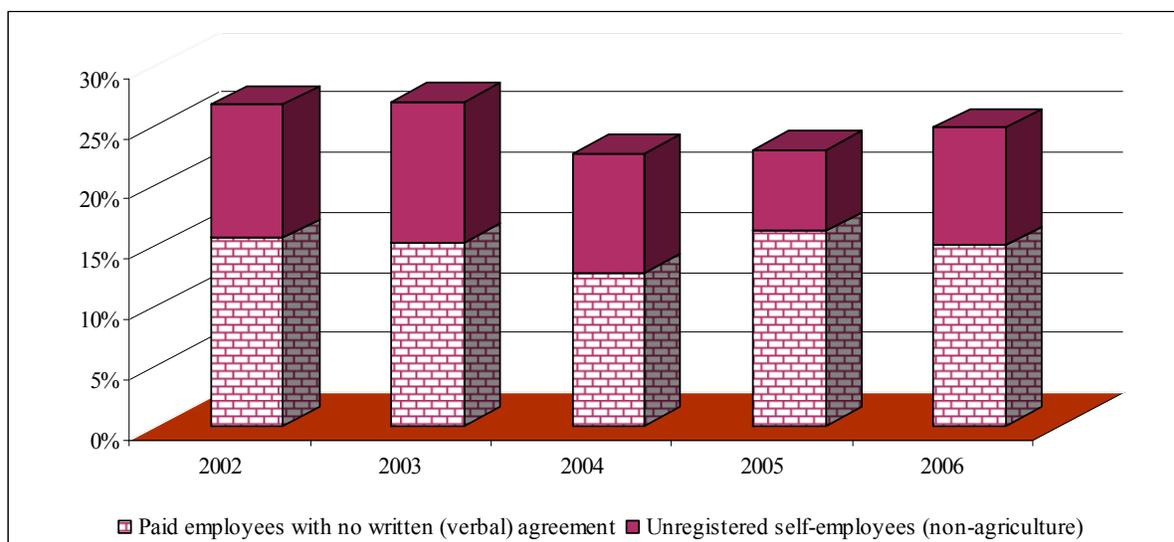
the rest of the sectors the trends of 2002-2006 will be maintained, as a result of which the share of employed in the commercial services in 2021 will get to 50%; the share employed in social services and public administration will go down to 25% and the share of employment in industry, mostly due to capitalization increase, will remain around 20%. This estimate is based on the sector forecast of the Armenian economy perspective developments and employment elasticity estimates, which are based on the economic growth and labor productivity estimates and for social services and public administration sectors – on the expected efficiency indicators of population's and involvement degree forecasts.

305. The expected changes in the structure of non-agricultural employment will have their positive impact on formalization of the employment, as well as in general the employment revenues increase conditioned by the labor productivity.

6.7. Formal and informal employment

306. The level of informal employment in Armenia continues to remain very high making it 25% of non-agriculture employed in 2006. According to LFS findings the share of the hidden employed in overall employed number in 2002-2006 went down by around 2% - mostly at the expense of reduction of unregistered self-employed. The level of informal employment is even more concerning, if we take into account the fact that the lion share of employed in the Armenian agriculture does not comply with the major indicators of formal employment and thus with certain reservations can be rated among informal unemployed. The share of informal employment in the overall employment re-calculated in this way is around 45-50%.

Figure 6.7. Indicators of informal employment (% in the employment structure)

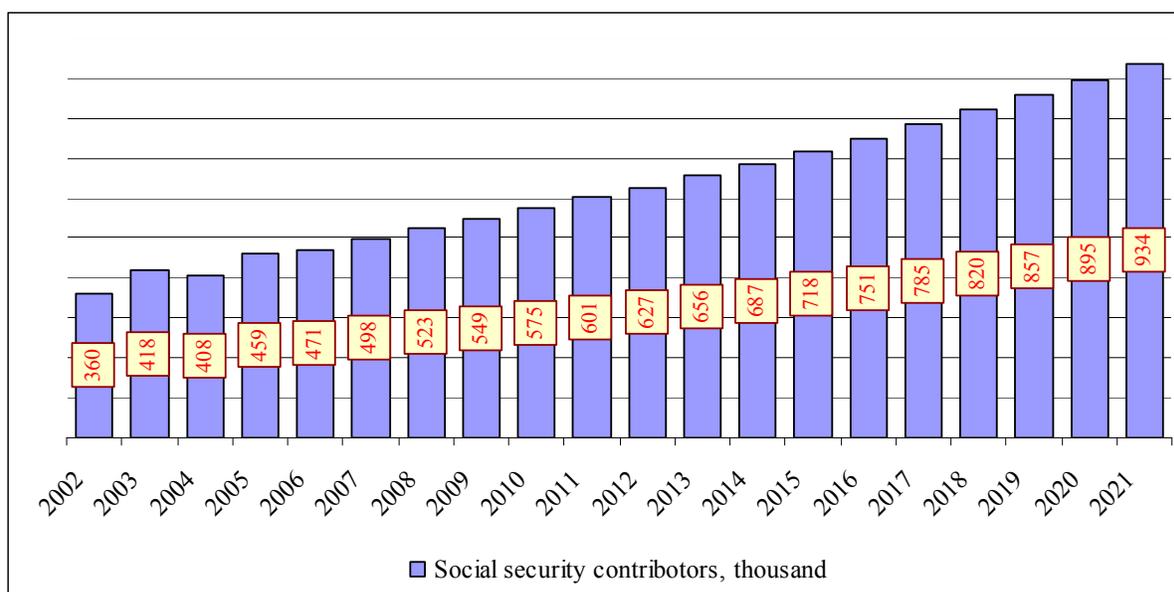


307. The formal employment' expansion of recent years is also witnessed by the fact that in 2002-2006 under the conditions of approximately unchanged level of informal employment the number of mandatory social insurance contributors went up by 110

thousand - from 360 thousand to 470 thousand. Taking into account that in the same period there was a reduction of share of people employed in highly formal public and social services sectors in favor of construction and commercial services, where traditionally the informality degree is high, then the positive changes are quite promising. Nevertheless, even under the conditions of such positive changes in 2006 only 45% of overall employed made mandatory social insurance contributions. Such situation is indeed one of the major reasons that did not allow under the conditions of existing pension system to ensure the pension levels envisaged by PRSP.

308. It is expected that in the forthcoming years the trends of increasing the employment formality will go on. The present structural changes in sectors will contribute to it in favor of non-agriculture sectors, maintenance of present low level labor taxation and measures aimed at the improvement of tax administration, as well as the gradual expansion of corporate governance traditions in the private sector. In more conservative scenario it is expected that once in each five years the formality degree will be increased by 15%.

Figure 6.8 Number of social insurance contributors in case of expected scenario of formality degree in 2002-2021¹²³

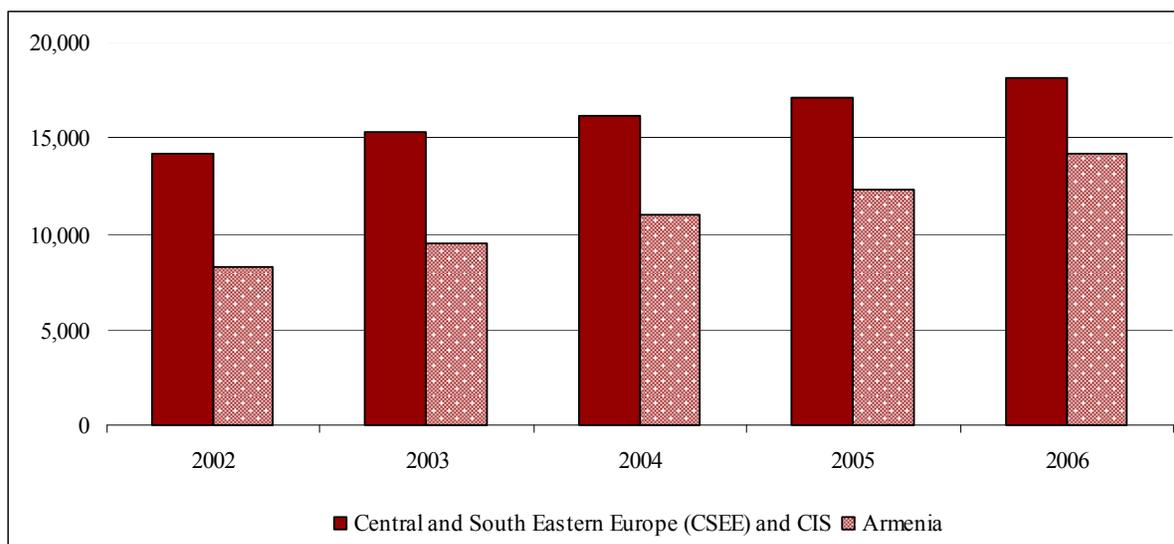


6.8. Growth of labor productivity as the key driving force for the economic growth in Armenia in 2002-2006

¹²³ It should be mentioned that the number of social insurance contributors is a provisional definition and in the future it is possible that such category will be unusable – due to formality degree assessment. Nevertheless, the number of taxpayers from the salary or number of formal salary recipients can fully replace this category.

309. The labor productivity, especially in non-agricultural sectors, in recent years has been one of the major sources of employment income increase and poverty reduction. The labor productivity growth in Armenia in 2002-2006 was around 60% - substantially surpassing the average indicator of Europe and CIS countries. At the same time the labor productivity level in Armenia falls behind the level of the aforementioned countries making around 80% of their average indicator. There is even a deeper rift between Armenia and the 8 new EU member countries¹²⁴ which is around 4 times, and taking into account the purchasing power parity indicators - around 2.7 times¹²⁵.

Figure 6.9. Labor productivity in 2002- 2006, constant 2000 PPP US dollars

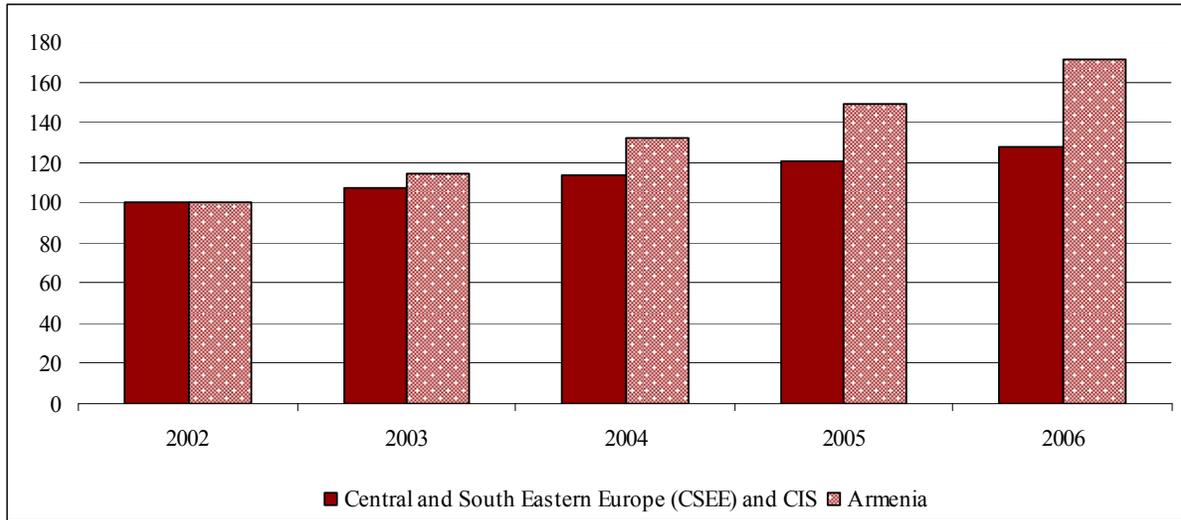


310. In mid-term and long-term perspective the labor productivity growth rate will be mostly conditioned by two major factors. On the one hand it is labor force supply quality and relevance increase. From this standpoint the primary role will be played by enrollment increase in education and especially specialized secondary and higher education and quality increase, as well as the implementation of active employment policy. On the other hand the further growth of labor productivity will require considerable increase of investments in the economy and sector distribution in favor of the relative and absolute increase of demand presented by sectors ensuring higher productivity degree. With this purpose the program envisages to take consistent and sharp steps for the improvement of entrepreneurial and investment climate in the country; accessibility of financial mediation and increase of its level, as well as efficiency increase of public administration and social services.

¹²⁴ The new EU members are the following countries: Poland, Hungary, Check Republic, Slovakia, Slovenia, Lithuania, Latvia and Estonia.

¹²⁵ The assessment is based on the indicators calculated in Euro – using 2005 Eurostat IA database.

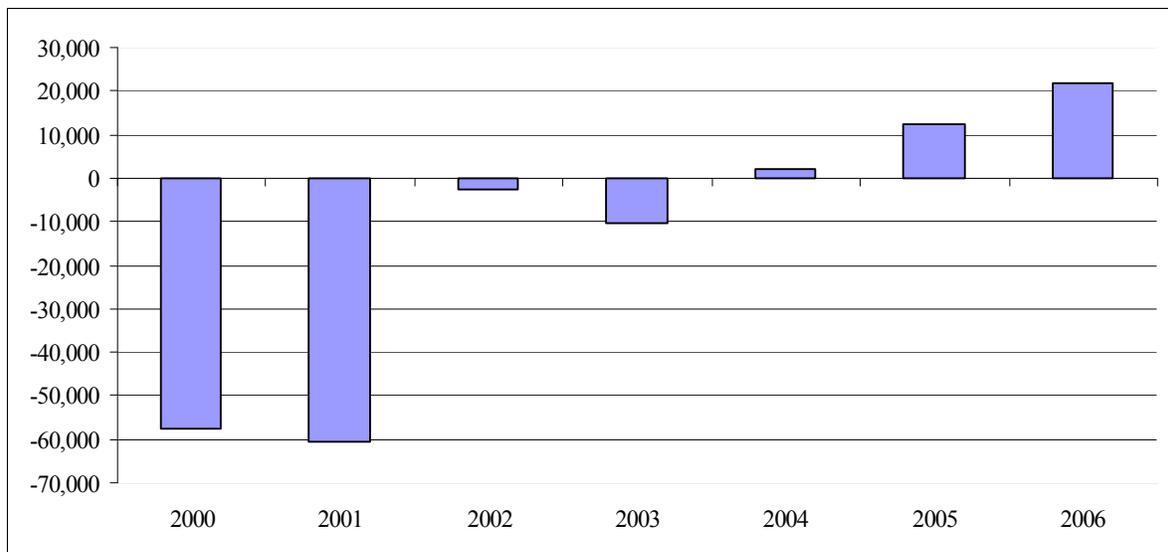
Figure 6.10. . Labor productivity index(2002=100), constant 2000 PPP US dollars



6.9. *Emigration and other determining factors*

311. In recent years the migration trends have somewhat reflected the positive changes in the labor market, i.e. the increase of labor force demand and salaries. Together with the reduction of negative balance of official migration (change of permanent residence) in 2002-2006, a positive balance of unofficial migration was registered.

Figure 6.11. Migration balance in Armenia in 2000-2006, persons



312. The share of foreign remittances, including the remittances of labor migrants, in the monetary incomes of population in 2002-2006 decreased by around 6% points or

70% in 2006 making 9% instead of 15% in 2002. It should be mentioned that the foreign remittances like in the past have considerably decreased the poverty risk. At the same time the substantial volume of puts a certain pressure upon the labor market, which is also expressed by the reduction of the economic activity and increase of labor force price.

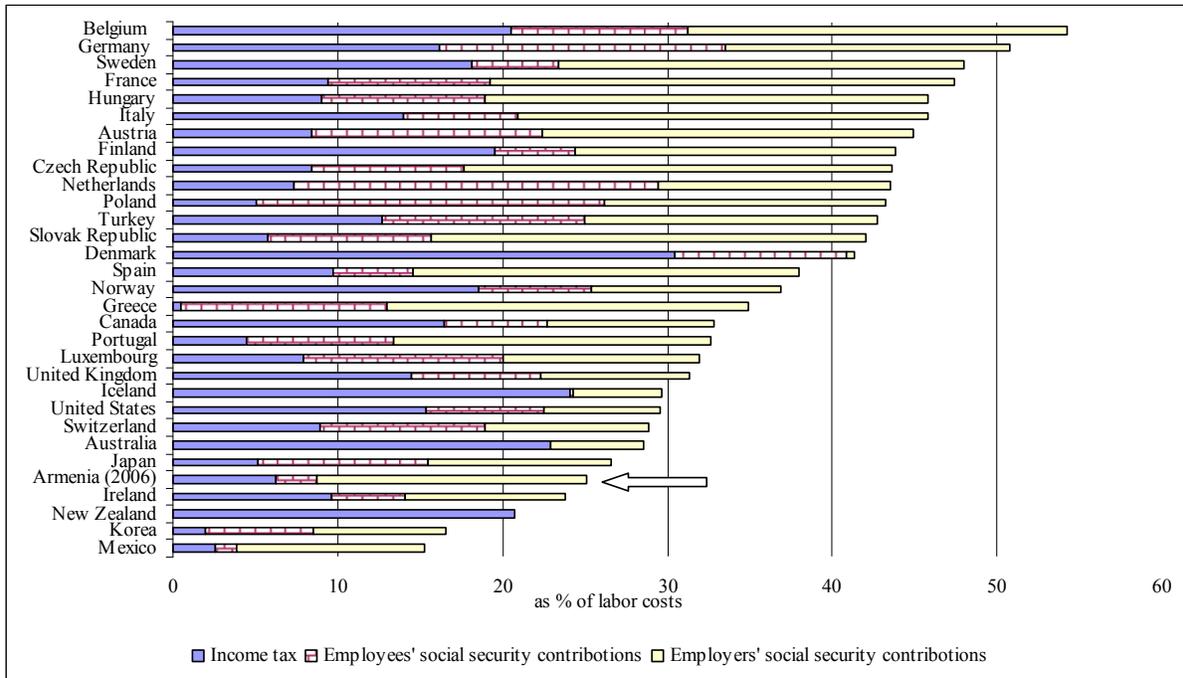
313. One of the major reasons for emigration was and continues to remain the considerable differences of the labor market demand conditions between Armenia and the Russian Federation, which is the major country receiving the labor migrants. The labor migration plays dual role from the standpoint of poverty risks for the migrants and their families. In short term perspective it has a substantial significance for the poverty reduction – taking into account the still high unemployment rate in Armenia. Nevertheless in the long term the informal migration contains serious risks for the migrants, which are mostly conditioned by unstable employment and lack of the minimal social protection elements. In recent years, serious efforts are made to mitigate the migration, including the labor migration; to provide information and consultative support to emigrants and immigrants more and more increasing in number. Such activities will go on in the future to inform and orient the migrant workers, as well as within the programs aimed at encouraging the immigration.

6.10. Labor market institutions and policies

314. As the international experience comes to show, from the standpoint of the economic growth, increase of labor force productivity and employment the following institutions of labor market regulation can play an important role: taxation system and level; the level of involvement in the trade unions; the minimal salary policy; the system and level of unemployment benefits; protection level of the employment, as well as the forms and level of labor market active policies.

315. The labor taxation level and dynamics are probably among the crucial indicators, which impact the expansion potential of the economic growth and employment, especially the formal employment. The legislation concerning the labor force taxation in recent years has not been substantially changed and its level is not considered as high.

Figure 6.12. Labor taxation in Armenia and OECD member countries



* Armenia: 2006; OECD member countries 2004.

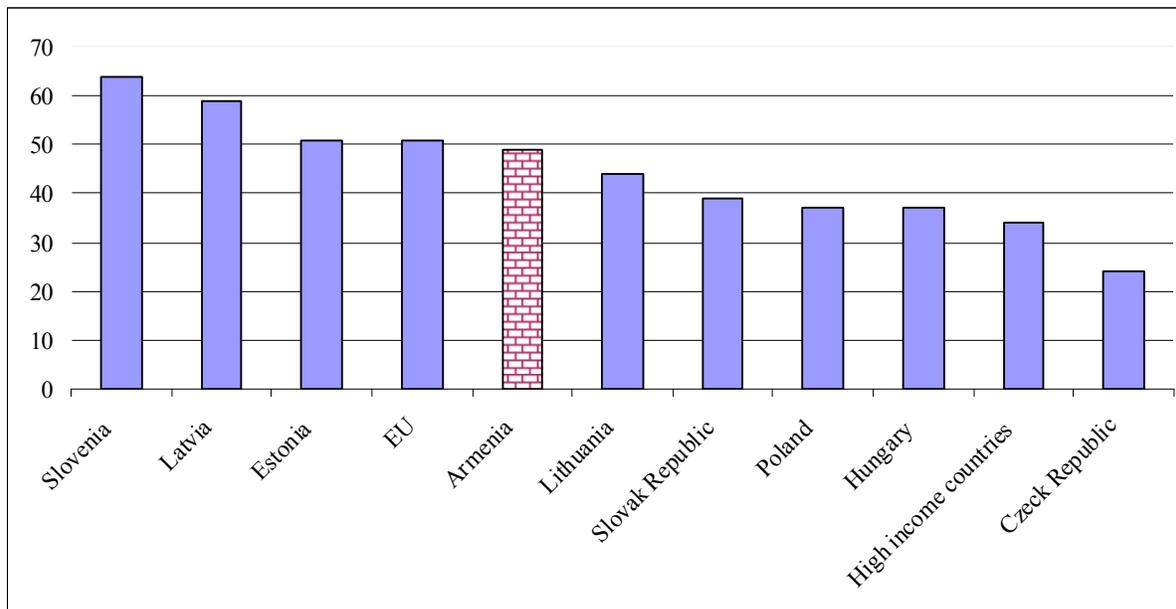
316. Nevertheless, taking into account the economic development level of Armenia, which substantially falls behind the level of developed countries, the increase of labor force taxation burden can seriously hamper the high economic growth rate and employment expansion. Moreover, considering the low level of formal employment, any increase of tax burden will lead to even more unequal competition and cannot contribute to expansion of formal employment. At the same time, taking into account the financial state of Armenia the perspective of reducing the tax burden also cannot be sound until the tax income collection rate is not substantially increased. Thus, in this area the major SDP policy shall be the maintenance of the present potential level of the labor force taxation and in parallel increase of its efficiency level by means of formalizing the employment¹²⁶.

317. The legislative limitations applied with the purpose of employment protection, the major of which is about the conditions of firing from the work, can have a positive impact not only in terms of protecting the rights of the employees, but also indirectly contributing to the accumulation of working experience and skills. However, at the same time from the viewpoint of entrepreneurial environment their rigidity is considered a serious obstacle especially to the expansion of small and medium enterprises and their employment capacities. The rigid conditions are serious obstacles especially with regard of the reduction of youth unemployment. By the WB widespread employment rigidity index, in 2005 the employment rigidity index in Armenia was 49,

¹²⁶ At the same time, parametric reforms of tax legislation are envisaged, the major objective of which will be to simplify and unify the labor force taxation regime (see the respective section).

i.e. it was substantially higher than the average of high income countries (38), as well as the average of low and medium income countries of Europe and Central Asia (44).

Figure 6.13. Employment rigidity index in Armenia and a range of EU member Eastern European countries in 2005, WB

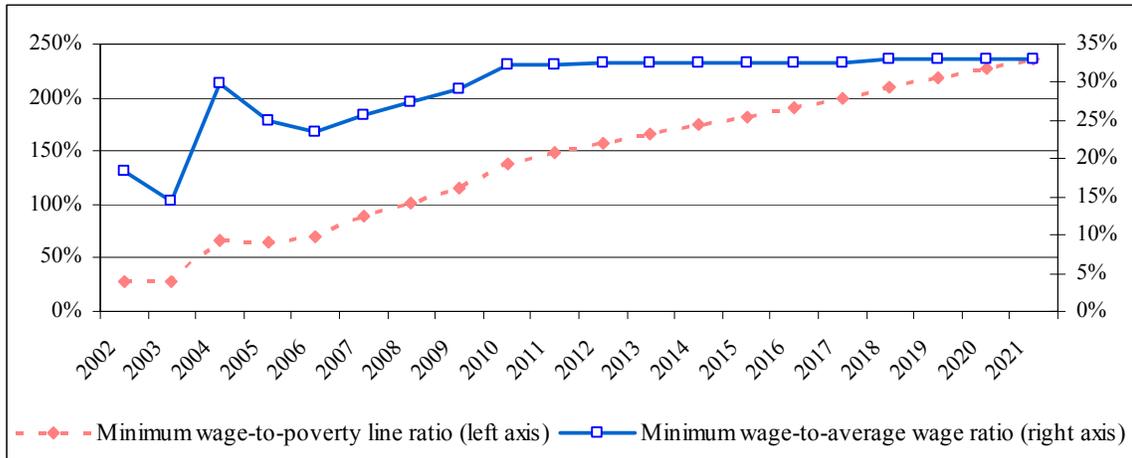


318. Since independence, the minimal salary policy in Armenia was aimed at encouraging the entrepreneurship development and at the same time contribute to the expansion of formal employment. From this viewpoint at present Armenia is rated among the countries with mosey liberal labor market. Nevertheless, as the experience of the previous years comes to show such modest approach of the minimal salary policy did not lead to the desired consequences. Based on the experience of previous years, the PRSP new approaches for the minimal salary policy were proposed, the major of which was the establishment of correlation between the minimal salary and poverty threshold. In the forthcoming future the minimal salary policy will be more balanced. In the mid term perspective minimum salary will grow faster to ensure first of all the poverty threshold in 2008 and then up to 2010 equal to 32-33% of the average salary, after which it will mostly follow the average salary growth rate.

319. The balanced policy of the minimal salary will have its impact also on the unemployment benefits' level given that the present legislation relates the unemployment benefit size to the minimal salary. It should be mentioned that in general, the frequent use of the minimal salary for various types of social assistance projects and especially for sizes of administrative punishment or other purposes irrelevant to the labor market will not be encouraged and all such legislative provisions will be gradually reviewed.

320. The international experience of the active employment policy shows that even in case of the most unfavorable scenario the results of the labor market active policy are quite modest, although they can be useful for certain groups. Even in EU countries, where the budgets of active programs are quite big and where the implementation of such programs is based on wide experience, there is a high rate of unemployment and inactivity among the people that make use of them. Taking this into account, one might come to a conclusion that first the needs of job seekers should be identified in order to later on relate them to the active employment programs.

Figure 6.14. Minimum wage in 2002-2021



321. Based on the OECD experience, Armenia shall redirect all of its efforts towards the activation policy¹²⁷. The successful activation policy elements are: (i) improvement of personal, social and vocational skills and capacities; support to social integration; (ii) individually tailored ways of participating to $2P2\theta$ given the age, experience, needs and priorities of the person; (iii) beneficiary’s use of resources and capacities; (iv) networking with the labor market services, social services, health services, housing sector and communities; and (v) cooperation and interaction between beneficiaries and agencies in planning, shaping and implementation. To achieve the abovementioned, the capacities of the State Employment Service should be built, which at present is insufficiently staffed, incompletely equipped and weakly motivated. As regards other active labor market projects, a special attention will be devoted to their expansion possibilities giving a priority to the most cost-effective projects.

322. The involvement of social partners into the labor market regulation and decision making process concerning the ways of state intervention will be encouraged to the highest possible extent. The social partners, i.e. trade unions and employers will have to play a bigger role in labor relations. With regard to the Armenian district employment centers, the adopted successful practice should be continued and partnership between

¹²⁷ The activation policy encourages some unemployed to actively look for a job and further on be actively engaged in various projects. Finally, the receipt of the benefit on the principle of activation is conditioned by the participation in the projects – in the process of changing the balance of rights and obligations of the unemployed.

the public and private entities should be established with the purpose to develop and implement local strategies for the job creation. The involvement of social partners will make it possible to ensure broad participation in the development of legislation, creation of training content, as well as in monitoring the activities of the State Employment Services and vocational institutions to make them more flexible in responding to the labor market developments.

323. The employers should have a voice in the solution of issues concerning vocational education. Based on 2004 Vocational Education Reforms strategy, in July 2005 the Law on Vocational Education and Training was enacted to improve the position of social partners. Now they are considered full-fledged partners of vocational education. The participation of the employers' organizations is an important means to reduce the mismatch in the labor market. The working standards or job descriptions should be stipulated by the employers based on introduced requirements following the procedures negotiated with all stakeholders. The training standards or job descriptions should be used with the purpose to develop educational programs in the educational institutions¹²⁸.

324. The Sustainable Development Program will give special significance to the introduction of the institute of social enterprises with due consideration of the experience of EU countries. The aim of establishing social enterprises (where at least 50% of the employees are disabled) is the integration of persons with disabilities in the society through providing them with employment opportunities. This process will be incorporated in the comprehensive set of activities aimed at rehabilitation of persons with disabilities stipulated by the RA Law On Social Protection of Persons with Disabilities, and on the one hand will be directed towards settling the social problems of the disabled and ensuring for them equal opportunities, on the other hand using their labor potential for the benefit of the society.

325. Ensuring accessibility and availability of vitally important services (healthcare, educational, social) in marzes will also have its notable impact on poverty reduction. In this respect realization of programs aimed at regulation of internal movement of the labor force that will serve to mitigate the unequal development of labor markets.

7. Agriculture and Rural Development

326. The agriculture is one of the main economy sectors in Armenia and the main business of population in rural areas. As evidenced by data in the Table 7.1, the specific weight of agriculture in the GDP decreased by almost two times in the last 11 years due to a lower growth rate of agriculture as compared to overall growth rate of economy. In 1995-2006, the GDP has grown by 2.59 times, value added in agriculture – by around 1.7

¹²⁸ 2 volume WB report on the labor market dynamics in Armenian details the ways of public intervention in the employment area and increasing the efficiency of such interventions; the proposed policy directions have been incorporated in the SDP.

times, while the value added produced in non-agricultural sector of economy has grown by 2.93 times.¹²⁹

Table 7.1: Main Indicators of Agricultural Development, 1996-2006

Indicators	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Specific weight of agriculture in GDP, %	34.80	29.41	30.85	26.96	23.21	25.54	23.40	21.49	22.58	19.05	18.65
Specific weight of agricultural employment, %	40.82	41.29	42.46	43.32	44.35	45.06	45.26	45.95	46.87	46.23	46.16
Incomes earned in agriculture, as % of salaries in non-agricultural sector	74.70	59.83	42.97	50.43	51.17	54.93	53.62	58.54	55.44	52.39	61.10
Work productivity in agriculture, as % of productivity in non-agricultural sector	77.37	59.25	60.45	48.29	37.93	41.81	36.93	32.21	33.00	26.82	25.60
Labor force unit cost in agriculture, %	28.94	39.03	41.62	51.10	64.50	55.77	51.51	60.83	61.44	75.40	78.82
Labor force unit cost in non-agricultural sector, %	24.97	27.72	33.20	31.43	31.23	29.26	24.08	24.20	25.63	25.93	24.59

Source` ROA NSS

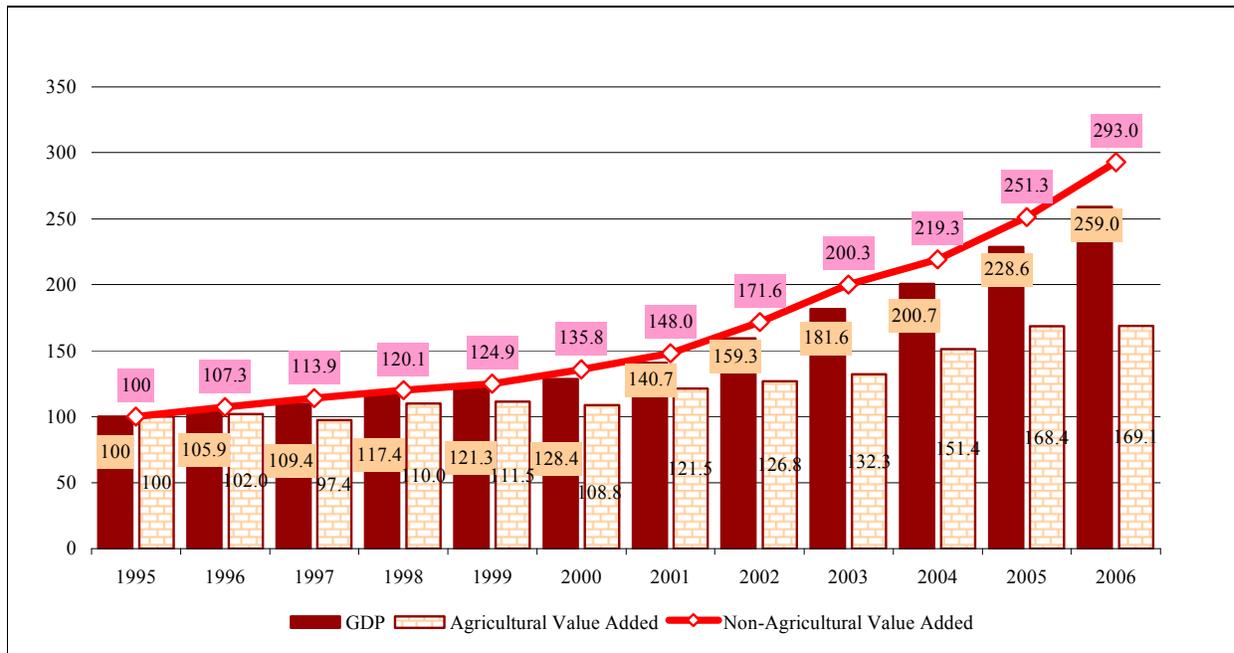
327. However, due to the main feature of non-agricultural sector's economic growth in Armenia in 1995-2006, i.e., the fact that the growth was almost exclusively attributable to the increase in work productivity and the number of newly opened official workplaces was lower than the number of redundant ones, there was no flow-out of labor force from agriculture to non-agricultural sector, rather, *vice versa*, in 2001-2006 it has stabilized accounting for 45-46 percent of overall employment.¹³⁰

328. As a result of maintaining a stable and non-decreasing employment level in agriculture, the gap between agricultural and non-agricultural sector productivity has essentially increased; if the labor productivity in agriculture in 1996 was one third of non-agricultural sector's productivity, in 2006 it was almost four times lower. Nevertheless, under conditions of agricultural growth and relatively stable employment, the labor productivity in agriculture in 2006 has increased by 92.6 percent as compared to 1996 or by 6.8% annual average, while the productivity of non-agricultural sector by 3.94 times or by 14.7% annual average.

¹²⁹ Since 2001 the development rates of economy in general as well as agriculture have sharply increased. Thus, in 1996-2000 the average economic growth comprised 5.1%, including 1.9 % in agriculture and 6.3% in non-agricultural sectors. Same figures for 2001-2006 comprise 12.4%, 7.5 % and 13.7% respectively.

¹³⁰ Such phenomenon as growth without employment is specific to a number of transition countries (see World Employment Report 2004-2005, ILO, 2005), however, in Armenia it is displayed in more evident manner.

Figure 7.1. GDP, Dynamic of Value Added in Agricultural and Non-Agricultural Sectors, 1996-2006 (index, 1995=100)



329. On the other hand, the notable increase of prices¹³¹ for agricultural products in the recent years due to increase of international prices for food products as well as progressive growth of population incomes leading to rapid expansion of domestic demand, has essentially improved conditions for implementing agricultural activities and provided an opportunity to increase earned incomes of people employed in agriculture, which in 2006 comprised 61.1% of average salary in non-agricultural sector (74.7% in 1996), increasing from 1996 to 2006 by 5.9 times in nominal terms (during the same period, in non-agricultural sector the average salary in nominal terms has grown by about 7.2 times.)

330. Taking into account notably lower rates of labor productivity increase, the aforementioned fact has resulted in an increase of labor force unit cost (ratio between salary and labor productivity). If in 1996 the labor unit cost in agriculture and non-agricultural sector was almost the same, in 2006 it was more than 3 times higher. This means that the opportunities to improve conditions for agricultural growth financing and performance at the cost of internal resources are significantly lower, than in non-agricultural sector.

331. Taking into account the need to maintain a level of earned income comparable to non-agricultural sector as well as the impossibility of quick reduction of redundant labor

¹³¹ As compared to 2001, the sales price index for agricultural producers in 2006 has grown by 23.9 percent, meanwhile, during the same period the consumer price index has increased by 18.6 percent. The increase of international prices for food products is caused by progressively growing demand for food products in developing countries as well as by gradual reduction of subsidies allocated to farms in the US and EU countries.

force in agriculture and its transfer to non-agricultural sector during the period of SDP implementation, this fact presupposes:

- Consideration of the public sector expenditure priorities in the agrarian sector within the SDP program timeframe
- wide use of public resources for maintenance and renovation of agricultural infrastructures¹³²;
-
- increase of availability of credit funds and expansion of banking and other types of financial opportunities for farms¹³³;
- development of an efficient farm subsidizing system that should take into account natural conditions of agricultural activities and be able to ensure effective agricultural production under unfavorable conditions;
- implementation of effective technologies in the main agricultural sectors, such as crop production and cattle breeding; realization of the policy aimed at zonal specialization and effective location of production;
- creation of favorable conditions for the development of production and service infrastructures in agricultural sector;
- development of agricultural products processing sector; promotion of effective location of processing units, introduction of innovative technologies, improvement of production competitiveness, marketing assistance and contractual relations with primary producers, creation and expansion of small and medium enterprises in rural areas as well as obligatory realization of relevant sanitary and phyto-sanitary activities in line with the international standards
- development of an efficient risk insurance system for farms with the participation of public funds and through application of public-private partnership principles.¹³⁴

¹³² Currently proceeds of the grant provided by the US Government's Millennium Challenge Corporation as well as funds allocated from the State Budget of Armenia are used for those purposes (renovation of irrigation system and rehabilitation of rural roads).

¹³³ At the end of 2006 banks' credit investments into agriculture accounted for AMD 14,196 billion, or 5.5 percent of total credit investments and 3 percent of agricultural value added. Crediting of industry at the end of 2006 comprised AMD 39,263 billion, 15.1 percent of total credit investments and 9.8 percent of value added in industry.

¹³⁴ The establishment of such system was also envisaged under the PRSP, however, it is not in place yet.

Table 7.2: Export and Import of Agricultural Products, 1996-2006

Indicators	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Export of agricultural products, USD million	1.18	3.53	1.45	2.06	2.41	2.56	4.43	8.99	13.72	17.23	26.79
Specific weight in total exports, %	0.41	1.52	0.66	0.88	0.80	0.75	0.88	1.31	1.90	1.77	2.67
Specific weight in agricultural value added, %	0.21	0.73	0.25	0.41	0.54	0.47	0.80	1.49	1.70	1.87	2.32
Import of agricultural products, USD million	184.11	135.67	149.91	135.52	120.47	130.50	170.01	170.03	179.33	170.03	179.33
Specific weight in total imports, %	21.51	15.20	16.61	16.90	13.62	14.87	17.22	13.29	13.28	9.44	8.17
Specific weight in agricultural value added, %	33.07	28.11	25.66	27.22	27.15	24.12	30.57	28.18	22.18	18.50	15.52

Source: ROA NSS

332. As shows the Table 7.2 data, the integration level of Armenia's agriculture into the world economy has significantly increased both in absolute and specific weight terms, despite remaining very unsatisfactory. The export of agriculture products from 1996 to 2006 in current dollar terms has grown by 22.7 times, while the specific weight in agricultural value added by 11 times. It is noteworthy that the dominant share of growth in exports has taken place during 2002-2006, when it has grown by 10.5 times, while the increase in export during this period accounted for 94.6 percent of total increase in exports.

333. One of the main priorities of the Government policy in this sector would be to encourage a progressive growth of export of agricultural products and to ensure the increase of their specific weight. This policy would be implemented within the framework of an overall strategy for promotion of foreign trade, improvement of customs administration, reduction of transportation costs and elimination of technical barriers for trade as well as by encouraging the establishment of integrated private structures and enterprises for primary processing of agricultural products and ensuring the availability of credit financial resources for them; taking into account the specifics of agricultural production.

334. The data in the Table 7.2 also suggest that the level of country's supply with domestically produced agricultural products has significantly increased. Thus, during 1996-2006 the specific weight of imported agricultural products in agricultural value added has decreased by more than 2 times and in the overall import of goods - by 2.3 times. Further increase of the country's supply level with domestically produced agricultural products is one of the main priorities of the Government agrarian policy. During the SDP period this priority would be implemented by ensuring the growth rates

estimated for agriculture, encouraging the increase of farm marketability and the change of commodity production structure through a policy aimed at stimulating a progressive growth in production of highly marketable agricultural products.

Table 7.3: Main Indicators Characterizing the Activities of Farms, 1996-2006

Indicators	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Number of farms, thousand	319.5	321.1	333.8	335.1	332.6	334.8	334.7	337.9	338.5	339.2	339.2
Specific weight of the production of farms in agricultural output, %	98.9	99.2	99.2	98.5	97.5	96.9	96.8	96.2	96.2	97.2	97.6
Average number of employed per farm, people	1.83	1.72	1.67	1.64	1.66	1.65	1.47	1.49	1.48	1.48	1.48
Value added per farm, AMD thousand	712.1	730.8	875.8	782.5	701.8	865.7	922.0	994.1	1222.6	1205.0	1376.3
Level of marketability, %					45.1	49.9	54.1	58.9	55.7	55.8	54.2
Sales, AMD thousand					316.5	432.0	498.8	585.5	681.0	672.4	808.2
Domestic consumption, AMD thousand					385.3	433.7	423.2	408.6	541.6	532.6	568.0

Source: ROA NSS

335. Majority of agricultural products is produced by individual farms, whose specific weight has even increased in 2003-2006, while participation of commercial agricultural enterprises in production of agricultural products has fluctuated in the range of 0.8-3.8 percent.

336. Thus, vast majority of agricultural production was provided by farms and farm consolidation planned by the PRSP has not happened, on the contrary, with some increase in number of farms the number of people employed and of plots owned by them has declined. Nevertheless, the marketability level of farms has quite increased exceeding the PRSP forecasts.¹³⁵ The increase of marketability level was influenced by the following main reasons, which will continue to have effect in medium- to long-term perspective:

- rapid growth of domestic demand for agricultural products, and absolute and relative decline of imports of agricultural products;
- increase of prices for agricultural products and creation of relatively more favorable conditions for agricultural production;
- reforms of irrigation system and improvement of irrigation water supply conditions;
- as a result of combined impact of all those factors: improvement of crop pattern through progressive growth of production volumes for highly marketable agricultural products and relative decrease of production volumes for agricultural products (particularly, wheat) with low marketability.

¹³⁵ In the PRSP it was envisaged to bring the marketability level of farms to 48% in 2005 and to 54.2% in 2006. The actual marketability level was 55.8% in 2005 and 58.7% in 2006.

337. All these factors have also affected the increase of volumes of value added produced by a farm: in 2000-2006, it has almost doubled in nominal terms, while sales¹³⁶ have increased by 2.55 times. Nevertheless, the farms still maintain in-kind nature of management caused by low monetary output, insufficiency of inner resources for development and extremely small sizes.

338. The main indicators of the SDP for agriculture development are presented in the Table 7.4. Agricultural development forecasts are based on the following framework of policies:

- The still existing impact of the potential for extensive growth of agriculture based on internal resources and rapid expansion of country's autonomous domestic demand will gradually decrease during the period of the SDP implementation; due to this reason in the medium-term perspective a shift to intensive development would be made, which should be based on marketability, efficiency and potential for export;
- nevertheless, small farms will remain the basis of agricultural production, and increase of farm marketability and productivity as well as ensuring the availability of credits would continue to be the main priorities of agrarian policy;
- at the same time, the policy will be also aimed at promoting the development of large commercial enterprises;
- the increase in overall efficiency of agriculture would be ensured through promotion of progressive development of sectors providing services to agriculture, including integrating structures, primary processing enterprises, network of supplying and marketing cooperatives;
- large government investments into agricultural infrastructure, specifically, in areas of irrigation (which are implemented and will continue to be implemented parallel to the establishment and strengthening of a new institutional structure of irrigation system) and rural roads as well as other (land improvement; selection of cultivated plants and seed farming; promotion of advanced technologies; development of consulting system) would be another important factor ensuring the increase of efficiency;
- natural risks associated to agricultural activities will be mitigated through development of relevant infrastructures (antihail stations; antispatate measures; etc) as well as through development and introduction of an appropriate insurance system;
- development and introduction of an efficient system for agricultural subsidies aiming at mitigation of objectively existing regional differences and creation of equal conditions for agricultural production as well as impacting farm crop pattern by encouraging production of highly marketable agricultural products.
- With the aim to ensure the most effective use of labor force and increase the labor productivity in rural areas assistance will be provided to establish small and medium

¹³⁶ Sales in drams, barter and in-kind payments for services

agrarian enterprises in rural areas; increase the possibilities of organic agriculture; develop agro-tourism and other sectors, which would help to ensure employment in rural areas.

339. Nevertheless, based on the need to make a shift to intensive development, which will require significant restructuring, the SDP envisages lower growth rates for agricultural sector than in 1996-2006 and rates lower than in non-agricultural sector leading to a deeper gap in main indicators between agriculture and non-agricultural sector during 2007-2015, which will start to lessen after 2015.

340. Based on the 1996-2006 employment trends both in agricultural and non-agricultural sectors of economy, which show that there was no labor force flow-out¹³⁷ from agriculture and the employment level in the sector, in essence, was unchanged, the SDP estimates that the current employment levels will also be maintained in 2008-2021. Nevertheless, it should be mentioned that the real employment in agriculture (re-estimated by full employment) due to data generated through household questionnaires including dedicated labor force sample¹³⁸ is about 2 times less than those provided by official statistics. In particular, according to sample surveys conducted in 2006 employment in agriculture constituted 24.3% of overall employment or about 240 thousand people (46.16% or 504.3 thousand people according to official statistics).

341. Thus, the program envisages that the degree of present over-employment in agriculture which in 2006 made 47.5% (average labor time of one employee, in percentage as compared with the full employment level) wouldn't increase. Moreover it is likely to decrease to a certain extent conditioned by about 50% growth of agricultural employment in 2006-2021.

Table 7.4: Main Indicators for Development of Agriculture, 2006-2021

Indicators	2006	2010	2015	2021
Total				
Value Added, AMD billion, in current prices	495	697	982	1379
% of GDP	18.7	14.8	12.5	10.5
Index, 2006 = 100	100	125	148	173
Average annual actual growth rates %		5.74	3.44	2.64
Average annual actual price increase in agriculture %	11.9	3.4	3.0	3.0
Employment, Labor Productivity and Incomes				
Number of employed	504.3	504.3	504.3	504.3
Labor productivity, AMD thousand, in current prices	948.4	1383.1	1946.0	2734.3
Average annual growth rates of labor productivity, %		5.74	3.44	2.64

¹³⁷ Decline in agricultural employment in 2002 (500,800 people) compared to 2001 (570,000 people) was a result of reduction of employment level estimations in economy based on the results of population census in 2001. On the other hand, a stable and constant nature of agricultural employment is explained by calculation methodology: all adult and economically active members of a farm are considered as employed. Nevertheless, the absence of labor force flow-out from agricultural to non-agricultural sector of economy is conditioned by the fact that the employment in the latter has rather declined during the entire 1990-2006 period.

¹³⁸ See The Labor Force in RA 2001- 2006. Yerevan, RA NSS, 2007

As % of non-agricultural sector productivity	30	25	23	23
Labor force unit cost, %	78.82	70	65	60
Earned monthly income from agricultural activities, AMD thousand, in current prices	46.39	80.7	105.4	164.1
As % of average monthly salary in non-agricultural sector	61.1	57.1	52.2	52.2
Export and Import				
Export of agricultural products, USD million	26.8	56.8	177.3	498.5
Specific weight in total exports, %	2.67	3.5	4.1	4.8
Specific weight in agricultural value added, %	2.32	2.6	5.9	11.8
Import of agricultural products, USD million	179.3	386.1	506.1	542.5
Specific weight in total imports, %	8.17	7.5	5.2	3.0
Specific weight in agricultural value added, %	15.5	16.8	15.7	12.0
Farms				
Number of farms, thousand	339.2	330.8	320.4	307.9
Specific weight in agricultural output, %	97.6	95.2	92.2	88.6
Average value added by a farm, AMD thousand, in current prices	1376.3	2000.6	2825.8	3968.1
Marketability level, %	58.7	63.0	70.0	75.0
Sales, AMD thousand	808.2	1167.9	1824.3	2575.5
Domestic consumption, AMD thousand	568.0	685.9	781.8	858.5
Financing volumes				
Credits to agriculture, as % of agricultural value added	2.97	6	11	18
Credits to agriculture, AMD billion, in current prices	14.2	41.8	108.1	248.2

342. Nevertheless, the Sustainable Development Program envisages that as a result of agrarian policy promoting the establishment of large commercial farms their specific weight in agricultural value added will gradually increase from 2.4% in 2006 to 11.4% in 2021. The number of farms will respectively reduce by 10% and there will be a migration of labor force from farms to commercial enterprises.

343. The main policy components ensuring such transition are improvement of business and investment environments, application of effective mechanisms for pawning of agricultural lands, reviving of land market and significant reduction of informal transactions related to land sales.

344. The main driving forces for development of agriculture and intensification of production in 2008-2021 would be progressive growth in export of agricultural products and sharp increase of food self-provision level. It is estimated to increase by 2021 the exports of agricultural products in nominal USD terms by approximately 12.6 times and bring in 2021 the specific weight of exports in agricultural value added to 11.8 percent, over 2.32% in 2006. As of increase in food self-provision level, it would be implemented in a form of import replacement, where the specific weight of imported agricultural products in agricultural value added will decline from 15.5 percent in 2006 to 12 percent in 2021.

345. As of the autonomous expansion of domestic market, which was the main driving force for development of agriculture in 1996-2006, its role during the SDP effectiveness will diminish due to the fact that as a result of development the demand for agricultural

products will grow with slower rates, than the demand for non-agricultural goods and services.

346. Progressive growth of exports of agricultural products and increase of country's food self-provision level will be ensured within the framework of an overall policy aimed at improvement of business and investment environments, further liberalization of trade, elimination of technical barriers and reduction of transportation costs as well as by results of the SDP agrarian policy.

347. The decisive role here would be played by an estimated sharp increase of financial intermediation volumes (it is expected that in 2001 crediting volumes will reach 18% of agricultural value added, against 3% in 2006) and creation of effective structures servicing agriculture (a system of supply and service cooperatives, integration structures, primary processing enterprises.)

Table 7.5: Target Indicators for Development of Agriculture, 2005-2021

Indicators	2005	2006	2010	2015	2021
GDP*, AMD billion	560.3	638.9	1,005.5	1,498.3	2,252.5
Agricultural value added	411.1	469.3	684.4	963.0	1,353.1
Value added in non-agricultural sector	149.3	169.5	321.1	535.3	899.4
Value added in agriculture, as % of GDP	73.4	73.5	68.1	64.3	60.1
Value added in non-agricultural sector, as % of GDP	26.6	26.5	31.9	35.7	39.9
Employment, thousand people	601.1	606.7	623.6	637.8	653.6
in agriculture	500.7	500.7	500.7	500.7	500.7
in non-agricultural sector	100.4	106.0	122.9	137.2	152.9
Employment in agriculture, as % of total employment	83.3	82.5	80.3	78.5	76.6
Employment in non-agricultural sector, as % of total employment	16.7	17.5	19.7	21.5	23.4
Per capita GDP, AMD thousand	484.4	551.4	855.9	1,247.3	1,847.0
Value added in agriculture	355.3	405.1	582.6	801.7	1,109.5
Value added in non-agricultural sector	129.0	146.3	273.3	445.6	737.5
Per capita GDP, USD	1,058.2	1,325.4	2,802.5	4,084.1	6,047.7
Value added in agriculture	776.3	973.7	1,907.7	2,624.9	3,632.9
Value added in non-agricultural sector	281.9	351.7	894.9	1,459.1	2,414.7

* The nominal estimates of added value created in rural areas

348. Main problems of rural development are driven by an absolute prevalent role of agriculture in rural areas. As evident from data in Table 7.5, in 2005 agricultural activities generated 74 percent of GDP in rural areas, while employment in agriculture comprised 83.3% of total rural employment. Such situation puts the welfare of rural population into an undesired dependency from development level and growth rates of agriculture. Taking into account lower agricultural development rates envisaged by the SDP, the gap in the living standards between rural areas and other cities of the country and specifically Yerevan will inevitably widen.

Table 7.6: Target Indicators for Development of Agriculture, 2006-2021 (Year 2005 = 100)

Indicators	2006	2010	2015	2021
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GDP*	108.9	144.3	181.0	226.1
Value added in agriculture	109.1	133.9	158.7	185.2
Value added in non-agricultural sector	108.5	172.9	242.8	338.9
Employment	100.9	103.7	106.1	108.7
in agriculture	100.0	100.0	100.0	100.0
in non-agricultural sector	105.6	122.4	136.6	152.3
Per capita GDP	108.8	142.1	174.4	214.5
Value added in agriculture	109.0	131.9	152.8	175.7
Value added in non-agricultural sector	108.4	170.3	233.9	321.5

* The nominal estimates of added value created in rural areas

349. In 2008 a comprehensive national program of territorial development having as a component a rural development program will be developed in Armenia to prevent further deepening of this gap and to reduce in the future the differences in living standards between Yerevan, other cities and rural areas of the country. The main benchmarks of the latter are presented in the Tables 7.5 and 7.6.

350. The main objectives of this program would be diversification of activities for rural population, promotion of progressive development of non-agricultural sector branches and creation of non-agricultural employment through development and application of arrangements and directions for efficient use of public and private financial resources.

351. It should be mentioned that currently the carrying out of employment policy (in particular proactive policy) activities among rural population is significantly hindered by lack of definition of the employment status of the rural population. In this respect as far as expanding the spreading and raising the productivity of employment policy activities among the rural population are concerned revision and clarification of the employment status of the rural population based on the current situation, shaped realities and international experience will be of top priority.

8. Infrastructure Development

352. Throughout the recent years, Armenia's industrial infrastructures – transport, energy, water and irrigation and telecom registered certain positive developments. The access to and scope of the services provided for the population and various economic sectors and the financial sustainability of service providers has increased, direct and indirect subsidies to the system have decreased considerably, there has been a significant increase of public and private investments in infrastructure development, and public-private cooperation for infrastructure management has deepened.

353. In spite of the achievements, Armenia still lags behind Eastern and Central European states in terms of structural and management reforms required for proper operation of infrastructures in a free market.¹³⁹ In perspective such situation may

¹³⁹ EBRD Transition report, 2007.

eventually stall the rapid growth rate. Delays in the reform process contain fiscal risks and may significantly limit opportunities for public spending and distribution efficiency.

354. The obsolescence of infrastructure assets continues to remain a major challenge for sustainable development and poverty elimination. In order to modernize and rehabilitate the infrastructure assets one of SDP priorities will be ensuring increase of public investment, with parallel increase of the private investment. On the whole, telecom sector excluded, the annual investment demand in the sector is estimated at the level of 3 to 5 percent of GDP. SDP public investment framework comprises an average of about 4.6 percent of GDP annually; about 50-60% of which will go to industrial infrastructure.

8.1. Drinking Water

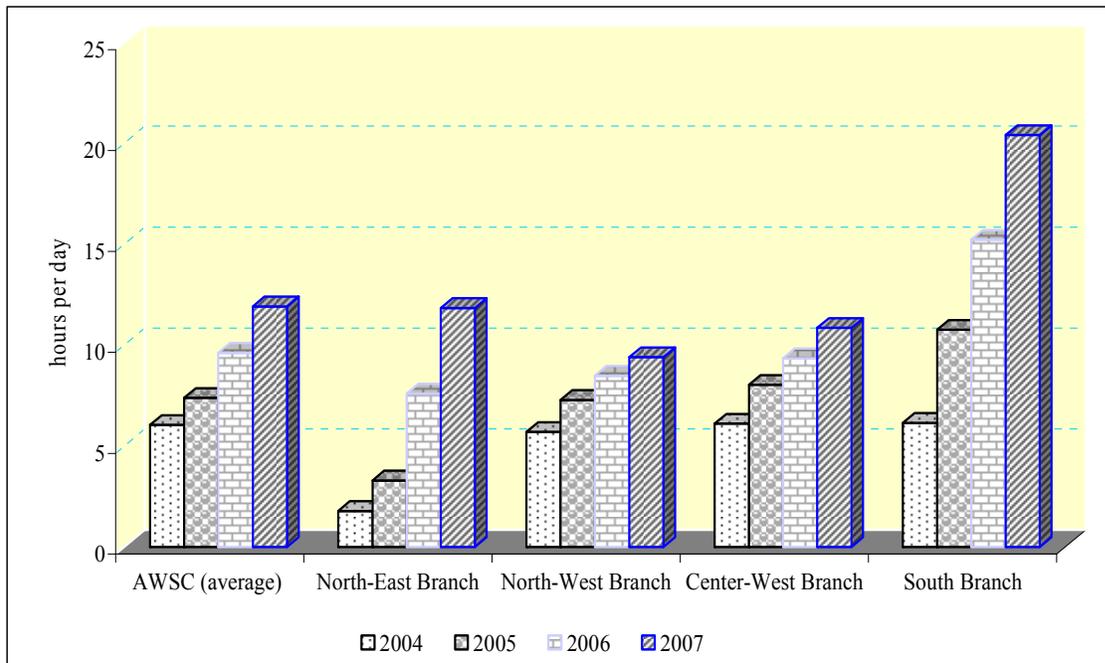
355. In the last years there have been significant improvements in accessibility, supply duration and safety of drinking water. In 2006, the average supply duration across the country was 12.1 hours per day, exceeding 1998 corresponding indicator by 4 hours. At the same time centralized water supply coverage of rural areas has increased significantly growing from 64.7% to 78%. One of the major achievements was the drastic decrease of those users of centralized water supply system that received water for less than 1 hour daily; this number decreased from 16.3 percent in 1998 to 0.5 percent in 2006 (see Table 8.1).

Table 8.1. Armenia. Household access to drinking water, comparison between 1998/99 and 2004- 2006 (% of the population)

Main source of drinking water	Population total			Urban population			Rural population		
	1998/99	2004	2006	1998/99	2004	2006	1998/99	2004	2006
Centralized supply	83.7	88.9	91.3	96.2	96.5	98.1	64.7	74.0	78.0
Less than 1 hour	16.3	1.6	0.5	4.1	1.6	0.6	35.0	1.6	0.1
1-5 hours	43.2	39.5	35.9	56.4	40.9	37.2	23.1	36.0	32.8
6-12 hours	15.8	21.5	25.9	19.6	22.5	25.9	9.9	19.0	25.9
13-23 hours	4.1	4.5	4.3	4.9	5.2	4.9	2.8	2.8	2.9
24 hours	20.6	32.9	33.4	15.0	29.8	31.4	29.2	40.6	38.3
Well, spring	5.9	3.8	3.9	1.2	0.9	1.4	13.0	9.4	8.9
Local source	2.0	2.6	3.3	0.4	0.2	0.1	4.4	7.3	9.5
Carried water	8.3	4.5	1.4	2.1	2.3	0.3	17.8	9.0	3.6
Other sources	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.3	0.0

Source: RA NSS, Household Survey, 1998/99, 2004 - 2006

Figure 8.1. Dynamics of water supply duration, 2004-2007

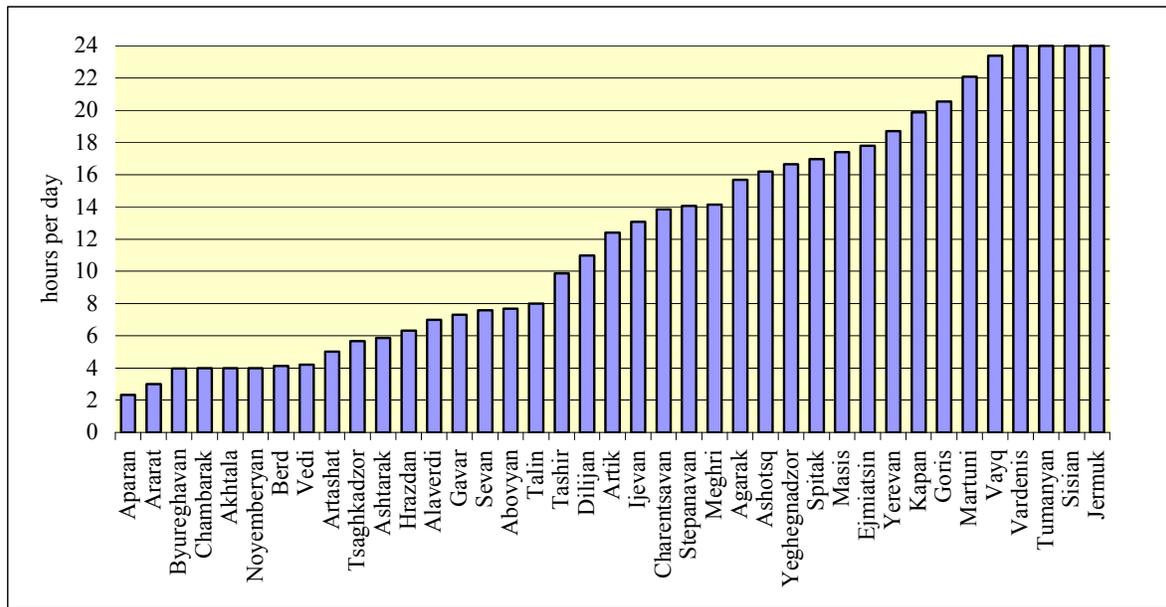


* The monitoring area comprised the service area of Armenia Water and Sewerage Company including about 300 rural communities and all cities with the exception of Yerevan, Gyumri, Vanadzor, Armavir, Maralik and Metsamor.

Source: State Water Committee of the Ministry of Territorial Administration

356. Nevertheless, the supply duration continues to remain low and greatly varies across regions. In about half of Armenia's urban communities the supply duration is less than 12 hours a day, and in 6 towns it does not exceed 4 hours (see Figure 8.2). While the average supply duration in rural areas exceeds that in urban ones, the disparities are even more acute in view of the limited coverage and dependence on carried water in some of the villages. Another big issue is the collection of complete and systematic data on water supply in rural areas considering the fact that there are about 560 villages that are not covered by specialized service companies.

Figure 8.2. Average daily water supply duration in Armenia's towns, 2007



Source: State Water Committee of Ministry of Territorial Administration

357. One of the long-term development issues of the drinking water system is the cost-recovery. Currently the drinking water and sanitation tariffs do not fully cover the costs, and in all areas except Yerevan do not even cover the running costs of the service. This situation is a serious obstacle for further deepening of the management reform and virtually it precludes private investment. Thus the long-term development of the drinking water supply system, on the whole, fully depends on the state budget capacities and efficiency of public spending which, according to international experience, seldom contributes to improved quality of the service and efficiency.

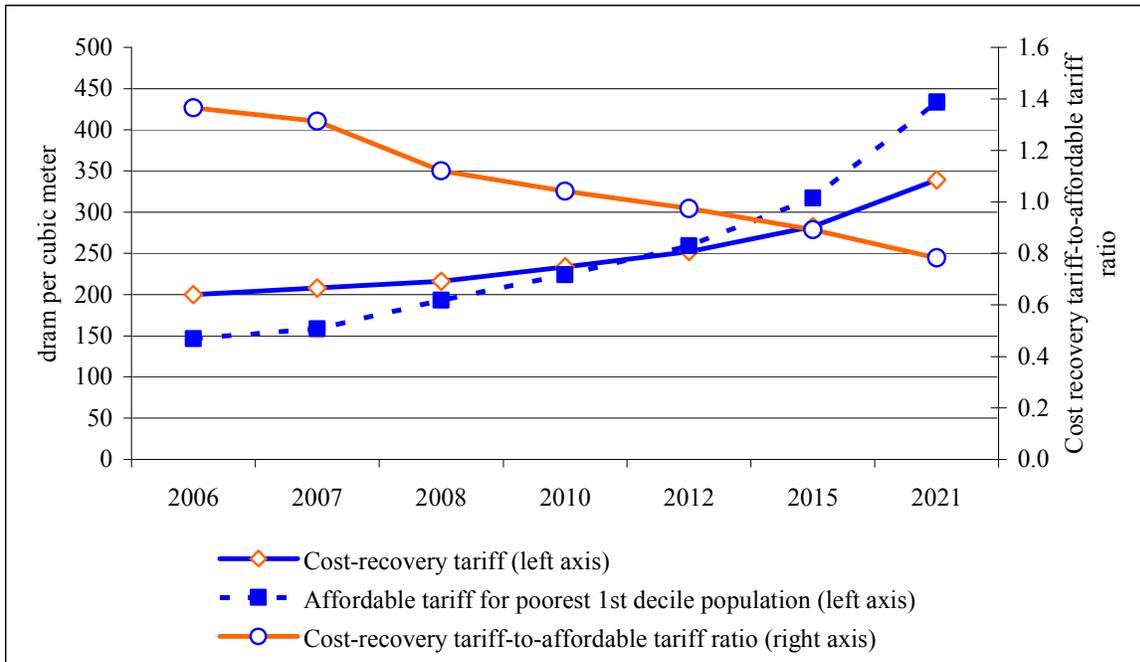
358. There is no doubt that the main reason for not switching to cost recovery tariffs is the accessibility of drinking water, which, despite the recent improvements, continues to remain low even with current tariffs, especially for low-income households.

359. The key indicator for assessing the access to drinking water is the ratio of the estimated minimum consumption to the total consumer spending. In the absence of internationally recognized and unified standards for estimating the minimum consumption, the most frequently used standards are those proposed by WHO, 50 liters per capita daily¹⁴⁰. It is accepted that with affordable tariffs, the average daily consumption per capita or per household should not exceed 3% of the consumer

¹⁴⁰ This approach is taken according to UN Economic and Social Council's Economic, Social and Cultural Rights Commission General Comment No. 15 (2002) for the right of access to drinking water. It should be mentioned that the current average consumption in households that installed water meters is 90-100 liters, or about half of the prudential requirement formerly used in Armenia.

spending or disposable income¹⁴¹. According to 2006 estimates based on these values, the average national affordable tariff is AMD465 AMD/cubic meter per month, which considerably exceeds the current tariff of AMD140 per cubic meter. At the same time and based on the same estimates, the affordable tariff for the first consumption decile is AMD146 for cubic meter, which is almost the same as the current average tariff. The affordable tariff projections are based on SDP consumption decile projections which indicate that in the medium-term, it would be possible to considerably increase the level of cost recovery in the sector without jeopardizing the access to drinking water for the most vulnerable population groups.

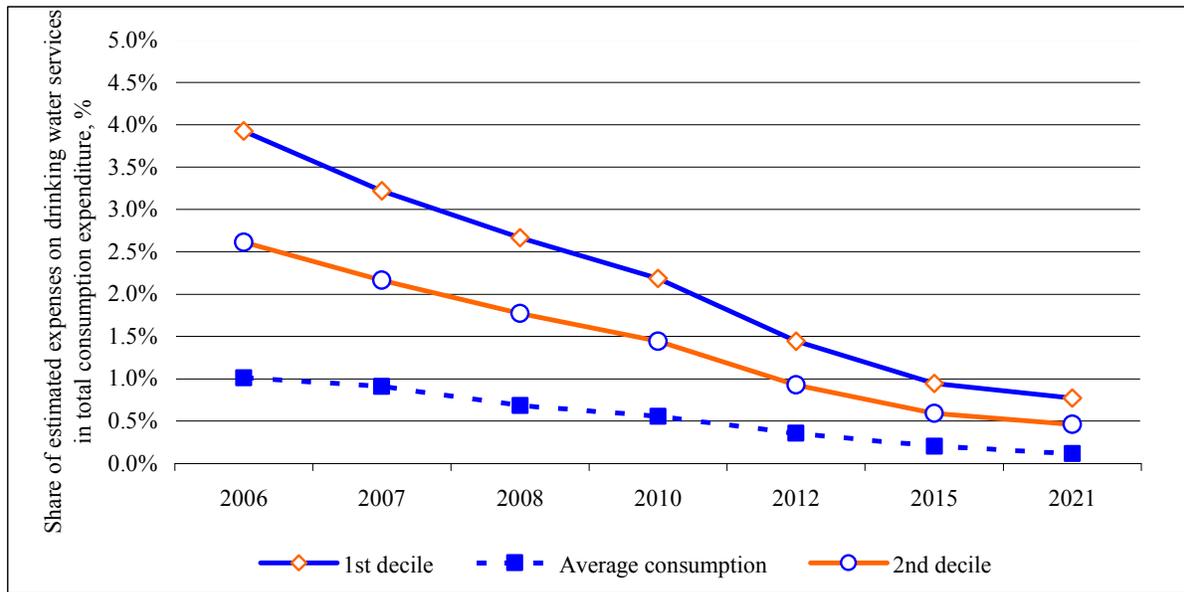
Figure 8.3. Drinking water affordable and cost-recovery tariff projections, 2007-2021



360. As for Yerevan, in 2006 the tariffs for the next 10 years were established under a trust management agreement, whereby the affordability of drinking water in the city will gradually increase due to the population income growth and tariff reduction.

¹⁴¹ See, for example, Samuel Fankhauser and Sladjana Tepic, Can poor consumers pay for energy and water? An affordability analysis for transition countries, EBRD Working Paper No. 92, May 2005.

Figure 8.4. Drinking water affordability projections, average consumption 1st and 2nd deciles



361. In view of the fact that at least in the medium term, the affordable tariffs will not cover the required capital costs, the sector will continue to remain among the public investment priorities throughout the entire period of SDP implementation. It is planned to finance this public investment mostly from bilateral and multilateral donor assistance including concessionary loans and grants. Overall, the level of public investment will reach and stay at the level of around 0.3% of GDP.

362. At the same time, in view of the insufficiency of the public funds to cover the needs of the sector, as well as the fact that the size of concessional loans to Armenia will gradually decrease, in the foreseeable future it would be necessary to increase the attractiveness of the sector for private investors. To meet this goal the Government will continue and deepen the management reforms in the sector through further and wider denationalization of the system management.

363. Further reforms of drinking water systems will be aimed at ensuring their reliability and efficiency as well as reducing losses and improving the quality of water supply and sanitation services.

364. Universal access to safe drinking water will require the development of community water supply investment programme, whereby public investment will be used to address the priorities of such programme.

365. The program target indicators and public investment levels for drinking water are presented in Table 8.2.

Table 8.2. Main target indicators for drinking water supply

		Baseline	2012	2015	2018	2021
Reform index	EBRD Transition Indicators	2.33 (2007)	2.67	3.33	3.67	4.00
Average national indicator for water supply duration	hour/day	12 (2006)	16	20	22	22
Level of public investment, % of GDP	Annual average for previous 3 years	0.25% (2007)	0.4%	0.4%	0.3%	0.3%

8.2. Irrigation

366. Most of Armenia's agricultural products are still produced in over 300 thousand extremely small and small farms; the income level of half of such farms greatly depends on availability, affordability and reliability of irrigation. Structural and management reforms of the irrigation sector, introduction and strengthening of participatory management in the last years have greatly contributed to the improvement of irrigation indicators. According to latest surveys, the size of the areas that are not irrigated due to the lack of access has decreased considerably, and so has the number of rural households, which believe that their key problem is the lack of access to irrigation.

367. At the same time, in conditions of wear and tear of irrigation systems, high energy consumption and inefficient management, only 70 percent of irrigable land is irrigated. Due to the same reasons and also because of low return on cultivation of some crops, introduction of cost-recovery tariffs for irrigation may make agriculture financially unappealing for many farmers.

368. Taking to consideration the direct dependence of the access to irrigation from rural poverty level, the effective calendar of transition to cost recovery tariffs for irrigation and, accordingly, the level of subsidies according to PRSP were reviewed in 2006-2007. The new calendar for gradual increase of cost-recovery was established in line with MCA target indicators, to reach 72% in 2011. At the same time, in order to support the establishment of WUAs and increase the efficiency of public expenditure, there will be a transition from subsidies to results-based public funding. The new system also encourages WUAs to establish higher tariffs and to apply a multiple tariff system.

369. Further reforms of the irrigation sector will be aimed at strengthening participatory management all the way through to denationalization of the whole system while WUAs develop and create unions and as the level of cost-recovery increases. At the same time, the state funding and provision of budget grants according to the established procedure will continue into 2018 to cover the current deficit. The size of the grant program will be established within MTEF framework based on SDP target indicators for cost-recovery level increase.

370. Public investment for recovery and modernization of irrigation systems, including MCA e, will remain at the level of 0.2% of GDP throughout the entire period of SDP implementation, and the selection of projects to be financed from the state budget will be made based on the economic efficiency of investment.

371. Program main outcome indicators and projected levels of public funding presented in Table 8.3 .

Table 8.3. Main target indicators for irrigation sector

		Baseline	2012	2015	2018	2021
Reform index	EBRD Transition indicators	2.33 (2007)	2.67	3.00	3.33	4.00
Irrigable areas	Thousand ha	123 (2006)	160	180	180	180
Current cost-recovery level	%	40% (2006)	75%	85%	100%	120%
Public investment level, % of GDP	Annual average 3 previous years	0.05% (2007)	0.2%	0.2%	0.2%	0.2%

8.3. Transport

372. Development and increased efficiency of the transport system is viewed as an important prerequisite for ensuring high growth rate, increased access to and efficiency of social services, increase labor force mobility and elimination of regional disparities.

373. In the recent years due to a number of objective reasons the structure of transport services has changed considerably in favor of road transport. Currently this type of transportation accounts for about 59% of cargo transportation and about 90% of passenger transportation. In the given situation the condition of the national road network significantly preconditions the margin of transportation costs, basically, for the whole economy. In this respect SDP framework envisages large-scale investments aimed at improving the national road network, with most intensively used segments of the network as a priority.

374. At the same time, taking to consideration the importance of the national motor road communication with respect to accessibility of social services, development of agriculture and tourism, increased labor force mobility, as well as reduction of regional economic and social disparities, it is planned to considerably increase public funding for local road infrastructure development. The investment priorities include ensuring at least one proper motor route that would connect each settlement in Armenia to the regional centres and developing the network of roads leading to major tourist attractions; a prioritized list of such roads will be established within the framework of a long-term development programme for the national automobile road network.

375. In order to prevent accelerated deterioration of the road network and ensure safer, faster and easier road transportation public investments for motor road maintenance will be augmented and disbursed more effectively.

376. To design a transportation structure that would be most balanced in respect of the transport system and most optimal for the country's sustainable development model for balanced development of the national transport system and sustainable development, it is planned to continue and deepen management reforms in the railway and air transportation sectors.

377. Program main target indicators for the transport sector and projected levels of public spendings are presented in Table 8.4.

Table 8.4. Main target indicators for transport sector

Indicators		Baseline	2012	2015	2018	2021
Road transport						
Reform index	EBRD Transition indicators	2.33 (2007)	3.00	3.33	4.00	4.00
Communities with at least one adequate road connecting them to a regional centre, % of the total number of communities	%	3%	20%	40%	60%	80%
Length of properly maintained roads compared to the total length of same category roads	International	90%	90%	90%	90%	90%
	National	40%	80%	90%	90%	90%
	Local	10%	30%	50%	70%	90%
Public investment, % of GDP	Annual average for 3 previous years	0.8% (2007)	1.0%	1.2%	1.5%	1.5%

8.4. Energy

378. Armenia's energy sector has gone through an extremely difficult period of reforms. Currently the national energy system fully meets the domestic demand and maintains some export potential.

379. Electricity distribution and sale is realized by a private company, while generation is done by 5 independent power producers, one Aeolian power plant/ wind farm and numerous private small hydropower plants. In 2007, the total electricity generation was 5,897 KWh, 31.4% of which was generated by hydropower plants, 25.3% by thermal power plants and 43.3% by Armenia's Nuclear Power Plant.

380. In 2007, Armenia imported 2,055 mln cubic meters of gas from Russian Federation. The number of users at the end of the last year was 519 650, of which 514 200 are residential users.

381. The revaluation of the energy system assets identified an urgent need for replacement and modernization of the generation capacities. Such replacement and modernization is required in electricity and natural gas transmission and distribution networks, as well as natural gas underground reservoirs. Other challenges of Armenia's energy sector include the lack of local fossil fuel deposits of industrial significance, dependence of the significant part of generating capacity on single source supply and limited capacities of the current transport system.

382. The Government has already taken some steps to improve the situation, including:

- In the recent years the structural reforms in the energy sector continued and have intensified even further. The natural gas supply system, electricity distribution network, Sevan-Hrazdan Cascade (in the framework of debt/ equity swap with Russian Federation) and all small HPPs were privatized. Electricity market support structures including a System Operator and Metering Center have been established, a system of direct contracts for wholesale trade that promotes further liberalization of the market has been introduced. To ensure long-term development of nuclear energy the law on Energy was amended to eliminate the state's monopoly in the nuclear energy sector .
- The structural reforms resulted in maximizing the service fee collection; currently the consumers fully pay for the consumed electricity and natural gas. The current balance of public energy companies has been positive since 2003.
- The modernization works at the majority of 220 KW transmission network substations were finalized with KfW Bank and World Bank loan support. The construction of the second Iran-Armenia transmission line was completed. An Automatic Meter Reading (AMR) system was deployed with USAID technical assistance.
- With the support of EU INOGATE project a gas metering station was built in Koghb and some modernization works were carried out in Abovian underground gas reservoir.
- With technical and financial support of donors, about US\$90 million worth of maintenance was carried out at Armenian Nuclear Power Plant to increase its safety; such maintenance will continue in the future.
- Based on the loan agreement between governments of Japan and Armenia signed in 2005 construction works of a 242 MWt combined cycle power facility have started in Yerevan Thermal Power Plant .
- The construction of the first (Meghri-Kajaran) section of Iran-Armenia gas pipeline was completed; the construction works for the next Kajaran-Aparan section are underway.

-
- Rehabilitation of small hydropower plants has started within the framework of a grant provided by Energy Efficiency and Renewable Energy Fund and German KfW bank. In the last five years, the total output of small HPPs doubled and currently the total generated capacity is about 58 MWt. With grant funding provided by Islamic Republic of Iran the first wind power plant with capacity of 2.6 MWt , was built in Pushkin pass.

383. To ensure long-term development of the sector, meet the growing domestic demand for electricity, ensure the nation's energy security and independence, the following key directions of the energy sector development strategy are especially highlighted:

- usage of renewable energy recourses;
- Nuclear power engineering;
- Diversification of energy supply and regional integration;
- Promoting and encouraging energy productivity in all sectors utilizing energy recourses.

384. Based on international principles for energy security and recommendations of a 2006 national program on the development of Armenia's energy system, the national policy will aim to modernize the generation capacities of the network combining public and private investments, with the following priorities:

- Electricity generation; maximum possible use of local renewable energy sources (hydro, wind, thermal, solar),
- Construction of new NPP facility¹⁴²,
- Meeting the remaining local and external demand for electricity using thermal and combined cycle power facilities;

385. The following measures are envisaged for diversification of energy supply, strengthening overall reliability of the energy system and promoting regional integration:

- (i) Completion of Kajaran-Ararat section of Iran-Armenia gas pipeline, which will enable the import of required natural gas quantities;
- (ii) Enlargement of underground natural gas reservoirs;
- (iii) Construction of a hydropower plant to utilize the hydropower potential of Arax river;
- (iv) Improving the transmission networks is of utmost significance in terms of strengthening the overall reliability of energy system and promoting regional integration. Strengthening Armenia-Iran electricity transmission intersystem

¹⁴² Feasibility study and environmental impact assessment works for the construction of a new nuclear power facility have already started with the technical assistance of USAID.

connections through construction of the third high-voltage (400Kw) overhead transmission line, construction of a new Armenia-Georgia 400Kw overhead transmission line , and reconstruction of the 220Kw Kars line that are considered intersystem connections, as well as a feasibility analysis for construction of new transmission lines to ensure proper integration with regional power grids;

- (v) Implementation of joint projects with international energy associations in CIS, BSEC and other frameworks;
- (vi) Creation of a regional energy market.

386. Significant improvement of the level of energy saving and efficiency in all sectors utilizing energy resources will be a priority in terms of ensuring Armenia’s energy independence, competitiveness of economy and improved living standards of the population.¹⁴³ To this end, in 2007 the Government will consistently implement the policy stipulated by the national program on saving energy and renewable energy resources of RA approved in 2007.

387. Program main summary indicators and projected levels of public investments are presented in Table 8.5

Table 8.5. Main target indicators for energy sector

Indicators		Baseline	2012	2015	2018	2021
Reform index	EBRD Transition indicators	3.33 (2007)	4.00	4.00	4.00	4.33
Public investment, % of GDP	Annual average for 3 previous years	0.5% (2007)	0.3%	0.2%	0.2%	0.2%

¹⁴³ According to estimations in 2004 Armenia by its energy intensity indicator equaling to about 704 kg per capita, was holding the 106th place among 149 countries (source: “World Development Indicators”). However such a low indicator is conditioned rather by low capital intensity of the economy, and not by energy efficiency, and is mainly conditioned by the significant share of agriculture and construction sectors in the GDP.

9. Regional Development

388. Since the beginning of 2000s regional development disparities have been increasing parallel to the accelerated economic growth, and are mainly reflected in the growth of economic role and significance of the capital, Yerevan, as a result of which the difference between living standards in Yerevan and the rest of Armenia has been constantly growing and in the recent years became alarming.

389. Pursuant to the analysis offered in the section of the document in question devoted to the material poverty, along with increasingly lopsided economic development, the difference in the regional poverty levels shrank between 1999-2005¹⁴⁴: However, further uncontrolled growth of economic development disproportions¹⁴⁵ is highly undesirable for a number of reasons. Specifically, uneven economic growth creates problems both in terms of internal stability and outflow of the population from underdeveloped regions and unregulated inflow to the capital.¹⁴⁶

390. Table 9.1 figures attest to the increasing economic role of Yerevan and decreasing economic roles of the regions. Yerevan's share in Armenia's GDP grew from 42.1% in 1999 to 58.4% in 2006¹⁴⁷, while the share of Yerevan population remained essentially unchanged making up to 34 percent.

Table 9.1. GDP in Armenia. Regional distribution, 1999-2006 (AMD bln, current prices)

Indicators	1999	2000	2001	2002	2003	2004	2005	2006
Armenia	987.4	1031.3	1175.9	1362.5	1624.6	1907.9	2242.9	2656.2
Yerevan	416.0	477.2	537.4	648.2	820.2	979.7	1249.8	1550.8
Aragatzotn	41.6	28.5	34.2	44.5	46.6	50.5	53.4	68.0
Ararat	72.7	73.0	70.4	93.5	101.0	116.2	119.9	132.4
Armavir	97.0	87.8	81.2	94.6	94.3	114.6	122.7	126.7
Gegharkunik	58.1	57.0	66.9	74.8	92.9	101.3	99.8	114.0
Kotayk	86.6	87.8	108.9	105.1	127.6	125.9	144.0	149.2
Lori	62.8	64.0	72.3	79.7	90.7	108.2	110.3	139.1

¹⁴⁴ These trends, according to the latest available Household Living Standards Survey data, continued into 2006 (see Armenia's Social Snapshot and Poverty, NSS RA, Yerevan, 2007).

¹⁴⁵ The significant and growing difference in the living standards, between Yerevan and elsewhere in Armenia, is typical for almost all transition and developing countries. However currently Armenia is one of the first in respect of this ,

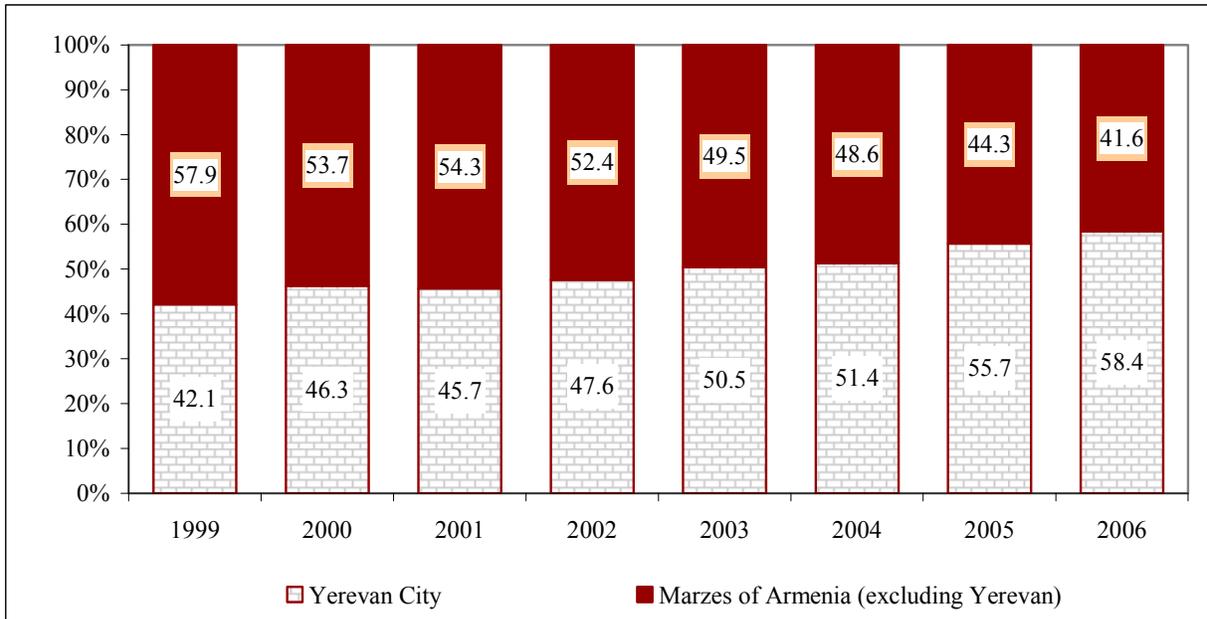
¹⁴⁶ Uncontrolled concentration of the population in the capital is one of the core socio-economic challenges currently faced by developing countries. particularly the small ones.

¹⁴⁷ NSS RA does not calculate region-disaggregated GDP. The added value and GDP estimates quoted in this and other sections of SDP were calculated by experts (Avag Solutions) based on the regional distribution of manufacturing, agriculture, construction, transport and communications, trade and services across the regions (Yerevan and marzes). As for aggregated data of GDP distribution between Yerevan and the country's other urban and rural settlements, these are also expert assessments based on regional GDP estimates. The estimation resulted in the following assumptions : regional industrial production is fully concentrated in urban settlements, while agricultural production output for other urban settlements in Armenia is estimated based on per capita consumption in Yerevan, construction, trade, services (including healthcare) transport and communication in the regions were broken down according to the urban/rural population ratio, professional, vocational and extracurricular education services are provided mainly in urban settlements, while other education services are broken down based on the population size, and finally, indirect taxes were calculated against non-agricultural added value totals.

Shirak	64.2	63.6	67.9	84.0	93.4	90.4	90.3	100.4
Syunik	45.7	53.7	75.4	73.3	90.7	142.8	172.7	186.6
Tavush	26.7	23.6	31.7	39.9	38.7	45.1	45.3	51.5
Vayots Dzor	15.5	14.5	29.5	23.6	27.5	33.3	34.4	37.7
Total (without Yerevan)	571.5	554.2	638.5	714.3	804.4	928.2	993.1	1105.4
Other cities	230.5	240.8	253.1	289.2	335.3	383.7	432.8	469.1
Rural communities	341.0	313.4	385.5	425.1	469.1	544.5	560.3	636.2

Source: NSS RA, expert assessments

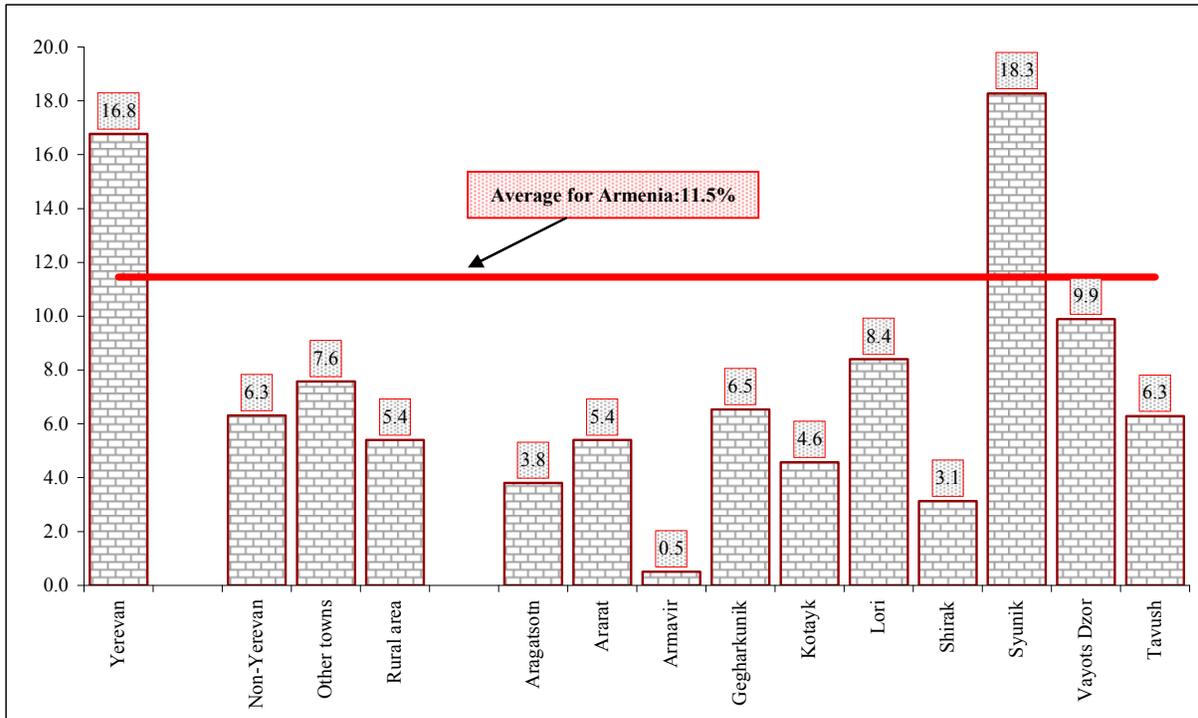
Figure 9.1. Yerevan share in national GDP, 1999-2006, % of the total



Source: RA NSS and expert assessments

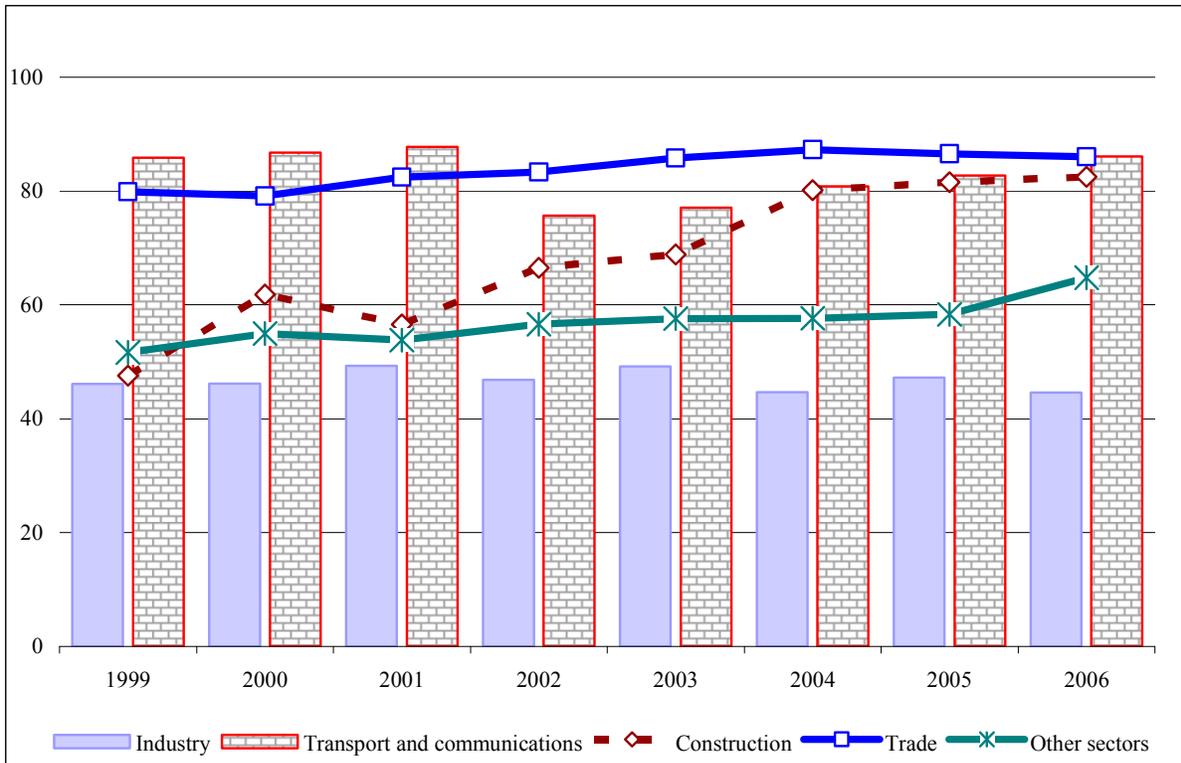
391. Among the main causes underling this process are: the ongoing concentration of the most rapidly growing economic sector, i.e. construction in Yerevan, 82.5% in 2006 against 47.5% in 1999; concentration of trade, which is the second most rapidly growing sector, has also increased from 80% in 1999 to 86% in 2006. The share of other sectors has also increased from 51.7% in 1999 to 64.8 in 2006. Due to the impact of these and a number of other factors, the rate of economic growth in Yerevan between 2000-2006 was considerably higher than the average national and exceeded it by factor of three. In 2000-2006, the average annual economic growth rate in Yerevan was 16.8%, against the national average of 11.5%. At the same time, the average growth rate outside Yerevan in the same period was 6.3%, with 7.6% in urban settlements and 5.4% in rural ones. As for regional growth rates, the only marz where it exceeded the national average was Syunik (18.3% average annual), mostly due to the rapid development of mining industry.

Figure 9.2. Average annual growth rate between 1999-2006, by regions



Source: RA NSS and expert assessments

Figure 9.3. Yerevan share in the total value added produced in the country, 1999-2006, %



Source: RA NSS and expert assessments

Table 9.2. GDP per capita in Yerevan, Marzes, Rural and Urban Areas, 1999-2006

Indicators	1999	2000	2001	2002	2003	2004	2005	2006
	<i>AMD thousand, in current prices</i>							
Yerevan	376.7	432.1	486.6	587.5	744.3	889.1	1,134.1	1,404.9
	<i>% of Yerevan indicator</i>							
Total Armenia	81.6	74.3	75.2	72.2	68.0	66.8	61.5	58.7
Total without Yerevan	72.0	60.8	62.2	57.7	51.3	49.4	41.4	37.1
<i>Other cities</i>	<i>63.0</i>	<i>57.3</i>	<i>53.5</i>	<i>51.2</i>	<i>46.9</i>	<i>45.0</i>	<i>39.8</i>	<i>34.8</i>
<i>Rural areas</i>	<i>79.6</i>	<i>63.8</i>	<i>69.7</i>	<i>63.2</i>	<i>54.9</i>	<i>53.1</i>	<i>42.7</i>	<i>39.3</i>
Aragatsotn	79.8	47.6	50.7	54.7	45.1	40.8	33.8	34.7
Ararat	71.0	62.2	53.2	58.5	49.8	47.8	38.6	34.3
Armavir	93.2	73.5	60.4	58.1	45.7	46.3	38.7	32.2
Gegharkunik	64.9	55.5	57.8	53.5	52.3	47.7	36.8	33.8
Lori	58.2	51.8	51.9	47.6	42.9	42.9	34.3	34.9
Kotayk	84.3	74.6	82.1	65.7	62.8	51.6	46.1	38.5
Shirak	60.2	52.0	49.3	50.6	44.5	36.1	28.3	25.4
Syunik	79.5	81.5	101.4	81.7	79.6	104.9	99.5	86.7
Vayots Dzor	73.3	60.1	108.3	71.9	66.1	67.0	54.3	48.1
Tavush	54.3	41.9	49.4	52.3	40.2	38.0	29.8	27.1

Source: RA NSS and expert assessments

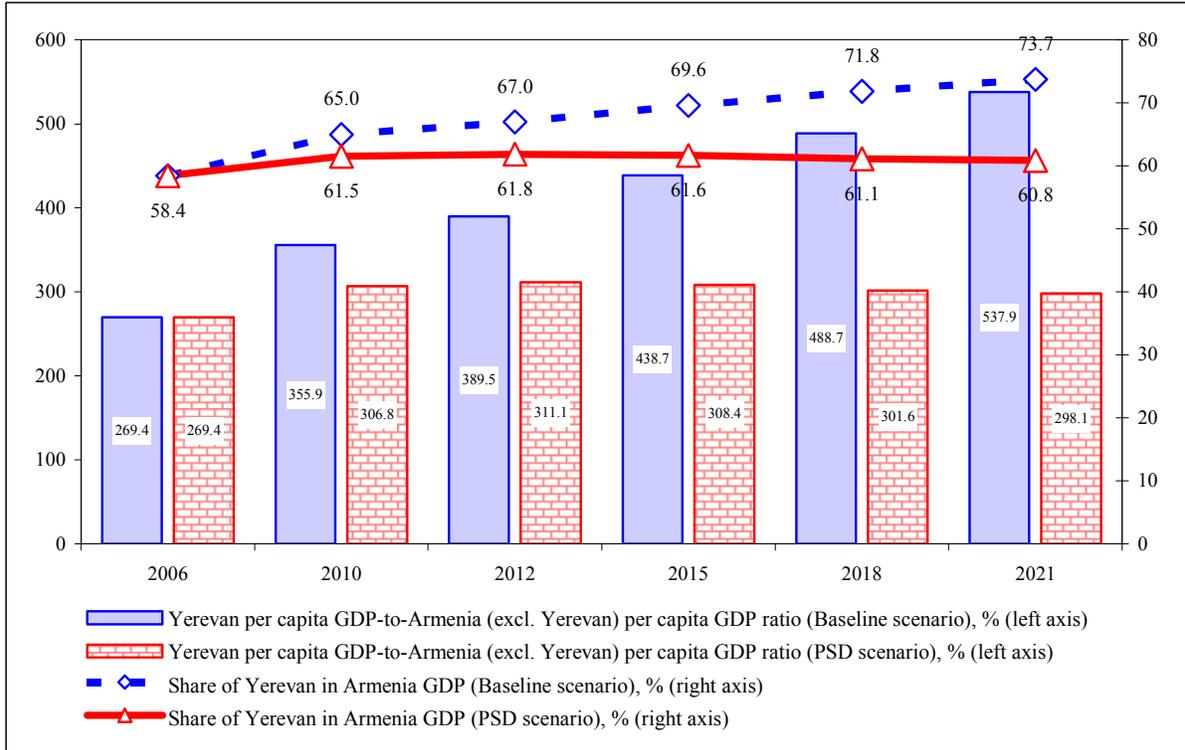
392. The gradually growing gap between the living standards in Yerevan and the regions, as well as between urban and rural settlements, that are measured by per capita GDP indicators, is the direct consequence of the mentioned developments. While in 1999 GDP per capita in rural communities and other cities of Armenia compared to Yerevan were 79.6% and 63% respectively, in 2006 this ratio went down to 39.3 and 34.8 percent (see Table 9.2.). The disaggregated analysis of regional GDP per capita indicates that the increasing difference in the economic development levels in Yerevan and elsewhere in Armenia was characteristic for all marzes except Syunik, where growth rates in 1999 – 2006 exceeded those in Yerevan. As for other regions, this gap has gradually increased, and in two, the poorest Shirak and Tavush marzes, the difference in 2006 was 4 and 3.7-fold correspondingly, while back in 1999 GDP per capita in Shirak was 60.2% and in Tavush 54.3% of that in Yerevan.

393. In case the trends of regional development set in 1999-2006 continue into SDP programming period (baseline scenario), the gap between Yerevan and the marzes, as well as between Yerevan and other cities and villages will grow even further thus causing highly undesirable consequences, threatening the national stability and increasing the divide between the capital and the rest of the country (see Figure 9.4.)¹⁴⁸. According to the baseline scenario, the concentration of economic life in Yerevan will

¹⁴⁸ The baseline scenario of regional development is based on the assumption that in 2008-2021 the relationship between the growth levels in Yerevan and elsewhere in Armenia will remain at the average level registered during 2000-2006, i.e. 1 percent of economic growth in Yerevan will correspond to 0.551 percent of such growth in the regions.

continue into PDS programming period and will reach 67% of GDP in 2012, 69.6% of GDP in 2015, 71.8% of GDP in 2018, and 73.8% of GDP in 2021. The difference of living standards between Yerevan and the other regions, measured by per capita GDP indicators, will also increase approximately by factor of 3.9 in 2012, 4.4 in 2015, 4.9 in 2018, and 5.4 in 2021.

Figure 9.4. Baseline and SDP regional development scenarios, 2006-2021.



394. Unlike the baseline scenario, the model of regional development proposed by SDP envisages the implementation of a targeted regional development policy, which is missing in the baseline scenario and which is aimed at promotion of increased economic growth outside Yerevan. The implementation of such policy will result in bringing the regional growth rate close to that of Yerevan in the period between 2008 – 2014, and by 2015 to creating a situation whereby growth rates in the regions will exceed those in Yerevan. The capital's share in national GDP will continue growing and will reach 62% in 2014, while in 2015 and in subsequent years it will gradually decrease to 61.1% in 2018 and 60.8% in 2021. Accordingly the disparity in the living standards will stabilize and starting from 2015 will gradually decrease down to factor of 3.12 in 2014 and 2.98 in 2021.

395. In the recent years the ongoing investment concentration continues to remain the main cause of continuing concentration of economic growth in Yerevan¹⁴⁹. Between

¹⁴⁹ Currently Armenia's official statistics does not announce information on the regional distribution of public and private investments. For the purposes of SDP the estimates of regional distribution were made based on the

2001-2006, the nominal investments grew by an average 30.7% annually; the growth in Yerevan was 46.2% against 12.1% elsewhere (i.e. the investment growth in Yerevan was about 4 times higher than outside Yerevan). Therefore, Yerevan share in the total public and private investment grew from 41.6 to 72.8 percent, while the share of the rest of Armenia dropped from 58.4 to 27.2 percent (see Table 9.3.).

Table 9.3 Distribution of investments across Armenia, 2001-2006, by regions

Indicators	2001	2002	2003	2004	2005	2006
	<i>AMD billion, in current prices</i>					
Armenia total, of which	232.3	295.2	394.1	464.6	666.1	886.2
Yerevan	96.7	175.3	258.6	261.6	537.4	645.5
Marzes (without Yerevan), incl.	135.6	119.9	135.5	203.0	128.7	240.7
Other cities	19.7	57.2	69.3	79.3	97.3	78.0
Rural areas	115.9	62.7	66.2	123.7	31.4	162.7
	<i>% of total investment</i>					
Yerevan	41.6	59.4	65.6	56.3	80.7	72.8
Marzes (without Yerevan), incl.	58.4	40.6	34.4	43.7	19.3	27.2
Other cities	8.5	19.4	17.6	17.1	14.6	8.8
Rural areas	49.9	21.2	16.8	26.6	4.7	18.4

396. In order to realize the Sustainable Development Program regional development scenario a drastic increase in the regional economic growth rate is required approximating it to Yerevan growth rate and by 2015 ensuring its prevalence. To ensure growth growth rates (see Table 9.4.) envisaged by the project some fundamental measures will be required, primarily re-directing public and, especially private investments from Yerevan to other cities and rural settlements, as well as promotion of more even distribution of investments across regions.

397. The economic growth rates envisaged by regional development scenario of SDP are presented in Table 9.4. .

Table 9.4. Regional development (GDP growth) average annual rate, 2008-2021.

Indicators	1999-2006	2007-2010	2011-2012	2013-2015	2016-2018	2019-2021
Armenia total, of which	10.4	10.5	7.7	6.6	5.9	5.4
Yerevan	16.8	12.1	8.0	6.5	5.8	5.4
Marzes (without Yerevan), incl.	6.3	8.1	7.2	6.7	6.1	5.5
Other cities	7.6	9.1	9.6	9.4	8.2	6.7
Rural areas	5.4	7.4	5.2	4.3	3.9	3.6

398. It is planned to approximate regional development rate to Yerevan rate in 2008-2014; starting from 2015, this rate should exceed Yerevan growth rate. Besides, it is planned to ensure more even development rate across regions thus minimizing interregional differences in the living standards.

assumption that the return on investments in a given year is the same everywhere in Armenia and their regional distribution is made based on the ratio of national GDP growth to regional GDP growth.

399. In view of the current peculiarities of economic development in rural areas, (in particular agriculture as the main occupation and source of income and limited opportunities for non-agricultural activity and income diversification), the development of rural areas is expected to take place at a lower rate compared to Yerevan and other cities. SDP plans to mitigate these limitations by developing and implementing rural development initiatives; these limitations, however, will continue to remain significant and growth in such areas will continue to depend on agricultural development rates, which will be lower than in other sectors. The size of the rural population and agricultural production ratios will continue to remain among the factors determining the difference in the levels of interregional development throughout SDP implementation period.

400. In contrast to rural settlements, the development rate of Armenia's cities beginning from 2010, should be higher than the national average and Yerevan development rates. Thus the policy aimed at mitigating regional development disparities will primarily target other cities and towns, the overwhelming majority of which both in terms of economic development and living standards is behind Yerevan and, on average, rural areas, and are characterized to have a significantly higher level of poverty and extreme poverty.

401. So far Armenia does not have an integrated policy for regional development promotion; only separate elements of such policy are introduced, in particular the Ministry of Territorial Administration has been established, a national centre for SME development tasked , primarily, with SME promotion outside Yerevan is operating, as well as regional development projects for separate marzes, namely Tavush and Gegharkunik, were developed.

402. In 2008-2009 Sustainable Development Program envisages to develop and introduce a comprehensive state policy aimed at reducing development disparities and accelerating regional development¹⁵⁰. The policy package will in particular include:

- Directing public investment programs towards elimination of gaps in industrial and social infrastructure predominantly outside Yerevan, as these gaps may impede the socio-economic development inside and across marzes;
- Regular analysis of entrepreneurial and investment climates, shortcomings of public and local administration (mostly in cities and towns of Armenia) and their approximation with the best national standards for a drastic improvement of the quality of entrepreneurship and investment climate and public and local administration;

¹⁵⁰ This policy is justified by best international and EU experience, whereby various structural funds channel considerable resources for equalization of the member state economic development levels, acceleration of such growth in underdeveloped regions, as well as accession support. This approach is presumably based on the fact that as a rule, unregulated economic growth tends to increase regional disparities due to the so-called development polarization, currently witnessed in Armenia.

- Development and introduction of a public funding system for regional development, which will include the following key elements: public funding of investment programs for intra- and inter-regional industrial and social infrastructure development, public funding for the promotion of rural development, as well as for agriculture subsidies, public support to SME development outside Yerevan,¹⁵¹ a system of structural funding for accelerating the growth in other cities.

403. Based on EU regional policy experience the system of structural funds is the key funding tool of the regional development policy, designed to attract additional private investment for augmenting the added value generated in a given city. As a rule, such augmentation is ensured by creating conditions necessary to bring in more investment using the fund resources¹⁵². It is planned to deploy the structural fund system from 2010; the organizational structure and functions of these funds, as well as the list of cities where such funds will operate will be determined in the course of 2008-2009. In order to accelerate the development of other cities and increase the volume of private investments SDP envisages using these funds to allocate means, which will total, in 2009 – 2014, 0.1% of GDP and will grow to 0.15% of GDP between 2015-2021.

404. The regional development rate (see Table 9.4) projected in the program requires a considerable re-distribution of investments between Yerevan, other cities and rural areas (see Table 9.5). It is planned to significantly reduce Yerevan share in such investments, mostly due to re-directing these investments to other cities (in 2021 in comparison to 2006, the investment level in nominal terms will increase ten-fold increase in investment in nominal terms, and structural funds will have an important role to play in ensuring such increase).

Table 9.5. SDP regional distribution of planned investments

Indicators	2006	2010	2012	2015	2018	2021
	<i>AMD billion, in current prices</i>					
TOTAL	100.0	100.0	100.0	100.0	100.0	2867.2
Yerevan	72.8	67.2	63.4	58.4	60.5	1678.5
RA marzes (excluding Yerevan) including	27.2	32.8	36.6	41.6	39.5	1188.7
Other towns	8.8	17.7	18.3	24.1	25.4	756.2
Of which structural funds *	0.0	1.9	1.9	2.3	2.3	18.3
Rural area	18.4	15.1	18.2	17.6	14.1	432.5
	<i>% of the total</i>					

* Ratio to investments to be made in other cities

¹⁵¹ Including resources to be provided as collateral for loans taken by small and medium enterprises.

¹⁵² According to the best EU and international experience with using structural funds for acceleration of regional development at the level of individual cities, first the given area is analyzed (the city and surrounding areas), the main development obstacles are identified, an action plan for mitigation of elimination of such obstacles is designed, the potential competitive advantages and disadvantages of the region are identified, the economic sectors with the highest potential are identified, and then respective development plans are designed. The structural fund money, as a rule, is used as seed money to attract private investment to fuel the rapid growth of the region.

405. The implementation of a policy for mitigation of regional development disparities is expected to ensure the following living standard indicators in the regions (see Table 9.6). In particular, it is expected that the growing disparity of the living standards will be significantly mitigated by 2014, and from 2015 this disparity will decrease, eventually leading to less difference in the living standards in Yerevan and elsewhere in Armenia.

Table 9.6. GDP per capita indicators, by regions

Indicators	2006	2010	2012	2015	2018	2021
Yerevan, AMD thousand	1405	2596	3229	4244	5469	6987
Yerevan, USD thousand*	3.4	8.5	10.6	13.9	17.9	22.9
	<i>% of Yerevan indicator</i>					
Armenia total, of which	58.7	55.4	55.1	55.2	55.4	55.3
Marzes (without Yerevan), incl.	37.1	32.2	31.7	31.9	32.2	32.0
Other cities	34.8	31.3	32.2	35.0	37.4	38.7
Rural areas	39.3	33.0	31.3	29.4	27.8	26.4

*2010-2021 GDP per capita denominated in USD was calculated using USD1 = AMD305 exchange rate

10. Public Administration and Judicial System Reforms

406. The efficiency of public administration and judicial system, quality of provision and accessibility, transparency, accountability and controllability of relevant services are key preconditions of poverty reduction strategy. As shown by international analyses, public administration and judicial system reforms in a long-term perspective could have a decisive role for poverty reduction process. Thus, according to the World Bank experts, a one standard point improvement of public administration indices in a long-term perspective could result in the growth of per capita incomes from two to three times.¹⁵³

10.1. Public Administration System Reforms

407. Public administration has variety of manifestations and different traces used to assess that system. Therefore, there does not exist general integrated index for the assessment of public administration. Thus, for the assessment of public administration a group of six types of indicators developed by the World Bank and most commonly accepted in international comparisons is used in this SDP.¹⁵⁴ The indicators below, which assess political, economic and institutional aspects of governance, have percentage rating and the higher is that rate so the higher is the assessment of the relevant sector characterizing public administration. Those indicators are:

- (i) Civil society participation in the government formation process, freedom of speech and mass media. This indicator characterizes the real ability of citizens of a given country to elect their government, as well as the level of pluralism, freedom of speech and mass media.
- (ii) In this context, the indicator of political stability measures the likelihood of overthrowing government through unconstitutional ways or by a *coup d'état*.
- (iii) Government effectiveness characterizes the quality of public services, the quality of civil service, the degree of its independence from political pressures, and the ability of the government to develop and implement a policy.
- (iv) Regulatory function quality of the government. This indicator measures the ability of the government to develop and implement policies aimed at supporting and developing the private sector.
- (v) Rule of law shows the extent to which society is governed by the laws adopted by itself. In particular, the performance quality of the judicial system is especially emphasized

¹⁵³ Measuring Governance Using Cross-Country Perceptions Data. D.Kaufmann, A.Kraay, M. Mastruzzi.WB.2005.

¹⁵⁴ See, for instance, WGI 1996-2005: Worldwide Governance Indicators Country Snapshot.WB.2006:

- (vi) Control of corruption characterizes the degree to which the government is corrupt or, in other terms, the extent to which its exercise of power is being guided by private and elite interests.

408. The aforementioned indicators are being measured since 1996 for around 200 countries by 25 international organizations using 31 different types of data sources. The dynamics of indicators measuring the ROA Governance System for 1998-2006 is presented in the Table below. As evident from the Table 10.1 in the recent years main progress is reported for the indicators measuring political stability and government effectiveness (2-4). At the same time, in 2003-2006 indicators measuring control of corruption and rule of law did not show any tangible progress, while the indicators measuring elections, freedom of speech and mass media had some declining tendency as compared to 1998-2000.

Table 10.1: The Indicators of the ROA Governance System (percentage rating, 0-100,1998-2006)

	1998	2000	2002	2003	2004	2005	2006	2007
1. Civil Society Participation in the Process of Government Formation, Freedom of Speech and Mass Media	35.3	37.2	34.8	33.3	30.0	30.4	26.9	30.0
2. Political Stability	22.6	17.9	23.6	28.3	31.6	38.2	35.1	42.3
3. Government Effectiveness	29.7	18.7	45.5	45.5	44.5	49.3	51.2	46.4
4. Regulatory Function Quality of the Government	26.6	28.1	56.7	57.1	53.2	56.9	59.0	60.2
5. Rule of Law	38.0	36.1	35.6	39.4	38.0	41.5	38.1	40.5
6. Control of Corruption	21.6	23.0	32.4	33.8	28.9	33.5	35.0	30.0

409. According to the World Bank assessment, the indicators characterizing the governance system in Armenia are, generally, in a more favorable position than in the CIS countries, while they are significantly lower than respective governance indicators of Eastern Europe and Baltic countries (see Table 10.2).

410. The reforms of public administration system in Armenia were launched later than main macroeconomic reforms (in late 1990s). The prior objective of those reforms was to develop effective governance institutions, to improve provision of public (government) services, management models and mechanisms, to expand decentralization and deconcentration of governance, to develop responsibility, transparency, accountability of civil service, to ensure civil society participation in policy development process.

Table 10.2: The Indicators of Governance System of the CIS and Eastern Europe Countries, 2007 (percentage rating, 0-100)

Countries	Civil Society Participation in the Process of Government Formation, Freedom of Speech and Mass Media	Political Stability	Government Effectiveness	Regulatory Function Quality of the Government	Rule of Law	Control of Corruption
Armenia	30.0	42.3	46.4	60.2	40.5	30.0
Georgia	42.3	23.6	52.1	58.7	42.9	48.3
Azerbaijan	14.9	24.0	28.0	31.1	23.3	11.1
Moldova	36.5	36.1	19.4	42.7	29.5	29.5
Belarus	4.3	52.9	9.0	5.3	12.4	19.3
Tajikistan	10.6	19.2	14.2	15.5	10.5	20.3
Kazakhstan	17.8	57.7	32.7	34.5	23.8	17.4
Kyrgyzstan	28.4	15.4	24.2	37.4	9.0	7.7
CIS average	21.2	32.8	27.4	30.4	21.4	20.6
Czech Republic	77.9	77.4	80.1	80.1	73.8	64.7
Slovakia	77.4	80.3	76.8	81.1	60.5	65.2
Poland	71.6	66.8	67.3	72.3	61.4	61.4
Estonia	82.3	69.7	84.8	92.2	83.8	80.7
Latvia	73.6	70.7	71.1	81.0	65.7	66.2
Slovenia	84.1	84.1	83.4	74.8	75.2	78.3
Romania	61.1	51.4	53.1	66.0	50.5	55.6
Bulgaria	66.3	61.1	59.2	69.9	51.4	53.1
Average for Eastern Europe and Baltic countries	64.0	55.1	62.0	68.1	54.4	56.9

411. Public administration system reforms are implemented in three key directions:

- Structural and functional reforms of public administration system;
- Introduction and development of civil service;
- Reforms of financial management system.

10.1.1. Structural and Functional Reforms of Public Administration System

412. Main reforms of the ROA governance system have been implemented in 2000-2006, when bodies adjunct to the ROA Government and ministries were included into the administrative systems of relevant ministries as agencies, inspectorates, state non-commercial entities, the functions of public administration bodies were clarified, etc.

413. The implementation of the ROA public administration system reforms ensured the following important results:

- A functional analysis was conducted at the public administration bodies that revealed overlapping, redundant functions and functions non-specific to that body;

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- Relevant management entities were created within the public administration and local government bodies. The functions of heads of the entity and the governing body were separated from each other;
 - Agencies and inspectorates with a detached unit status were established within ministries that are specialized in the area of service provision, regulation and implementation of supervisory and inspection functions ;
 - Various advisory committees and councils adjunct to the ministers were established, which came to replace former “collegial” governance bodies;
 - 21 bodies adjunct to the Government were included in the structure of relevant ministries as agencies , inspectorates or structural units;
 - Many institutions of the ministries, operating within the system of bodies adjunct to, the Government were reorganized into state non-commercial entities, with management functions being detached from them;
 - Management structure of ministries was consolidated with secretariats, departments and divisions formed within them;
 - New organization charters of the ministries were approved; they were brought into full compliance to strategic tasks and functions reserved by the laws and other legislative acts.

414. The aforementioned reforms of the public administration system resulted in laying off more than 750 government employees, while the number of ministries was reduced from 21 to 16. Meanwhile, it should be noted that though some progress has been made in the area of reforming the administrative structures, the management capacities are yet to be established. The ministries still lack sufficient capacities to formulate effective policies and the issue of timely and efficient implementation of adopted policies and legislation remains a major problem. This, particularly, relates to the strengthening of strategic planning approach of political and discretionary officials, while for professional administrative staff it is about proposing approaches and methods for the implementation of strategic goals, as well as tactical solutions. Clear delineation of political and professional administrative services within the public administration bodies is the most important component of the public service development policy. Here particular importance should be given to the development and enhancement of the chief of staff institute within ministries and other public administration bodies. The latter will allow to improve strategic planning and to clarify the role of political and discretionary officials in the decision making process. Formulation of a new concept on the chief of staff role and functions will assist the Government in improving further development of the system. Clear delineation of political and administrative services in the public administration bodies sets the task of strengthening the management capacities of chief of staff. The latter is still considered as a position that tackles housekeeping and organizational issues. Besides, though considered heads of administrative entities, current chiefs of staff, do not have a mandate to settle management issues of that institution, particularly, they do not have power to appoint officials directly subordinate

to them. They also lack authority for staff planning and rational distribution and use of resources.

The same also applies to the management of staff's financial funds, tangible assets and procurement. This situation impedes the establishment of professional management principles at the public administration bodies.

415. The system of cooperation between the ministries is not functioning adequately and in many cases it leads to delays in the decision making system. Creation of e-governance, electronic documentation circulation, unified databases and information exchange means will reduce burdensome paperwork, will result in optimization of staffing levels of public servants as well as in their professional development.

416. Despite the views existing in Armenia on the formation of information society, the e-governance is not well advanced. Government bodies in Armenia have taken some steps towards the introduction of e-governance creating, in particular, their websites; however Armenia lacks a unified approach to provision of online services. According to the five-level classification system of the complexity (development) of on-line e-governance systems applied by EU it can be stated that Armenia currently is mainly on the last two levels, i.e. public administration bodies limit themselves merely to providing information or maximum allowing to download necessary documents and forms.¹⁵⁵

417. In this respect the Government of Armenia started to implement a number of measures for introduction of e-governance. For instance, introduction of a new system supporting the electronic documentation flow at the ROA government bodies is envisaged under the Public Sector Modernization Project implemented by the ROA Government with the World Bank credit and aimed to improve the efficiency of the Government decision making and implementation process as well as the effectiveness of the public administration sector. The project has five components:

- The first component has an objective of strengthening the public service management. The pilot program will be implemented at the ROA Government Staff, the ROA Ministry of Finance and Economy and the ROA Ministry Economy. It is expected that the testing will result in drafting a document that outlines all the gaps and issues, which will be explored as a result of introduction and application of this pilot system. Only after the results of this study are available, it will be possible to decide on options and format for future targeted introduction of such systems at other government bodies.

¹⁵⁵ According to the 7th report "Benchmarking the supply of online public services in Europe" developed by Capgemini Consulting Company by request of European Commission in 2007 there are five levels of complexity of providing online services: 1. Only information is provided online. 2. Forms can be downloaded from the internet, however they can be returned only in hard copy. 3. Separate operations can be realized through the internet: to fill in forms, make orders and corresponding payments for them online. 4. Multiple operations can be carried out online: the services are interconnected, the operations between the administration bodies, enterprises and individuals are fully automated. and 5. online services are personalized and completely adjusted to consumer needs (for more detail see : Benchmarking the supply of online public services 7th Report, September 2007, Capgemini, European Commission):

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- The second component objective is the installation of government electronic procurement system both at the central and regional and city of Yerevan levels.
 - Under the third component it is envisaged to strengthen the Supervisory Board through elaboration of audit standards and methodologies as well as developing e-governance capacities.
 - The fourth component has an objective of developing capacities for improved policy development and implementation, which also includes the installation of electronic documentation flow system.
 - The last component envisages capacity development for the local-self governance bodies through introduction of electronic systems for provision of services.

418. Further development of e-governance strongly requires strategic approach and a high level of coordination. The currently existing approach towards introduction of e-governance is not well coordinated and can be costly and lead to repeated investments, whereas the improvement of the process calls for identification of the role of public administration bodies. The approaches presented herein are in line with the problems raised in the Concept of information technologies development elaborated by the RA Ministry of Economy and introduce a number of common directions with regard to e-governance.

419. The following two factors will have an important role in the development of e-governance: **construction of a broadband backbone and development of a compatibility framework**. The construction problems of the required backbone in principle can have two variants of settling:

- The network infrastructure of e-governance can be based on a e-governance backbone specially designed for that purpose, with only public administration bodies being connected to it¹⁵⁶, or
- A national telecommunication backbone is established, within which the Government acquires a certain volume of capacities in order to provide its electronic services and to insure intergovernmental communication.

420. The first approach could ensure a higher reliability and independence of the network, whereas in the second case it would become possible to involve representatives of the private sector. Given the limited public resources the participation of the local IT private sector in the process of developing and providing e-governance services can be viewed as the beneficiary variant. In this respect with the view of e-governance development it is also deemed necessary to develop legal, institutional and regulatory framework for the cooperation of the public and private sectors.

421. Another significant issue is the elaboration of the compatibility framework, which will serve as the basis for providing high quality online services without which

¹⁵⁶ For example, in Hungary a similar system is operating since 2004., All agencies of the central government are connected to it. (See Hungary, OECD e-government studies, 2007)

the elaboration of a unified system and its further development is not possible. The compatibility framework is a system of standards and guidelines, which determines the ways of interaction between organizations. Standards and approaches set in the all-European compatibility program must be taken into consideration when developing the RA compatibility framework.

422. Three main aspects are highlighted in the all-European compatibility framework:

- Organizational compatibility. In this respect compatibility means identification of business objectives, modeling of business processes and cooperation of different administrative units aiming at exchange of information flows and having different internal structures and processes.
- Semantic compatibility. This aspect of compatibility has an objective of ensuring adequate semantic perception of transmitted information by any other program, which initially has not been designed to receive such information.
- Technical compatibility. In this respect the e-governance systems must be technically capable to connect with each other and interact. This aspect of compatibility includes interaction environment, interconnection of services, presenting and exchanging information, accessibility and security.

423. The development of RA compatibility framework unambiguously requires existence of strong and efficient institutional basis. Thus, the establishment of the Integration Competency Center can have a significant role in terms of proper organization of works aimed at coordinated development of e-governance programs and services. Besides establishing such a unit, which will carry out coordination of the technical part of the development of e-governance system, it is also important to focus on the problem of developing a unified and commonly accepted policy and strategy of e-governance in Armenia.

424. in the context of reforms in the public administration sector further development of e-governance must promote savings, as the new system of providing services not only alters the way of servicing, but also the processes that are part of its contents and therefore the units involving in the e-governance system must carry out reengineering of operating business processes. Unified information centers and technological platforms must in a mandatory way exclude double investments and impact on most efficient implementation of programmatic developments by different parts of the government. At the same time currently even the basic technical infrastructures for e-governance system in Armenia are not on a sufficient level: telecommunication network of the government, government's unified portal and the user identification point (entrance point for visitors using electronic services of the government), and the mentioned problems must be settled urgently.

425. in the initial target group of RA e-governance services 20 public services subject to benchmarking on national levels in EU member states and in a number of other countries could be chosen. The essence of benchmarking is determination of complexity (proficiency) level of the given online service based on the abovementioned 5 levels. These 20 services are formed on the basis of citizens' "case-studies/life situations" and "business episodes" of businesses, for which e-governance services are rendered.

426. Within the framework of Sustainable Development Program it is envisaged that already in 2012 Armenia will reach EU average indicators with respect to development level of e-governance services provided to business sector, and as far as the citizens are concerned this process will last longer. It is expected that by the end of 2010 the GoA will develop a comprehensive program aimed at ensuring the mentioned level of e-governance services, which will comprise a detailed action plan, estimations of required investments and a corresponding supervision framework. At the same time the expenditures of e-governance maintenance and development must be included in the budget framework and have the corresponding reflection in 2010-2012 Medium Term Expenditure Frameworks. Besides it is also essential to carry out analysis of total incomes and expenses necessary for achieving the set goals for each separate service, which will allow determining a resource distribution priority program.

427. It should be emphasized that the expanding of e-governance services and raising their quality should not be an aim in itself. In particular it is important to assess the demand level of citizens and/or business circles for each of e-governance online services, especially taking into consideration the problems faced by certain population groups with respect to accessibility of computers and internet (e.g. mainly persons from socially vulnerable population groups are going to make use of social security services). It is supposed that the GoA will continue its efforts aimed at ensuring accessibility of internet and raising computer literacy level of the population; at the same time expanding e-governance services in its turn can motivate the usage of internet and computers.

428. And at last, expanding of e-governance services can become a reliable tool in ensuring transparency of public administration bodies' activities and reduce corruption risks. The experience of new member of the EU comes to prove that introduction of electronic systems and reducing direct, personalized communication between civil servants and private sector have a positive impact in terms of fighting against corruption.

Table 10.3. Public E-Services Subjected to Benchmarking by EU and ensuring them in Armenia by 2021

	Type of Public Service ¹⁵⁷	Maximum Complexity level of the Service	EU average indicator «Ø ÛÇÇÝ óáóó³ÝÇßÁ in 2007 ¹⁵⁸ (% of maximum level)	Armenia				
				2008	2012	2015	2018	2021
	For Citizens*							
1	Income Tax	5	90	1	3	4	4	5
2	Job Seeking services	4	97	1	3	4	4	4
3	Social Security	5	72	1	3	4	4	5
4	Personal Documents (passport, driving license)	5	47	-	2	3	4	5
5	Registering a car	4	70	-	2	3	4	4
6	Construction permit	4	50	1	3	4	4	4
7	Police announcement	3	77	-	1	2	3	3
8	Public Libraries	5	76	1	3	4	5	5
9	Certificates	4	63	1	3	4	4	4
10	Entering Higher Education Institution	4	75	1	3	3	4	4
11	Announcing changed address	4	62	-	3	4	4	4
12	Healthcare services	4	45	-	2	3	4	4
	For business							
13	Social payments of employees	4	95	1	4	4	4	4
14	Profit Tax	4	94	2	4	4	4	4
15	VAT	4	96	2	4	4	4	4
16	Registering a new company	4	79	1	4	4	4	4
17	Submitting data to statistics service	5	85	1	4	5	5	5
18	Customs declaration	4	95	2	4	4	4	4
19	Permissions regarding environmental issues	5	50	1	2	3	4	4
20	Public purchases	4	82	1	4	4	4	4

* The timeline and purposes for RA e-governance services for citizens can undergo changes based on the results of detailed analysis to be held within the framework of the program.

429. In September 2007 an inter-ministerial working group chaired by the ROA Minister of Trade and Economic Development was established by the ROA President Decree No. NK-113-A dated July 3, 2007, assigned to submit by the end of the year a new draft concept paper on development of information technologies, which would also include the introduction of electronic governance system in Armenia.

¹⁵⁷ For detailed description of mentioned services see report: Benchmarking the supply of online public services 7th Report, September 2007, Capgemini, European Commission

¹⁵⁸ Besides 27 EU countries average indicator also includes corresponding indicators of Turkey, Norway, Island and Switzerland.

430. Currently, a number of pilot projects have been initiated to this effect, specifically, designing and building of internet networks in some regions (marzes), implementation of distant learning programs for children of remote (bordering) villages through use of those networks and with support of specialists from schools in Yerevan or marz centers, provision of medical consultancy and services.

431. Since 2001 in 10 marzes and starting from 2003 in 12 towns of Armenia elements of e-governance have been introduced through the support of the UNDP “Support to IT Society and Democratic Governance Development”, internet centers and a regional administration system has been established (www.region.am). As a result, the availability and information exchange ease has increased. It is planned for 2009 to introduce the e-systems of regional administration in 219 communities. Besides, in 2009 it is envisaged to establish local networks in 84 self-governance bodies, It planned to implement activities aimed at establishment of a unified information network for the communities and undertake measure aimed at capacity enhancement (including training of the staff).

432. In the coming years the communication between the Government staff and the ministries will be enhanced for better and more distinct coordination and systematization of functions. Specifically, the relation between the SDP and other strategies of the ROA Government, the functions of the Government staff and ministries will be clarified by using a standard evaluation approach to policy development and policy assessment at those bodies. The ROA Government supervision over strategic programs will be strengthened by establishing a project management/performance control unit within the Government, which will be accountable to the Prime Minister, will submit progress report on the implementation of set objectives and will monitor the process of performance improvement at the governance bodies. Some of those functions are currently carried out by the ROA Public Sector Reform Commission, the PRSP Secretariat, the ROA Ministry of Finance and the ROA Ministry of Economy. These functions will be transferred to the relevant unit of the Government staff. The presence of such supervision at the central government level will be necessary to implement continuous and sustainable reforms of the public governance sector. Criteria for assessment of service provision process and quality improvement of service provision will be introduced at ministries and departments. The ministers will be required to submit annual reports of conducted assessments and undertaken improvement measures.

433. Enhancing publicity and transparency of operation of public administration bodies, ensuring civil society participation in decision making processes. The development of systems for increased governance effectiveness, transparency and accountability at different levels of public administration has been enhanced by the adoption of the ROA Law “On Freedom of Information”. The Government policy in 2004-2006 was aimed at the introduction of main provisions of the new Law on information freedom and the establishment and capacity development of relevant structural units within the government bodies that ensure processing and dissemination of information. Some positive trends of public participation development were noted in Armenia in the recent years. Public participation in the public governance process

encourages creation of professional, advisory boards adjunct to different governance bodies, where representatives of civil society – specifically, non-governmental organizations – are involved. To this end, the current challenge is to locate experience accumulated in the process of developing the PRSP (SDP) and anti-corruption program at the level of ministries, regional governments and local self-governance bodies. Strengthening of NGOs as well as promotion of cooperation between the civil society and public administration bodies also serve the purpose of ensuring success of public participation process. Another positive precedent is the ROA President decree “On Approval of Procedure for Allocating Funds from the State Budget as Grants to Non-Governmental Organizations” dated May 13, 2005 that creates opportunities for development of a participatory process culture.

434. Institutional foundations of the SDP monitoring and evaluation system will be laid down at the ROA public governance bodies providing opportunities for participatory monitoring and leading to a more complete implementation of accountability, transparency and publicity principles of government functioning.

435. Key principles of decentralization and deconcentration, strengthening of local self-governance, more comprehensive inclusion of regional development specifics into the strategic national programs were used as a basis for reforms of territorial administration and local self-governance.

436. In 2002-2006 international organizations supported designing of prospective regional development plans for a number of marzes in Armenia (Tavush, Gegharqunik, Ararat, Vayots Dzor, Syunik). In contrast to other programs, these plans had one specific feature, i.e. the donor organizations also supported the implementation of program provisions ensuring, to this effect, appropriate financial injections into the ROA State Budget. Comprehensive regional development plans for Gegharqunik and Tavush were designed based on the PRSP priorities, principles and structure taking into account region-specific features. Participatory process (non-governmental organizations, community representatives, independent experts, etc.) – one of the important priorities of territorial administration and local self-governance development – was widely used during the preparation and implementation of plans. Monitoring and evaluation process (including participatory monitoring) – a foundational principle of program management – was also introduced in the aforementioned marzes. Taking into account the experience of Tavush and Gegharqunik accumulated in the three years of project development and implementation the government will take measures to apply the institutional system formed here in other marzes as well. This will allow to achieve the objectives mentioned in paragraph 302 in a more systematized, justified and comprehensive manner. Within the framework of comprehensive regional development project through the local societies, local government bodies, regional authorities as well as the Ministry of Territorial Administration, the cooperation with the government of ROA will allow to define the field priorities in a more adequate manner, to involve additional financial, technical and professional recourses based on project requirements both from the state budget and from international and donor organizations, to ensure transparency of

undertaken activities and funds spent, to evaluate them with the monitoring system, as well as to involve wider circles of regional society in planning and implementation tasks. The participatory and transparent nature of the project will be ensured through structures established within institutional system, i.e. regional development committees operating within regional councils, field task groups as well as the system having ordered and distinct criteria of participation of the civic society in regional development planning process (regional NGO networks with their representatives mandated to present the views and advocate the interests of the population as members of regional development committees and field working groups). At the same time it is essential to ensure an equal representation both of regional authorities and the civic society in the above mentioned structures.

437. Taking into account the experience of medium-term comprehensive marz development plans as well as guided by the principles of governance decentralization and even development of marzes, the Government has designed a regional development concept, which includes the following fundamental provisions:

- (i) Main priorities and directions for regional development should be reflected in the medium-term comprehensive regional development plans, which will be prepared by the regional governments and approved by the ROA Government.
- (ii) The main objective of the Regional Development Plans (RDP) is to ensure the implementation of development priorities set by the PRSP and other strategic programs of the Government; taking into account region-specific features.
- (iii) Preparation and implementation of the RDPs should be done with active participation of the civil society.
- (iv) The RDPs shall go through periodic reviews connected, first of all, to review and approval of the SDP and other strategic programs of the Government as well as based on different circumstances arising in the process of the RDP implementation and explored by the monitoring and evaluation activity.
- (v) During preparation and implementation of the RDPs, the role of regional councils will increase and appropriate capacities to coordinate and manage the entire process will be created at the regional governments.
- (vi) Based on the RDPs drafted with a uniform methodology, the priorities of the Government regional policy will be clarified and set forth, which will, first of all, target the alleviation of human and income poverty and the mitigation of inequalities in regional development.

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- (vii) Regional structure of capital expenditures made by the Government for social infrastructures will target, first of all, the reduction of human poverty level with a priority given to poorer marzes.¹⁵⁹
- (viii) To reduce income poverty and to mitigate inequalities in economic development of marzes the Government:
- will allocate funds to study the economic potential of every marz;
 - most likely, will support the preparation of development plans for priority sectors in marzes and the presentation of these plans to local and foreign investors and entrepreneurs;
 - will make some investments into the regional infrastructures (also in cooperation with private sector) to significantly improve conditions necessary for business development
 - in certain cases will provide direct and indirect financial support to entrepreneurs in the poorest marzes and regions (especially, in high mountainous and bordering areas) for launching business.

438. The aforementioned priorities and activities will have a decisive role when the supreme board for development of medium-term expenditure frameworks makes a decision on intersector and, specifically, regional allocation proportions for the surplus of budget resources. Generally, in the coming years, plans and priorities formulated by the marzes using a uniform methodology as well as the Government territorial policy will have a more significant role in the process of designing strategic plans for country development.

439. An important task of the public administration system is to strengthen capacities of the local self-governance bodies. The new ROA Law “On Local Self-Governance” has improved and added functions and powers of the local self-governance bodies. However, a poor level of administrative capacities and administrative fragmentation in communities reduce the operational efficiency of local self-governance bodies in applying new mandatory and delegated powers. In this respect, consolidation of communities and creation of intercommunity unions, strengthening of management capacities in large rural communities, provision of workstations with modern hardware and communication means is important.

440. The following reforms are also required in the area of local self-governance:

- (i) Adoption of legislative acts on implementation of mandatory powers of communities, which:

¹⁵⁹ The assessment of the human poverty level will be based on the integrated human poverty index of the RDPs calculated by a uniform methodology.

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- Will set forth procedures, norms and criteria for implementation of mandatory powers;
 - Based on the procedure and norms for implementation of mandatory powers, will clarify and establish the least amount of financing required for exercising mandatory powers;
 - Based on the criteria, will provide an opportunity to carry out the internal (community council, community members) and external supervision over implementation of mandatory powers.
- (ii) Setting of procedure and financing mechanisms for implementation of powers delegated to the communities by the Government, which will clarify the implementation functions for delegated powers and the amount of financing required to carry out the delegated powers. Once the legislation defining the procedure for carrying out mandatory powers is in place, it will be possible to enforce the Article 67¹⁶⁰ of the Law “On the Local Self-Governance”, which is a fundamental provision of the European Charter on Self-Governance.

441. The Government wants to improve the financial equalization system in place to take into account not only per capita income capability of the community, but also its expenditure needs. As a result, there will be a more targeted distribution of equalization amounts and financial flows will be mainly directed to the poorest communities.

442. As a result of the aforementioned reforms, the local self-governance bodies will start to carry out many of the powers that currently are not exercised, administrative expenses will significantly reduce, the efficiency of the local self-governance system and the availability and quality of provided services will increase, new preconditions will be created for the supervision carried out by the community council and public, the efficiency of implemented powers and use of financial resources will increase.

10.1.2.Introduction and Development of Civil Service

443. Since 2001 the civil service and relevant professional services were introduced into the ministries, territorial administration bodies as well as local self-governance bodies providing an opportunity to separate political, discretionary and service positions and to recognize the chief of staff as the senior civil servant among professional civil servants. According to the requirements of the ROA Law “On the Civil Service”, all positions of the civil service were classified and provided with descriptions.

¹⁶⁰ Article 67: Any curtail of community budget revenues and increase of expenditures under the legislation adopted by the National Assembly shall be compensated by the State, except the cases of terminating the obligations for tax revenues (except the cases of tax exemption and tax abolishment) by the Law and other cases defined by the Law.

ARTICLE 84. item 12.

Provisions of the Article 67 on the community budget expenditures come into force on the second year after the law defining the procedure for implementation of mandatory powers has become effective.

444. The adoption of the civil service law and related secondary legislation are only the first steps towards the establishment of a professional civil service. The human resource management information system is yet to be developed and staff management capacities in the ministries remain weak. This limits the Civil Service Council's ability to efficiently enforce the Law on Civil Service and impedes the establishment of professional merit-based civil service. In the last 5 years, the civil service system in Armenia is going through a very active development process and a pilot period of establishment and introduction. In parallel to the growth of civil servants' professional knowledge and skills, a progress is made through the relevant attestation system as well as open competitions conducted for vacant positions. It presupposes a mandatory training once every three years. A pay scale is developed on the basis of position groups and subgroups, which is linked to professional skills and length of service. At the same time, the issues of social protection of civil servants – pension, life and medical insurance, other social security issues – are not completed yet.

445. The government policy for improvement of civil service effectiveness is aimed at development of main principles of newly created civil service. Specifically, the improvements of legal framework, the appointment to vacant positions on a competitive basis and the establishment of staff management units in governance bodies are defined as a preliminary phase. The development of relevant legislation for other types of service and the establishment of those systems raises the issue of reviewing the concept of civil service and public service, in general. Now, it is necessary to harmonize those services and create a link for moving from one type of service to another. This situation requires development of legislation on public service providing uniform principles of public service. In this context, it is necessary to have a full description of the public service system, where the requirements for political and discretionary officials are also set forth.

446. To this effect, it is planned to adopt the ROA Law “On Public [State] Service”, which will complete the legal framework in this area. This regulation will provide an opportunity to have a list of officials clearly classified by type and group of service with respective titles of positions. Professional positions will be linked to the content of implemented work and their titles will be brought into compliance to the nature of implemented work. Administrative positions will be separated from professional positions providing an opportunity to develop a differentiated staff management policy.

447. The remuneration and promotion system for public servants has crucial role in the context of efficient reforms of public administration system and successful implementation of anti-corruption strategy. The salaries of civil servants are now noncompetitive compared to those of private sector, which leads to a drain of highly qualified specialists into the private sector. The civil servants' pay system and pay level do not help to retain the qualified personnel, despite certain salary increases. Taking this fact into consideration, the official salaries of civil servants will increase during the entire SDP period with rates higher than the average for economy in general (see Table 10.4).

Table 10.4: Average Monthly Salaries for Employees of Public Administration System in 2007-2021 (AMD '000)

	2007	2008	2009	2010	2011	2012	2015	2018	2021
Employees of public administration bodies, of which	114.9	127.5	144.0	162.8	184.0	207.8	300.0	432.8	624.5
Civil servants	104.9	127.9	144.5	163.3	184.5	208.5	300.1	434.1	626.5

448. In the same time, it is important to provide civil servants with some social protection guarantees. To this end, relevant laws for pension and medical insurance of public servants will be developed and adopted in the coming years.

449. Another important direction for improvement of the civil service efficiency is introduction of the civil servant code of ethics. The code of ethics for civil servants currently approved by the Civil Service Council will be enhanced and brought into compliance to the unified code of ethics for public servants of the European Union.

450. Another direction for the establishment of the civil service system is the development of a training system. Though new programs and potential for the civil servants' training are in place, the implemented training policy is still passive. Approval of a new concept for training, liberalization of training and liberation from administrative regulations will provide an opportunity to replenish the civil service with knowledgeable personnel and motivate the staff to receive professional training.

451. As it was noted, the attestation process in the civil service system is exactly the same as the process of admission into the system. This does not encourage civil servants to mobilize their capacities to carry out tasks assigned to them. There is no direct link between the work assignment of civil servants, job description and material and moral incentives. This is directly related to the absence of a performance assessment system; its introduction would provide an opportunity to link performance results to remuneration and promotion systems.

452. In general, the abovementioned issues similarly apply to other types of public service (tax, customs, diplomatic, police, community service, etc.), because their activities are also regulated by main principles of civil service.

10.1.3. Financial Management System Reforms

453. In 2002-2006 the ROA Government has implemented major reforms of the public finance management system. The most significant of them was transition to the medium-term programming of public expenditures. Since 2003 the Medium-Term Expenditure Framework (MTEF) has been an integral part of budgeting process under the Law. This has provided an opportunity to have more predictable and realistic public medium-term strategic programs and assign to them specific financial resources. The capacities and independence of line ministries and departments in developing and implementing medium-term strategic programs have also improved. By reflecting the main principles and priorities of the PRSP, the MTEF became the main source to finance

its implementation by significantly increasing, on the one hand, the feasibility of the PRSP implementation and by ensuring, on the other hand, the consistency of medium- and long-term strategic programs of the Government.

454. The other important direction for reforms of the public finance management system relates to the process of introducing an output-based or program budgeting system. To this end, the first steps were undertaken in 2004-2006, which led to the following results:

- budgets and medium-term expenditure framework proposals of four selected ministries (Education and Science, Health, Labor and Social Issues, Culture) are submitted in a new, programmatic budgeting format;
- internal and external reports of those ministries are also submitted in a new format that, in particular, consolidates financial and non-financial output indicators of their activities;
- necessary capacities for budget preparation and execution on the basis of programmatic budgeting principles were established at those ministries;
- ten additional ministries and departments were included into the aforementioned process in 2007 and since 2008 involved also all other ministries and state agencies.
- In 2010-2011 the ROA Government will complete a full transition to the ROA State Budget preparation and execution by programmatic budgeting principles, which will create an opportunity to make more targeted and addressed budget allocations, to increase the spending efficiency of financial resources by expanding, specifically, the independence and flexibility of line ministries in the process of budget execution reserved to them by the Law. To achieve this objective, a special attention will be paid to the introduction of a system of program output indicators as well as the establishment of monitoring, evaluation and internal audit functions in ministries and departments. Advanced budgeting methods will be introduced also on regional level (programmatic budgeting or output-based budgeting).

455. The new constitution adopted in 2005 has further increased the sovereignty and independence of the ROA Chamber of Control as the supreme auditing body. Related relevant amendments have been stipulated in the new law on the ROA Chamber of Control. To this end, the segregation of internal and external audit functions, especially those of the ROA Chamber of Control and supervisory services of the ROA President and the ROA Prime Minister will be further clarified.

456. During 2007 the ROA Government with the assistance of World Bank drafted the law “On Internal Audit”, which is planned for discussion and adoption by the ROA National Assembly in 2008. the law will enter into force in January 2009. Meanwhile ROA government supported by World Bank will carry out the following activities:

- Developing of criteria (standards) for internal audit. Development and clarification of the criteria/standards of public sector internal audit, including the framework of

comprehensive professional activities, as well as rules of conduct that will be based on corresponding international standards.

- Developing a manual on internal audit, including sample documents necessary for the procedures (audit plan, sample forms of working documents, sample forms of reports, etc.)
- Developing training, teaching and certification plans for internal auditors, as well as preparation of examination tests for certification. The manual must be developed on the basis of the “Strategy for introducing teaching, continuous training and qualification system for public finance management system specialists”, which was developed with the assistance of the World Bank and will be approved by the ROA government in 2008.

457. The second generation reforms of the ROA Treasury System were launched in 2003-2006 having as the key objective a transformation of the accounting system deployed in the public sector since the Soviet era into a system that complies to the international public sector accounting standards, which should be consistent and compatible with the Government Financial Statistics (GFS 2001) standards approved by the International Monetary Fund and accounting standards used in the ROA private sector. During this period the ROA Government has approved the ROA public sector accounting system and the third generation treasury reform program (2003), has developed and approved new budgetary and accounting classifications and guidelines for their application, the action plan for introduction of financial reporting standards, identified the ROA Government units (including state non-commercial entities and organizations with state participation) subject to inclusion into the ROA consolidated reports. There were organized and conducted many training programs that resulted in strengthening of budget institution and community capacities needed to prepare and execute their 2008 budgets in accordance with the new classifications.

458. After the adoption of ROA Law “On State Non-Commercial Organizations”, a significant group of entities of the social sector reorganized into state non-commercial organizations. Currently the latter are main service delivering organizations in the social sector and the quality of services delivered by them has a significant impact on the effectiveness of activities aimed at poverty reduction. Taking into account this circumstance the efficiency of performance of state non-commercial organizations is of special importance for the government of ROA. In the given circumstances the government of Road finds highly important to increase the effectiveness of management and performance of state non-commercial organizations and, being the holder of founding and public assets of these organizations will take necessary measures to increase their performance accountability and introduce a monitoring system. The principles of ensuring independence of state non-commercial organizations together with free competition in that spheres will continue to remain the basis of the reforms as their main priorities.

459. The ROA Government, with the assistance of the World Bank, has also launched the implementation of works aimed at development of legal and institutional frameworks relevant for the adoption of accrual-based international public sector accounting standards (IPSAS) as well as designing of the Government financial management information system. The works in the aforementioned priority directions will be completed in 2009-2010.

460. Despite the efficient reforms undertaken in the state financial system in the recent years in some directions the reforms are speedier than in other sub sectors. In other words, improving coordination and evenness of reforms of this sector is of top priority. To this end within a year the government will develop a comprehensive strategic program for public finance management and a corresponding action plan aimed at its implementation.

461. Increasing Taxes/GDP Ratio. An annual 0.5 percentage point increase of tax and duty collections against the GDP was envisaged by the PRSP. Despite some measures aimed at development of tax and customs administration, the GDP/Taxes ratio in 2003-2006 remained almost unchanged. Taking into account this fact and the importance of increasing tax and duty collections as the main source for financing of budget expenditures and, consequently, the SDP activities, the Government is aiming to significantly improve this ratio in the coming years. Thus, it is planned to increase the GDP/Taxes ratio by 0.6 percentage points in 2007, by 1.6 percentage points against the GDP in 2008, and then by annual average of 0.3-0.4 percentage points during the entire planned period.

462. To achieve this objective, the Government is planning to implement the following main reforms and activities in the coming years:¹⁶¹

- (i) correct and timely taxation of large companies/large-scale business.
- (ii) defining an efficient tax burden for the small business through implementation of mild tax administration
- (iii) introduction and development of a system of voluntary exercise of tax obligations (self-assessment system)
- (iv) adoption of new tax policies
- (v) improvement of tax administration legislation, including simplification and clarification of tax legislation provisions and establishment of a unified tax system;
- (vi) development and introduction of mechanisms for the VAT assessment in agriculture;

¹⁶¹ See the ROA Government Decree N 941-N 07.08.2008 "On the Approval of the 2008-20011 Development Plan for the Tax System of the Republic of Armenia" dated May 24, 2007.

463. To ensure the increase in the GDP/taxes ratio and the process of tax administration development, the Government will carry on modernization and capacity enhancement of tax and customs bodies in the following main directions:

- Restructuring of tax and customs bodies and increase of efficiency of administration;
- improvement of logistics;
- installation of modern information technologies;
- deployment of modern policies for human resource management.
- overcoming cases of corruption in tax and customs bodies,

10.1.4. Main Target Indicators of the ROA Governance System Development

464. Taking into account planned developments of the governance system as well as the judicial system reforms and the anti-corruption strategy, the Government is planning that the indicators characterizing the ROA governance system will surpass the 2006 level of the Eastern Europe and Baltic countries already by 2012 and by 2021 they will reach the level of indicators characterizing governance system of the Western Europe countries in 2006 (see Table 10.5). Primary importance, particularly, will be given to a further democratization of governance process, securing the rule of law and anti-corruption measures. It should be noted that the aforementioned policy of governance system reforms is fully consistent with the main principles of the euro-integration process of Armenia.

Table 10.5: Planned Indicators for the ROA Governance System, (percentage rating, 0-100, 2006 - 2021)

Indicators	2006 (actual)	2007 (actual)	2010	2012	2015	2018	2021
1. Civil Society Participation in the Process of Government Formation, the Freedom of Speech and Mass Media	26.9	30.0	50.0	65.3	72.0	80.1	90.6
2. Political Stability	35.1	42.3	51.2	56.6	62.0	69.0	76.4
3. Government Effectiveness	51.2	46.4	58.1	63.1	71.5	81.6	90.0
4. Regulatory Function Quality of the Government	59.0	60.2	67.8	71.7	77.0	81.4	89.6
5. Rule of Law	38.1	40.5	45.1	51.3	63.4	78.7	90.0
6. Control of Corruption	35.0	30.0	47.1	55.3	68.9	79.3	90.2

10.2. Judicial System Reforms

465. Reforms targeting the development of more efficient and accessible judicial system stipulated by the PRSP continued in 2003-2006 and their main objective was to ensure the legal and social guarantees of the justice system, the accessibility of justice and protection of human rights and fundamental freedoms in that area as well as the increase of legal practice efficiency.

466. Implementation of constitutional reforms was an integral part of Armenia's commitments for accession to the Council of Europe, which were aimed, *inter alia*, at the establishment of an independent and efficiently functioning judicial system in the country. Constitutional amendments adopted by the referendum in 2005 have stipulated the establishment of the General Assembly of Judges as the supreme self-governance body of judicial authority as well as the development of new procedures for composition of the Council of Justice, which excluded the representation of the executive authority in the Council and significantly reduced the influence over appointments to judicial positions and initiations of disciplinary penalty proceedings.

467. The status of the Cassation Court was also clarified and it was declared the highest judicial instance of the Republic of Armenia (with the exception of constitutional justice matters) called to ensure the uniform application of law.

468. Pursuant to these developments, the ROA Government launched the second phase of judicial reforms; its concept is based on the principles of increasing the independence of judicial authority, introducing the ideas of autonomy and self-governance of judicial authority, financial independence of judicial authority, separating functions of judicial practice and court administration. Such concept of judicial reforms was also resulting from the requirements of the EU - Armenia ENP action plan.

469. In July 2006 the National Assembly has adopted the first package of legal initiatives for the 2nd phase of judicial reforms. It, specifically, includes the ROA Law "On Judicial Service", which stipulates the transfer of management and administration functions of the entire system to a newly created Judicial Department.

470. On February 22, 2007 the National Assembly has adopted a comprehensive legal document - the ROA Judicial Code – supplementing judicial system reforms, which includes the aforementioned conceptual provisions and the requirements of many sector related international agreements, defines self-governance bodies of the judicial authority, clarifies the mandate of the Council of Justice, envisages the establishment of separate administrative courts, specialized first instance criminal and civil courts and a court marshal service, regulates human resource policy issues of judicial bodies, stipulates the basic code of ethics for judges and prescribes the procedures for disciplinary sanctioning of judges. Besides, a Judicial Training School will be established to provide qualified specialists to the judicial system and to organize continuous education for judges.

471. The new Judicial Code adopted on February 22, 2007 stipulates the establishment of a new system of the first instance courts, which, alongside of the first instance courts of general jurisdiction, also includes specialized first instance courts, i.e., administrative, civil and criminal courts that have already been established in 2007. The need for establishment of the administrative court is also included in the Action Plan of the EU-Armenia European Neighborhood Policy (Primary Area 1, item 8).

472. The new Codes for Criminal, Civil, and Administrative Courts have been developed in line with the revised Constitution.

473. A revision of constitutional provisions related to the Constitutional Court and a radical expansion of circle of people eligible to apply to and disputes settled by the Constitutional Court were carried out under constitutional reforms. The ROA Law “On Constitutional Court” was developed and on July 1, 2006 adopted by the RA National Assembly to further detail the constitutional provisions.

474. The ROA Law “On the Office of Public Prosecutor” developed under judicial system reforms and adopted by the National Assembly on February 22, 2007 was another major legal document. In compliance to requirements of a number of international documents and modern approaches of developed countries to organization and functioning of the Prosecutor’s offices, the Law introduced a new concept that eliminated the over-centralization in the prosecutorial system, prohibited case investigations by the prosecutor’s office, reserving to the latter the right to oversee the legality of inquest and investigation, introduced a principle based on which the same prosecutor should be responsible for a criminal case proceedings from the beginning of its investigation to the end of court trial. Another achievement of the Law was the introduction of proportionate official salaries for judges and prosecutors. In the same time, a number of introduced provisions prohibited any interferences of the prosecutor’s office in the private sector, the initiation of planned inspections without any complaints, etc. Besides, a number of restrictions on prosecutor’s activities, a procedure for competitive appointments and a more warranted career development system were introduced to minimize corruption opportunities.

475. The Law “On Advocacy” was developed and adopted on February 14, 2004 by the National Assembly to guarantee the exercise of constitutional right for free legal assistance. The Law stipulates provision of state guaranteed legal assistance guaranteed for criminal cases as well as specific categories of civil cases. The Law has introduced the office of public defender to provide free of charge legal assistance. To promote the activities of those defenders and to equip the staff with appropriate specialists the pay for the latter was leveled with the pay of prosecutors.

476. The ROA Judicial Code stipulated the requirement to publish legal acts defining that the judicial authority shall have an official website and prescribing mandatory publication of key judicial acts of the Cassation Court both in the “Official Bulletin of the Republic of Armenia” and on the official website of the judicial authority. Meanwhile, the procedure for publication of judicial acts of courts of other instances on the official website of the ROA judiciary will be determined by the Council of Court Chairmen.

477. For more efficient implementation of justice, the National Assembly developed and on June 1, 2006 approved the Laws “On Amendments in the Civil Procedural Code”, “On Amendments in the ROA Law on Advocacy”, “On Amendments in the ROA Law

on Court Composition”, which abolished the institute of specially licensed lawyers required for appealing an officially enacted court decision using cassation procedure.

478. The National Assembly developed and on July 7, 2006 approved the ROA Laws “On Amendments and Addenda in the Criminal Procedural Code”, “On Amendments and Addenda in the Civil Procedural Code” stipulating the cassation appeal deadlines, reasons to take the appeal into proceedings by the court, the decisions made by the Cassation Court as a result of reconsidering the judicial acts; it was established that the decision of the Cassation Court shall be justified, shall ensure proper interpretation of the Law and promote the development of justice.

479. To promote more efficient implementation of justice, on February 22, 2007 the ROA National Assembly has also adopted the ROA Law “On Amendments and Addenda in the Criminal Procedural Code of the Republic of Armenia” that regulates the issues related to impermissibility of reconviction and repeated prosecution, closing of cases for specific types of offenses in the event of a settlement between the victim and the suspect (accused) or defendant, and application of an expedited procedure for court trial.

480. In 2005 the National Assembly has developed and adopted the ROA Laws “On Amendments in the Criminal Procedural Code” and “On Amendments in the Civil Procedural Code” for installation of court digital recording system; there was approved the procedure for operation, data archiving and maintenance of the “SRS Femida” special digital recording system.

481. In the first half of 2005 the US “DPK Consulting” company has implemented a consulting project on improvements of caseloads and court administration in the three courts of Yerevan to introduce a modern court administration system. The development of software for automation of court administration and case management was launched in the second half of 2005.

482. The PRSP has underlined the importance of strengthening material and technical base and appropriate staffing of testing centers, improving their social protection and accessibility of services to increase judicial protection of individuals. These activities were not implemented due to the lack of funding.

483. The ROA Law “On Commercial Arbitration” was developed to provide appropriate mechanisms for alternative dispute resolution that comply with international standards; it was adopted by the National Assembly on December 25, 2006. The Law is corresponding to the requirements of the Primary Sector 5 in the EU-Armenia ENP Action Plan and based on the terms and principles of the UNICTRAL model law.

484. To overcome legal inconsistencies and uncertainties, the PRSP found appropriate to have a permanently operating legal expertise process (independently from the Government authorized body) that will review both existing and proposed legal acts. The issue is regulated by the ROA Law “On Legal Acts” where the item 8 in the Article

31 envisages a possibility for other public bodies, legal entities and natural persons to provide conclusions (including expert opinion) on compliance of a proposed draft to the legal acts, independently from the government legal expertise of draft legal acts.

485. Under poverty alleviation priorities special importance is attached to **increasing the level of public participation** in the decision making process, underlining the necessity for public awareness and knowledge, social partnership, social inclusion and social participation . These issues are milestones for legal expertise of legislative acts as well as the process of developing draft laws.

486. Measures to expand cooperation with population through the application of modern information technologies, including electronic governance systems are being implemented under the Judicial Reforms credit project aiming to enhance public control procedures over the ROA Government bodies and ensure efficient cooperation with large segments of population. Specifically, the Armenian legal information search system “ARLIS” available at www.arlis.am www.laws.am www.legislation.am and on CDs as well as the website of the Ministry of Justice (www.justice.am) were launched in December 2005.

487. Since 2005 the most important draft laws are published on the website of the Ministry of Justice for public discussions to increase public access to legal acts and draft documents as well as receive relevant feedback from the public. All opinions received are discussed and also placed on the website. The framework of those activities is being expanded to ensure efficient cooperation with the ROA Government bodies and large segments of population. Production of “My Right” television show was ordered in 2005-2006 to raise public awareness and knowledge of legal issues and it was broadcast on the Public Television of Armenia.

10.2.1. Main Areas for Implementation of Judicial System Reforms

488. **Further expansion of structures for free legal assistance.** The public defender office was incepted in Armenia in 2006 and legislative amendments resulted in provision of free legal assistance for criminal cases as well as some categories of civil cases, including alimony collection, compensation for disability or other damages caused to health as well as compensation of losses caused by the death of breadwinner. It is expected to expand the range of free legal assistance provided by the state financed lawyers, taking into account the needs of socially vulnerable groups of population. Thus, if at the first stage legal assistance was provided for certain categories of civil cases, at the second stage its expansion for specific categories of subjects is envisaged. It is planned to simplify documentary justification required to obtain free legal assistance as much as possible. The enhancement of free legal assistance structures is considered as a priority in the Action Plan of the EU-Armenia European Neighborhood Policy (Primary Area 1, item 7), which stresses the importance of improving legal and, specifically, free legal assistance system through enhancing and strengthening lawyers’ system. In 2008 the corresponding project “Access to Justice” funded by the European Commission will be

launched, within the framework of which the “Bar Association” and “Judicial training school” will receive assistance.

489. **Significant salary increase for judges.** In the sector related international documents there is a univocal approach that the judiciary salaries should correspond to the mission of a judge; i.e., society, on the one hand, using salary increase as a way of reducing corruption risks, on the other hand and first and foremost, shows its respect to judge’s position. It is well known that value of a position in any society is judged by the salary. High remuneration speaks about the high esteem that society has for judges and it gives an opportunity to the judge to feel rather free from different pressures.

490. The Action Plan of the EU-Armenia European Neighborhood Policy specifies various means for fight against corruption and some of them (e.g. development of Code of Ethics for judges and establishment of structures to oversee its implementation) are already in introduced by the Judicial Code. At this stage the activity in the item 7 of the section 4.1.1. on “Fight against Corruption” receives special significance, i.e., increase the salary of judges to a level, which ensures service with dignity in order to reduce corruption.

491. At the same time, it should be noted that the funds allocated for remuneration of judges in 2004-2006 are almost twice less than the relevant targets set forth in the PRSP, while the judiciary financing/GDP ratio has been met only by 60 percent. It is mainly explained by the fact that the actual increase of budgetary resources was lower than expected predominantly due to the tax revenues/GDP ratio underperformance.

492. The specific weight of total judiciary expenditures in the state budget of Armenia is also quite low. In 2002-2004 it did not exceed 0.5 percent of total expenditures. Despite some improvements of in the following years (in 2007 the indicator comprised 0.9 percent), for this important indicator Armenia is still behind of some CIS and Eastern Europe countries (see Table 10.6).

493. The level of judiciary budget in Armenia is quite low compared to judiciary budgets of a number of countries with the same economic growth rates and similar judicial systems. Particularly, the level of total judiciary expenditures in the state budgets of the aforementioned countries significantly exceeds the same indicator for Armenia.¹⁶²

Table 10. 6: Specific Weight of Total Judiciary Expenditures in the ROA and Several Other Countries (2002)

	Country	Specific Weight of Total Judiciary Expenditures in the State Budget (%)
1.	Armenia	0.4
2.	Bulgaria	0.7

¹⁶² See §European Justice Systems,” European Commission for the Efficiency of Justice, 2004.

3.	Russian Federation	0.9
4.	Romania	1.7
7.	Lithuania	1.3
8.	Slovakia	1.2

494. Another indicator that shows a low level of total judicial system expenditures in Armenia is the level of per capita judicial expenses in several countries. It is evident that the figure for Armenia is significantly lower than the average figure for similar countries. It is noteworthy that in the near past those countries in terms of presence of corruption and establishment of judicial system were almost at the same level as Armenia now. Anti-corruption programs and implementation of reforms in those countries were based on the idea of sufficient financing of judicial systems and as a result the establishment of judicial system in those countries is now well grounded.

Table 10.7: Per Capita Expenses of Judiciary in the ROA and Several CIS and Eastern Europe Countries (2004)

	Country	The Ratio of Per Capita Judicial Expenses/Per Capita GDP
1.	Bulgaria	0.0025
2.	Estonia	0.0023
3.	Latvia	0.0019
4.	Lithuania	0.0021
5.	Romania	0.0019
6.	Russian Federation	0.0033
7.	Slovakia	0.0024
8.	Czech Republic	0.0028
9.	Armenia	0.0008

495. The above analysis suggests that the judges in Armenia are paid significantly less than in other comparable countries. This emphasizes even more the need to significantly increase the salary of judges. The table below presents the scenario for increasing the average monthly salaries in the judicial system revised during the SDP period. By 2021 the salaries in judicial system will increase by 5.13 and in prosecutorial system by 10 times as compared to 2007 (see Table 10.8). Higher growth rates for prosecutor's office are explained by the ROA Law "On the Office of Public Prosecutor" that requires to bring the salaries of public prosecutors to the level of the salaries for judges as well as by the fact the specific weight of public prosecutors in the prosecutorial system is 4.3 times than the specific weight of judges in the judicial system.

Table 10.8: Average Monthly Salaries in the Judiciary, 2008-2021 (AMD '000)¹⁶³

Indicators	2007	2008	2009	2010	2011	2012	2015	2018	2021
Judicial System	107.8	114.0	127.7	144.3	163.0	184.2	265.8	383.5	553.4
Prosecutorial System	119.9	245.7	277.0	313.2	353.9	400.0	577.0	832.6	1201.4

496. **Creation of private bailiff service.** At this stage the issue of efficient mandatory enforcement of court decisions is being solved by improving ESD (Enforcement Service Department) related legal framework and through technical replenishment of the ESD. Nevertheless, strategic solution of this issue is the establishment of independent, state licensed private bailiff services. This approach has already been adopted by a number of European countries. The essence of an independent enforcement is that a state licensed private entity is endowed with the authority to enforce the implementation of court decisions. To this end, the activities promoting the development of necessary legislation and institutional structure for licensed independent bailiff services shall be undertaken. In the same time, the introduction of this institute will exclude for people any new unwarranted expenses related to this area. It should be noted that the establishment of alternative services for enforcement of court decisions is considered by the Action Plan of the EU-Armenia European Neighborhood Policy as an important measure for increasing the efficiency and effectiveness of implementation of court decisions (Section 4.1.1, Reform of the Judiciary, item 8).

497. **Clarification of expert's status in criminal, civil and administrative proceedings.** Both the civil procedural code and the criminal procedural code stipulate today the expert's opinion as evidence. Nevertheless, the parties do not have equal rights for selection of expert, assigning examination to him/her and presenting the expert's opinion as evidence. This is more evident in the criminal proceedings. It is expected that expert related legal regulations will be clarified in the near future and both lawsuit parties will be provided with equal rights for expertise. Solutions are required for the issues such as whether a separate law on legal expertise is needed, or whether the discussed provisions should be reflected in the sections on evidence in the procedural codes, or what rights should the parties have in appointing an expert examination at the pre-court stage and at the court trial stage, or how the competence of a court expert will be checked, etc.

498. **Further improvement of witness and victim protection institute in the criminal proceedings.** The ROA Law "On Amendments and Addenda in the Republic of Armenia Criminal Procedural Code" adopted on May 5, 2006 stipulates significant innovations related to the enhancement of that area. Specifically, some clear procedural and extra-procedural activities aimed at protection of trial participants were defined. However, this issue is yet to be completely solved because the legislation does not regulate the procedures for implementation of those activities in the administrative and legal relations. It is expected that a law regulating those issues will be adopted.

¹⁶³ The average monthly salary of judges exceeds the average monthly salary of judicial system by about 2.7 times, and in case of prosecutor's the indicator amounts to 1.2 times.

499. **Enhancement of expedite trial in the criminal proceedings.** It is expected that further enhancement of expedite trial in the criminal proceedings will lead to exclusion of undue delays and cases of limiting people's rights through protractions of deadlines. Besides, it is expected to introduce an institute of consent, which will reserve notable procedural privileges to those suspects, who will provide support to the bodies conducting pretrial investigation to disclose offences.

500. **Development of commercial arbitration and mediation institutes.** The ROA Law "On Commercial Arbitration" has been adopted on December 25, 2006; it has established a legal framework for implementation of arbitration in Armenia that complies with international standards. Nevertheless, the development of arbitration institute remains a top priority. The issues mainly relate to the fact that Armenia has not had an arbitration institute in place till now; therefore there is a lack of qualified professional arbitrators as well as practices established in other areas for enforcement and abrogation of arbitration decisions of the court, appointment of arbitrators and overseeing of arbitration by the courts. Implementation of some activities aiming to solve those problems is planned in the next phase, e.g., training of arbitrators, inclusion of topical studies for judges as well as implementation of case arbitrations with participation of arbitrators with international standing. As of the mediation, development and application of legislation on the mediation, in general, and on the court adjunct mediation, in particular, that complies with the international standards is a very important task.

501. **Introduction of modern case distribution systems in the courts.** The application of a case distribution mechanism that will provide an automatic distribution without making specific decisions on a case by case basis is an effective tool for excluding the arbitrariness and interest on the part of the court chairman in assigning the case hearing to a judge and in fight against corruption. Various approaches to distribution of cases are adopted today in different countries; the issue might be solved in a number of ways, which, however, serve the same objective of making this distribution on an impartial basis. This purpose should be also served by the case distribution option that will be selected and applied by the Republic of Armenia in the future. The anti-corruption program of the ROA Government envisages the introduction of a computer-based case distribution mechanism.

502. **Establishment of an effective system for publication of judicial acts.** The Action Plan of the EU-Armenia European Neighborhood Policy plans to increase the transparency and predictability of judicial acts particularly through creating an effective system of publication of judicial acts (Section 4.1.1, Reforms of the Judiciary, item 4). The Judicial Code stipulates a compulsory publication of all the judicial acts on the official website of the judiciary. The works for creation and completion of the website are currently underway. Development of a unified judicial decision database and development and introduction of judicial decision classification system for making the use of precedent more accessible are envisaged in the future. Providing public accessibility of this database has a strategic significance.

503. **Outlining of primary areas (particularly, use of precedent and courses on use of software installed in the courts) for training of judges.** The Judicial Code stipulates mandatory training of judges; the judges shall annually take at least 80 and at most 120 academic hours of training. Both general as well as demand-based courses that have an utmost relevance for the judges in a given phase will be developed to fully implement this requirement. They particularly include the specifics of applying judicial decisions that have precedence importance, the classifiers, in the case of developing judicial decision classifiers, as well as courses explaining the IT to be used by judges.

504. At the same time, taking into account the functions assumed by the Council of Justice under new Constitution and the procedures to exercise them set forth by the Judicial Code, the facilitation of training for judges – members of the Council of Justice – specifically on issues related to appropriate implementation of their responsibilities as members of the Council of Justice has significant importance. This training will support due implementation of such functions of the Council of Justice as human resource policy in the judicial system, formulation of practice for interpretation of code of ethics of judges and application of disciplinary sanctions to judges.

505. **Training and education of judicial servants.** The judicial service system was introduced in Armenia in 2006. As a result of 2006-2007 legislative amendments the judicial servants have assumed many functions related to facilitation of regular operations of court system. To this effect, the development of judicial servants' training courses on such issues as preparation of budgetary requests for the courts, summarization of statistics and practices, human resource management, installation and application of IT receives special importance.

506. **Continue to provide equipment and technical assistance to the First Instance, Appeal and Cassation courts and the Constitutional Court.** The activities to be implemented in this area include, *inter alia*, introduction of modern approaches and technologies for archive management and maintenance, provision of new software for and technical assistance to the staff of the aforementioned courts for implementation of newly assumed functions.

507. **Raising public awareness about legal acts.** The sustainability and further enhancement of the achievements in the area of publication of legal acts will have a crucial role in the years ahead. An important strategic activity should be considered public discussions of draft legislative acts. It was already noted that draft legislation developed by the Ministry of Justice is published and submitted for public discussion on the official website of the Ministry. It is necessary that in the future such procedure is stipulated by the Law for legislation drafted by other government bodies as well, as this will be an important guarantee of civil society's awareness about draft laws and will ensure its active participation in the process of development of legislation.

10.2.2. Maintaining Public Order, Raising the Efficiency of Ensuring Public Security and Fight against Criminality

508. Maintaining public order, ensuring public security and efficiency of fight against criminality, as well as transparency of activities, quality and accessibility of corresponding services rendered by police to the population are key prerequisites of poverty reduction strategy.

509. In 2001-2007 the Police of RA being a public administration body and an important constituent of the Judicial system has carried out significant reforms in the following key directions:

- In the light of commitments made by the Republic of Armenia before the European Council structural and functional reforms of the police system are of special significance. In particular, in 2002 criminal-executive institutions were transferred from the RA Ministry of Interior Affairs into the system of the Ministry of Justice, and the Fire Protection Department is now administered by the field of Emergency Situations, which in its turn is currently coordinated by the RA Ministry of Internal Affairs. It should also be mentioned that over 2006-2007 the protection function of criminal-executive institutions was handed over from RA Police to RA MOJ by several phases. However the key structural reform of the system was the restructuring the Ministry of Interior Affairs into Police in 2003, which made irrevocable the depolitization process of the system. The guarantor of its realization has been defined by the RA Law On Police Service, according to which the post of the police chief is not a political post, and only a person serving in police can be appointed to this post. Besides, being a specialized agency police is replenished solely based on the principle of professionalism, and there do not exist political posts.
- In the first phase of judicial reforms, in 2001, the RA Law On Police was adopted, by which for the first time the tasks, legal basis and principles for activities, rights and obligations, the structure, legal and social state guarantees, as well as principles of financing the police, its material-technical replenishment and supervision of its activities have been defined. The Law on Police became the core on the basis of which police legislation was formed (8 laws, around 80 GoA decisions of normative act nature, 35 orders issued by the chief of police of RA etc.). However, activities aimed at adjusting police legislation to international standards within the police system will be carried on in a steady and coordinated manner, with the aim of emphasizing the predominance of the principle of human rights and developing amendments to laws aimed at excluding any type of possible arbitraries on the side of police.
- In 2002 RA Police was the first among public services that through the law on Serving in Police has set the main principles for serving in police, the order and conditions of serving in police, rights, obligations, responsibilities, posts and ranks

of officers, etc. The law stipulates for a number of mechanisms which are aimed at reducing to maximum possible level biased approaches that could be demonstrated by the leadership of police throughout their service term (clearly defined criteria for admitting new-comers, probation periods, trainings, an established attestation system etc.) In terms of ensuring objectivity of disciplinary practice implementation “The Disciplinary Rule Book of RA Police”, which was adopted in 2005, is of top priority. The mentioned law regulates the disciplinary rules of police service, appointing and carrying out official investigation, the order and rules of applying disciplinary punishments, code of ethics of persons serving in police. The improvement of the abovementioned laws and scores of subordinate legislative acts deriving thereof, is based on the principle of excluding any arbitrariness on the side of the leadership of police towards regular police staff. It should also be mentioned that there is major work to be carried out with regard to meeting the requirements of the RA Law On Special Public Service (in effect since January 1, 2008), i.e. introducing the system of special public service into the police system, harmonizing the former with police service, as well as developing and implementing the required subordinate legislative acts.

- Among the new functions of Police the one that refers to keeping the Public Register by RA Police should be specially highlighted, which is stipulated by RA Law On Public Register. The mentioned register, which accumulates information referring to the population comprised in the databases of various state agencies, is aimed at providing required information to authorized bodies in cases and order stipulated by law. In particular, the said register shapes the Register of Voters, from which election lists are formed. Therefore successful realization of a number of events having public significance depends on the accuracy of accumulation and developing information in the Public Register of the Population. In this respect in the coming years information accumulation mechanisms will be improved in order to ensure that the information in the register is always accurate and up to date. Also a strict supervision over the legal basis for utilizing the information accumulated in the register will be maintained, allowing citizens to acquire information on utilization of data referring to them at any time. To this end a number of legal acts must be passed, and large-scale organizational activities should be carried out. Upon realization of the mentioned steps The Public register of Population can serve as a core for the formation of an informational society, contribute to the full introduction of e-governance system and improve the quality of e-services provided to the population.
- Significant measures were undertaken in respect of ensuring publicity and transparency of police activities. In particular since 2005 based on an approved timeline the leadership of RA Police, Chiefs of key departments inform the public on the current situation in the sector, raise the existing drawbacks and shortcomings, clarify issues that raise interest of the public and provide answers to them through regular press conferences and briefings. The public can acquire

information on RA Police activities visiting www.police.am, where the legislation regulating police activities, the summary of crimes committed during the day, statistic and analytical information can be found. Citizens can address the leadership of police with questions that interest them and get irrefragable answers.

- As it was already mentioned the judicial reforms resulted in transfer of the function of investigation from the Prosecutor's Office to investigation bodies. Taking into consideration that about 90% of cases will be transferred from the Prosecutor's Office to the General Investigation Department of RA Police (GID), a number of organizational activities were carried out in advance, namely refereeing to structural changes of GID, training of investigators etc. Coming to the present stage of judicial reforms it should be mentioned that the courts, prosecution, investigation and inquest bodies have great expectations with regard to the new Code of Criminal Procedure, which is currently in the process of development, and which is expected to settle a number of problems faced by persons that were working in practice previously. Officers of law enforcement bodies anticipate major changes in the activities aimed at prevention of crimes and offences also within the framework of the state Program of Crime Prevention, which will create real prerequisites for the initiation of unified state policy in the mentioned field, will raise the efficiency of the crimes' social prevention system.

- Among institutional reforms within the police system the program aimed at increasing traffic safety should be highlighted, at the first phase of which the RA Police State Motor Vehicle Inspectorate was reorganized into a Traffic Police, and the whole system of organizing the works of the service underwent fundamental changes. In particular, all detachments were transformed into patrol service and were delegated authorities to fine drivers that violated traffic rules at place. Within the framework of these reforms significant structural changes were initiated in the system, in particular through the handing over the jurisdiction of services State Motor Vehicle Inspectorate from Territorial Police bodies to the centralized administration of Traffic Police. Also, the Construction and Mounting Department within the Police system, which dealt with introducing and maintaining technical systems of traffic regulation, was liquidated. The said function was transferred to municipal communities. Currently the function of carrying out technical examinations is also being delegated to private companies. Within the framework of reforms initiated in traffic police system in the future it is envisaged to fully reequip the service, as well as to raise the efficiency of the detachments carrying out the service. Also it is planned to install video monitoring and speedometer (velocimeter) equipment on major crossroads and highways of big cities, which will allow registering violations. As a result of the activities to be initiated it is envisaged to drastically raise the discipline of traffic parties, ensuring full implementation of the principle of inevitability of responsibility for law infringement, as well as to reduce corruption risks in Traffic police to maximum possible level. Among important steps taken in this last direction the fact of opening an off-budget

account for Traffic Police, which gives opportunity to direct 70% of the sums received from fines for administrative violations to the technical re-equipment of the service, and the remaining 30% will be paid to the police officer discovering the violation as a bonus.

- The establishment of the Citizenship and Migration Department adjunct to RA Police is also one of significant expected structural changes. It is expected that the mentioned department will contribute to efficient coordination of the sector. Since 2009 it is also planned to introduce Passports and ID Cards of RA citizens adjacent to international standards. Passports with vital data are to be used outside the Republic of Armenia, and the ID Cards only within the country. A package of legislative amendments will be developed for to this end, after which corresponding organizational works will be carried out.

510. In terms of ensuring efficiency of reforms of RA Police system, as well as successful implementation of anti-corruption strategy the system of remuneration and social security of police officers is of utmost importance. The average monthly salary of 2007 (63 thousand drams) is uncompetitive not only against the private sector, but also is substantially lower than the average monthly salary of the employees of the judicial system, prosecutor’s office and other public administration bodies. It is also substantially lower than the average monthly salaries of police officers in a number of European and CIS countries (see Table 10.9).

Table10.9. Average monthly salaries of police staff in RA, and a number of EU and CIS countries (2007)

	Country	Average Monthly Salary (USD)
1.	Estonia	1,630
2.	Poland	1,100
3.	Lithuania	1,050
4.	Bulgaria	450
5.	Russia	600
6.	Ukraine	700
7.	Georgia	500
8.	Armenia	200

511. The anti-corruption policy should be based not only on improving remuneration and ensuring social guarantees of judges and prosecutors, but also of officers of other law-enforcement bodies. Otherwise significant differences in salaries can themselves become a factor encouraging corruption in other law-enforcement bodies, as well as impact an increased outflow of highly qualified specialists. Thus, in the last 5 years among officers released of their posts only one out of each 4 posts has been replenished. This is mainly a result of an uneven combination of a responsible and hard work with unequal remuneration. Taking into account this circumstance throughout the implementation of the Sustainable Development Program it is recommended to raise

the official salaries of police officers in a progressive way bringing it to the level of average salaries of civil servants. (see Table 10.10):

Table 10.10. Average monthly salaries of RA Police officers in 2008-2021

	2008	2009	2010	2011	2012	2015	2018	2021
Average monthly salary of RA Police officers thousand drams	83.7	110.5	145.8	184.5	210.0	306.0	447.8	654.5

10.3. Anti-corruption Policy

512. Citizen surveys show that corruption in Armenia is rather problematic in the areas of commercial activities, issuance of licenses and permits, tax collection and customs services. The Corruption Perceptions Index calculated by the “Transparency International” in the last three years remains for Armenia at the same level (3.0 in 2003, 3.1 in 2004 and 2.9 in 2005). Armenia is ranked 88 among 159 countries. The anti-corruption strategic program is in place since 2003. Prior to that, a number of legal acts and organizational measures have been implemented in respect to these surveys (e.g., adoption of the ROA Law “On Civil Service” on December 4, 2001).

513. In 2003-2007 the ROA strategic anti-corruption program has carried out its mission, in particular, through adoption of many legislative documents aimed at prevention of corruption (more than 50 laws and secondary legislation documents), establishment of new institutional structures, accession to recognized anti-corruption international organization (the Council of Europe GRECO and the OECD Network for Fighting Corruption in Transition Economies) as well as signing and ratification of international agreements (the Council of Europe Civil Law Convention on Corruption and Criminal Law Convention on Corruption, the UN Convention against Corruption), etc. One of the challenges that our country faces is the fulfillment of commitments assumed under those documents.

514. The ROA strategic anti-corruption program has promoted the establishment of new institutional bodies and regulation of their activities in fight against corruption. In particular, to this effect by the ROA Presidential decree an anti-corruption council chaired by the ROA Prime Minister and an ROA anti-corruption strategy monitoring commission adjunct to the Council were established. An anti-corruption division was created within the structure of the ROA General Prosecutor’s Office, which later was reorganized into a department. The ROA Police and the ROA National Security Service have similar units.

515. The adoption of international anti-corruption conventions and the fulfillment of commitments/obligations of accession to the Network for Fighting Corruption in Transition Economies and GRECO serve as basis for development of new anti-corruption strategy of the country and identification of new direction in fight against

corruption. The development of anti-corruption policy and the establishment of an anti-corruption institutional structure should be prioritized among other strategic tasks. In the preceding period Armenia has made quite notable progress in ensuring the anti-corruption council and the anti-corruption strategy monitoring commission activities. Nevertheless, if the anti-corruption council could be considered an established structure, the operation of the anti-corruption strategy monitoring commission needs revising. The latter, lacking professional auxiliary structures and mainly consisting of representatives of political parties and NGOs proposed by those parties, is not sufficiently viable because the NGOs represented there are not yet showing interest in the process of joint fight against corruption. When adopting a new anti-corruption strategy, it is necessary to take into account the outcomes of performance of those bodies and revise the principle of composition of these institutional structures and the requirements set for them. The establishment of a specialized structure that will assume the implementation of the anti-corruption strategy and policies and the coordination of activities of specialized anti-corruption units within the law enforcement bodies shall be the subject of discussion. Currently those activities are partially carried out by the ROA General Prosecutor's Office. This new structure will have an opportunity to conduct awareness raising activities about fight against corruption. Cooperation with civil society will lend an opportunity to implement joint initiatives in fighting corruption.

516. Amid strategic issues, the development of a system for monitoring and evaluation of corruption level and fight against corruption complements the functions of the institutional structure. Prior to 2007, the country had an approved methodology for maintaining criminal corruption statistics under 59 cases and based on this methodology the ROA Police was summarizing data provided by the law enforcement bodies and submitting them to the ROA National Statistical Service. However, taking into account the international experience and being guided by the key principle that only violations related to the abuse of office could be considered as corruption, the number of corruption offences was reduced to 22, which reflects the fight against corruption more adequately and excludes consideration of economic crimes as corruption. At the same time, the abovementioned list of offences should be completed by a number of other types of crimes, which in compliance with the provisions of the UN Convention against Corruption are corrupt by nature and are subject to special registration /e.g. inducing to bribery or commercial bribery, bribing for false evidence, false conclusions or incorrect translation, etc/.It is necessary to develop and complete a system of anti-corruption monitoring and evaluation indicators to have more comprehensive picture of fight against corruption and to monitor it. This will allow to summarize and have a system of corruption monitoring indicators by all sectors: civil service, police, prosecutor's office, judicial system and others.

517. The involvement of civil society into the fight against corruption is another important mission of the ROA anti-corruption strategic program. Active propaganda and proactive participation of mass media, TV and NGOs in fight against corruption has communicated new signals to society and, especially, to government bodies. According

to the Transparency International, one of the reasons of the stable corruption perceptions index is the unawareness of citizens and population of Armenia about corruption or their own misinterpretations and inaccurate perceptions of corruption. From this perspective education and information campaigns among the population are extremely important. In other words, the implementation of educational and explanatory policies should be another important component in fight against corruption. Educational and instructional activities organized by NGO's or civil society association, incorporating subjects on reasons of corruption and its consequences into the official curriculum, facilitation of training seminars for public servants and private sector employees on such topics as methods of fighting corruption and anti-corruption mechanisms are extremely effective.

518. Precise definition of various corruption practices as criminal offence is one of the integral parts of fight against corruption. Corruption reduction trends resulting solely from the education of civil society and its awareness building are not sufficient. It is necessary to bring the definitions of corruption crimes and their content in the legislation into compliance with international standards, in particular, with requirements of the Criminal Law Convention on Corruption of the Council of Europe. The latter presumes the replacement of complex and segregated provisions with fewer provisions, which include all cases of active and passive corruption. Criminal responsibility for corruption offenses should be envisaged for legal entities as well.

519. Development of a unified public service system, application of unified European code of ethics for public servants, adoption of specific codes of ethics for certain professional services have significant role in fight against corruption and are urgent for Armenia. It is necessary to introduce strict disciplinary penalties to be applied for violating the code of ethics by public servants and establish in the public administration bodies detached units supervising the code of ethics of public servants, conflict of interests and financial statements.

520. The issues related to receipt of gifts by public officials and servants and avoiding conflict of interests as well as penalties envisaged for violation of rules related to receipt of gifts still remain unsolved in the context of public service. They are problematic in terms of legal and practical application. Establishment of controlling mechanisms over the property of public servants as well as examining the authenticity of financial disclosure of public servants among others, through clarifications and cross-validations carried out by the State Tax Service, has become specifically urgent. To this end, the level of responsibility of public servants to declare their personal incomes and property will be raised.

521. The question of recognizing legal entities as subjects of criminal responsibility is also an important issue. So far only natural persons are considered as subjects of criminal responsibility under the Criminal Code and this leaves a loophole for legal entities to escape punishment for participation in corruption crimes; only administrative

responsibility is currently in place. Relevant draft legislation regulating the aforementioned issue will be submitted to the ROA National Assembly.

522. A financial supervision center implementing the Republic of Armenia legislation on money laundering adopted in 2004 is established under the Central Bank of Armenia. Despite the progress made, this legislation still needs improvement; specifically, it should be brought into compliance with the requirements of international laws. Besides, the results of the center's activities are not tangible yet; to date the ROA General Prosecutor's Office has received only a few reports on suspicious transactions, but those cases were not fully investigated.

523. The issues of civil society awareness as well as accessibility of information in relationships between public officials and citizens still remains unsolved. The ROA legislation stipulates relevant administrative sanctions for holding back information and other cases, while the Criminal Code envisages penalties for provision of incorrect and outdated information. However, civil society and business community express serious concerns regarding provision of timely and comprehensive information.

524. The establishment of financial control/audit institutions and their targeted cooperation and performance are important factors in fight against corruption. Internal audit units were established in the ROA Ministry of Finance and Economy and other public administration bodies. Relevant reforms have registered some progress. External audit is carried out by the Chamber of Control of the ROA National Assembly; the new law on Chamber of Control regulates the activities of this constitutional body. It should become an important unit of fight against corruption in Armenia.

525. In the new anti-corruption strategy of Armenia the following will be considered as outcome indicators: the Transparency International's Corruption Perceptions Index of 2.9 in 2006 will reach 3.3 in 2009 and 4.0 in 2011; the Freedom House's transition corruption rating of 5.75 in 2006 will be reduced to 5.4 in 2009 and to 4.25 in 2011; and the World Bank Governance Indicator on Control of Corruption will grow from 33.5 in 2006 to 40.5 in 2009 and to 55 in 2011.¹⁶⁴

¹⁶⁴ As target indicators for 2011 were selected relevant indicators already met by Bulgaria and Romania that have passed in this area the "threshold" for accession into the European Union.

11. Social Protection System

526. According to the internationally accepted definition social protection is the comprehensive whole of activities carried out by state and non-state bodies that are aimed at expanding opportunities of households and individuals to withstand certain risks and satisfy needs.¹⁶⁵ The goal of social protection state policy is the management of social risks by the state with the objective of their regulation and reduction. At the same time, all those risks and needs that are subject to social protection according to international methodology are classified into the following groups:

1. **Sickness**, which includes sickness/temporary incapacity benefit (persons with disabilities excluded.)
2. **Disability**, which includes financial and non-financial, non-medical assistance to disabled people to overcome difficulties faced by them with regard to social and economic inclusion.
3. **Old-age**, includes financial and non-financial non-medical assistance with regard to old age.
4. **Survivors/surviving relatives**, includes financial and non-financial assistance connected with the death of the family member.
5. **Family/children**, includes financial and non financial, non-medical assistance with regard to pregnancy, delivery, adoption, child care as well as social assistance and protection to families and children.
6. **Unemployment**, includes financial and non-financial assistance connected with unemployment.
7. **Housing strategy**, which includes various state sponsored mechanisms aimed at assisting households and individuals in finding solutions to their housing problems.
8. **Other types of social isolation**, which include financial and non-financial assistance with regard to other types and cases of social isolation that were not listed above.

527. The functions of the state system of social protection for each of the abovementioned groups are clearly defined. Basically, in Armenia the risks that are ranked in the mentioned groups are being regulated by the state through the below mentioned programs for vulnerable population groups, within the system of social protection:

- State Social Assistance Programs, including family benefits, disability and other social pensions, one-off pregnancy and childbirth allowances, child care benefits, as well as other pecuniary and non-pecuniary social services,
- Social security programs for disabled, veterans and children, in particular rehabilitation programs for disabled based on data concerning specific individual rehabilitation needs of disabled, as well as social programs aimed at servicing

¹⁶⁵ The European System of integrated Social Protection Statistics Manual, EU, Eurostat, 1996.

disabled, veterans and children at home and in corresponding specialized institutions,

- Social protection programs for the disabled, veterans and children, in particular social-medical recreation programs, social programs for providing services to the children, elderly and disabled at home and in specialized institutions,
- State Social Insurance programs, that consist of old- age and disability pensions, as well as temporary incapacity and pregnancy benefits,
- Employment programs, including unemployment benefits, training of unemployed, as well as programs of public works,
- A system of allowances for separate target population groups.

528. Based on the SDP priorities, guided by the objectives of the social protection policy, as well as the principle that the social protection system should not weaken the economic motivation of all the circles of the society for proactive participation in the economic growth through efficient and targeted allocation of limited public recourses to the most vulnerable groups, SDP targets to increase public expenditure for this sector. In 2010 the public expenses for social protection as compared to the same indicator in 2007 will increase for about 2, in 2015-4.1, and in 2021 for more than 6.7 times. The ratio of public expenses for this sector to the GDP will also increase, and by 2021 will make 6.9 % against 4.7% of GDP in 2007.

Table11.1. 2008-2021 projections for main indicators of social protection system funding.

Indicators	2008	2009	2010	2011	2012	2015	2018	2021
Public expenditure allocated for social protection, AMD mln *	219,2	253,6	303.1	345.5	438.6	611.5	856.5	1,000.5
Ratio to GDP, %	6.0	6.1	6.4	6.5	7.5	7.8	8.4	7.6
Index, 2007=100	148.1	171.3	204.8	233.4	296.3	413.0	578.5	675.8
including`								
Pension provision, AMD mln	158.4	182.5	225.2	261.5	330.7	469.6	681.1	814.4
Ratio to GDP, %	4.3	4.4	4.8	5.0	5.6	6.0	6.7	6.2
Ratio to social protection expenditure, %	72.3	71.9	74.3	75.7	75.4	76.8	79.5	81.4
Index, 2007=100	173.5	199.8	246.6	286.4	362.1	514.3	745.9	891.9
Other programs of social protection, AMD mln	60.8	71.2	78.0	84.1	107.9	141.8	175.4	186.1
Ratio to GDP, %	1.7	1.7	1.7	1.6	1.8	1.8	1.7	1.4
Ratio to social protection expenditure, %	27.7	28.1	25.7	24.3	24.6	23.2	20.5	18.6

*Starting form 2010 including the expenditures for introduction of accumulative pension system.

529. Public expenditures for social protection are predominantly allocated to pension provision. Throughout the implementation of the program, based on priorities and objectives of SDP, the share of funds allocated to pension provision in the total expenditures for social protection will grow and by 2021 will constitute about 80 %. The total share of all the other programs will correspondingly decrease.

11.1. Social Assistance System

530. The development of the social assistance sector is based on cooperation between all the parties of the society- be it state, society, private sector or individual, as well as the manifestation of equal rights and corresponding responsibilities of those parties.

531. The developments of the social assistance sector are aimed at increasing goal orientation and effectively of financial assistance through key programs, i.e. public benefits, including family and other social benefits.

532. The next type of programs of social assistance include providing social services both separately and as a package. This services are aimed at satisfying social needs of individuals representing separate vulnerable population groups in case of eligibility.

533. One of the priorities of the social assistance policy is the progress of priorities, i.e. the transition from merely financial and non-financial aids to delivering comprehensive social services (in package). The packages of social services will be designed as social services deriving from needs of the clients and will be based on need assessment (for the disabled based on data of developed individual rehabilitation programs).

534. Gradually the types of alternative services and the number of organizations delivering them (both state and private) will grow. Public benefits, non-financial types of social services will be included in the package proposed to each separate client by the state as its constituent parts.

535. Based on general priorities of SDP, the programs of family benefits, childbirth one-off benefit, child care benefit for children under two, as well as benefits to first degree disabled people and families taking care of a “disabled child” will become the priorities of the social assistance sector throughout the implementation of the program. Based on main target indicators of SDP poverty reduction (see Table 3.2.) the comparatively lower rates of poverty reduction are registered with the families having 0-5, 5-16 aged children, disabled people and especially “disabled children”. Hence the financial assistance policy will target the mentioned socially vulnerable groups combining activities carried out within the framework of main programs of the social protection sector (benefits and pensions).

536. Below are the projections for main financial indicators of social assistance system priority programs.

Table 11.2. 2008-2021 Projections for Main Indicators of Social Assistance System Funding.¹⁶⁶

Indicators	2008	2009	2010	2011	2012	2015	2018	2021
Social assistance, employment and other social programs, AMD mln of which-	60.8	71.2	78.0	84.1	107.9	141.8	175.4	186.1
Family benefits, AMD mln	29.8	32.8	37.0	40.9	47.0	62.7	81.8	85.2
Share in Social assistance, employment and other social programs, in %	49.0	46.0	47.4	48.7	43.5	44.2	46.7	45.8
Childbirth one-off benefit, AMD mln	1.3	4.1	4.7	5.1	8.2	9.1	8.6	8.0
Share in Social assistance, employment and other social programs, in %	2.2	5.8	6.1	6.1	7.6	6.5	4.9	4.3
Child care benefit for children under 2, AMD mln	0.2	1.3	1.6	1.8	3.0	4.0	5.0	6.4
Share in Social assistance, employment and other social programs, in %	0.4	1.8	2.1	2.2	2.8	2.8	2.8	3.5
Benefit to families taking care of first group disabled persons and disabled child, AMD mln					4.6	5.9	7.3	10.0
Share in Social assistance, employment and other social programs, in %					4.3	4.1	4.2	5.4
Other programs, AMD mln	29.5	33.0	34.7	36.2	45.2	60.2	72.6	76.4
Share in Social assistance, employment and other social programs, in %	48.5	46.3	44.5	43.1	41.9	42.4	41.4	41.1

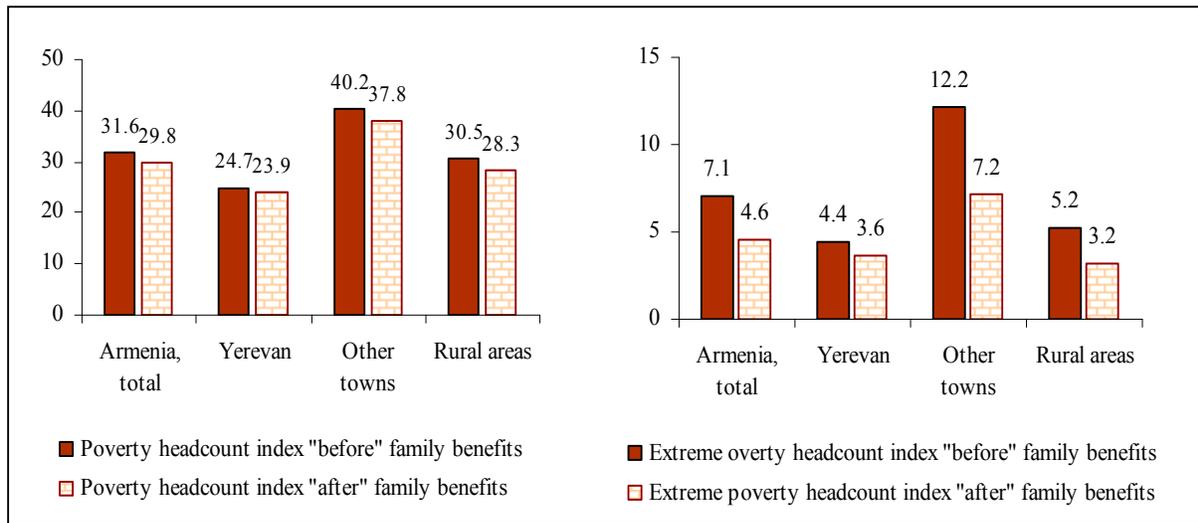
11.1.1. Family Benefits

11.1.1.1 Current Situation and Family Benefit Impact Assessment

537. The Poverty Family Benefit System (hereinafter PFBS, created in 1999) targeting the reduction of extreme poverty and inequality in the country is a significant factor in this process. According to the 2005 Integrated Household Survey (IHS) results, the PFBS activities help to reduce the poverty in the country by 1.8 percentage point, including a 2.5 percentage point reduction of extreme poverty. Thus, the system predominantly impacts the reduction of extreme poverty in the country as it was expected. Moreover, to this end, the PFBS influence is specifically significant in small and medium cities and rural areas of Armenia, where the poverty level is the highest.

¹⁶⁶ The calculations are based on child birth rate as well as on the average scenario of demographic projections on the third and subsequent child birth in the family. In case the scenario in question registers factual deflections the fiscal risks will be covered by means of other programs of the sector.

Figure 11.1: Pre-Benefit “Net” Poverty Rate and Actual Poverty Rate after the Impact of PFBS for Yerevan, Urban and Rural Areas, 2005



Source: ROA NSS, “Integrated Household Survey 2005”

538. The PFBS is based on vulnerability assessment of families registered in the system by applying self-identification principle. The eligibility of a family registered in the system to receive benefit and its amount are determined on the basis of the assessed vulnerability score for that family. During 1999-2007 the number of families registered in the PFBS has reduced by around 3 times. 22.1 percent of families in Armenia were registered in the PFBS in 2007 compared to 67.7 percent in 1999. The number of beneficiary families has also declined in 1999-2006, but with a lower ratio of 1.7 times. At the same time, the proportion of beneficiary families to registered families has constantly grown and comprised around 72 percent in 2007 (see Table 11.3). The declining number of the PFBS registered and consequently beneficiary families is explained by the reduction of poverty and, especially, extreme poverty in the country.

Table 11.3: Dynamics for Number of the PFBS Registered and Beneficiary Families in 1999-2007

Indicators	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number of families registered in the PFBS	520,009	394,773	319,587	272,696	216,550	210,053	208,910	181,907	172,484
PFBS registered families in percentage of total number of families in Armenia	67.7	52.8	44.0	38.6	28.4	27.0	25.4	23.7	22.1
Family benefit recipient families	211,555	199,456	174,800	149,603	141,218	134,224	127,167	130,190	124,689
Proportion of family benefit recipient families in the number of registered families, %	40.7	50.5	54.7	54.9	65.2	63.9	60.9	71.5	72.3
Family benefit recipient families as percentage of total number of families in Armenia	27.5	26.7	24.1	21.2	19.2	17.2	16.5	16.9	16.2

Source: ROA NSS, "Social Snapshot and Poverty in Armenia," 2005 and 2006, and the ROA Ministry of Labor and Social Issues

539. Due to poverty reduction in the country, the state budget allocations for family benefits have been reduced in 2000-2007 by almost 2 times and comprised 0.83 percent of the GDP in 2007. However, in nominal terms they increased by almost 1.5 times making possible, along with the reduction in number of families registered in the system, a two time increase of the average size of monthly family allowance for beneficiary families. The size of an average monthly allowance per member of a beneficiary family in 2000-2006 has also increased and in 2006 covered 38 percent of food poverty threshold.¹⁶⁷

Table 11.4: Dynamics of Public Expenditures Allocated for Family Benefits in 2000-2007

Indicators	2000	2001	2002	2003	2004	2005	2006	2007
Total amount of family benefits, AMD million	17,720	16,850	14,850	12,350	16,093	19,557	24,208	26,183
Percentage of the GDP	1.72	1.43	1.09	0.76	0.84	0.87	0.91	0.83
Percentage in the state budget expenditures	6.8	6.1	5.0	3.4	4.1	4.0	4.2	4.3
Average monthly allowance per family, AMD	7,196	7,712	6,554	7,099	8,254	12,200	15,495	17,499
Average monthly allowance per beneficiary family member, AMD	2,148	2,255	1,841	1,983	2,520	2,954	3,751	4,375
Average monthly allowance per beneficiary family member against food poverty threshold, % ¹	29.9	30.6	24.5	25.6	28.1	35.6	38.0	41.5*

*Projection

Source: ROA NSS, "Social Snapshot and Poverty in Armenia," 2005 and 2006, and the ROA Ministry of Labor and Social Issues

540. According to the 2005 IHS results, more than half of pre-benefit "net" extremely poor population and 25 percent of "net" poor population are beneficiaries. Due to the

¹⁶⁷ The ratio for 2000-2004 has been calculated using per capita food poverty line published by the RA NSS applying the WB simplified methodology (source: Social Snapshot and Poverty in Armenia: Statistical Report, ROA NSS, 2005.) The food poverty threshold for 2005-2006 is provided per adult. After making appropriate calculations and adjusting per adult extreme food poverty threshold to per capita threshold, it was assessed that the size of per capita monthly family allowance in 2006 will provide an opportunity to cover 38 percent of food poverty threshold. For 2007 projections of per capita poverty food threshold was used.

PFBS 35.9 percent of pre-benefit “net” extremely poor population has overcome extreme (food) poverty, but did not move over the general poverty threshold; however, 0.1 percent among them has even moved beyond the general poverty threshold and has overcome poverty. The PFBS impact was effective for 36 percent of the country’s “net” extremely poor population moving them beyond food poverty. The PFBS impact was effective for 5.8 percent of the country’s pre-benefit “net” poor population helping them to overcome poverty. Thus, the PFBS had specifically strong impact on the extremely poor population of the country moving more than one third of them beyond food poverty.

Table 11.5: PFBS Impact Assessments

	Pre-benefit “net” poor population	
	“Net” poor	“Net” extremely poor
Total, %	100.0	100.0
of which: beneficiaries, %	25.3	50.7
Moved beyond poverty (have overcome general poverty threshold) due to family benefit, % of beneficiaries	23.0	0.1
Moved beyond extreme poverty (have overcome food poverty threshold) due to family benefit, % of beneficiaries	...	70.9
Moved beyond poverty (have overcome general poverty threshold) due to family benefit, % of the country’s population in that group	5.8	0.1
Moved beyond extreme poverty (have overcome food poverty threshold) due to family benefit, % of the country’s population in that group	...	35.9

Source: ROA NSS, “Integrated Household Survey 2005”

541. In terms of poverty groups, the PFBS addressness is around 60 percent. To this end, the addressness of funds channeled to population through family allowances is around 61 percent.

Table 11.6: Distribution of Family Benefit Recipient Population by Pre-Benefit Living Standard, %

	Proportion of family benefit recipient population, %	Proportion of paid benefits in the sum total of benefits, %
Family benefit recipient population, %, of which:	100.0	100.0
pre-benefit “net” poor, %	59.6	60.6
including “net” extremely poor, %	26.9	29.0
non-poor	40.4	39.4

Source: ROA NSS, “Integrated Household Survey 2005”

542. Margin of error of mechanism applied to assess family vulnerability level could be determined through a comparison of the PFBS registered and beneficiary population. 92 percent of pre-benefit “net” extremely poor families registered in the PFBS receive allowance.¹⁶⁸ Thus, the system’s margin of error for registered “net” extremely poor families comprises 8 percent and the vulnerability assessment formula, essentially, does

¹⁶⁸ Calculated on the basis of IHS 2005 data

not leave the extremely poor outside of the benefit recipients' circle. In general, 80 percent of registered "net" poor families receive allowance. In this case the system's margin of error is 20 percent, i.e., the formula applied to the poor is much more "rigid". At the same time, 67 percent of registered non-poor families receive allowance. In the case of non-poor families the margin of error of the system is 3 times higher than for poor families. Therefore, the improvement of system's addressness and effectiveness is linked mainly to the reduction of error in coverage of non-poor families.

543. However, it must be taken into account that the vulnerability assessment of families is based on somewhat different, more inclusive mechanism than population's differentiation by poverty groups¹⁶⁹ only; it considers also population vulnerability (or poverty risk). Due to this reason precisely the PFBS impact is targeting the poorest groups and carrying out the assessment of the system's addressness for the poorest groups of population is more justified.

544. The PBFS addressness for the poorest 50 percent of population is around 80 percent and 78 percent of the PBFS funds is allocated to them. In this assessment the PFBS margin of error for inclusion of non-poor groups is 20 percent. Besides, around 35 percent of finances channeled through the benefit system are given to the poorest 10 percent of population, while 45 percent of people in that decile are benefit recipients. "Net" extremely poor and poor population that comprises the deciles 1 to 3 receives 60 percent of the benefit sum total. On the other hand, more than half of the poorest 10 percent of population (around 55 percent) does not receive allowance. However, this is mainly due to the composition of population being registered in the system.

545. A significant part of poor population is not registering in the PFBS. The 2005 IHS results suggest that more than half of the PFBS registered families (55.9 percent) were pre-benefit "net" non-poor families. The "net" poor comprised 44.1 percent of families registered in the system, including only 14.9 percent of the "net" extremely poor; i.e., a considerable number of relatively well-off families were registered in the system. The 39.1 percent of "net" poor families were registered in the PFBS, including 60.7 percent of "net" extremely poor and 12.6 percent of non-poor families; i.e., around 60 percent of "net" poor families and 40 percent of "net" extremely poor families were not registered in the system altogether. In 2005 only around 50 percent of the poorest 10 percent of population was registered in the PFBS. Therefore, the improvement of system's addressness and effectiveness should be also linked with increasing the number of poor applying to system.

¹⁶⁹ In reality, poverty groups formed on the basis of results of living standard surveys are quite sensitive to poverty line. Thus, an AMD 660 increase of food poverty line raises extremely poor population by 30 percent, while an AMD 1,000 increase of general poverty line generates an 8 percent poverty growth. This suggests that the monthly consumption of significant segment of poor and extremely poor population is concentrated around food poverty and general poverty lines. Therefore, it is inappropriate to unequivocally state that around 40 percent of benefit recipient population does not need, in fact, social assistance and that 40 percent of funds are being wasted.

Table 11.7: Family Benefit Recipient Population in Pre-Benefit Consumption Deciles and Funds Allocated for Benefits

Pre-benefit consumption decile groups	Share of benefit recipient population in decile population, %	Share of benefit recipient population in the total benefit recipient population, %	Share of monthly resources provided in the form of family benefits, %	Beneficiary/registered population ratio
Poorest 10%	44.6	33.4	35.3	0.9
2 nd decile	19.0	14.1	14.0	0.6
3 rd decile	15.5	11.6	10.7	0.6
4 th decile	13.6	10.1	9.4	0.6
5 th decile	11.3	8.4	8.7	0.7
6 th decile	9.0	6.7	6.4	0.5
7 th decile	7.2	5.4	4.5	0.5
8 th decile	6.5	4.8	4.7	0.5
9 th decile	4.5	3.3	3.7	0.5
Richest 10%	3.0	2.2	2.6	0.4
Total	13.4	100.0	100.0	0.7

Source: ROA NSS, "Integrated Household Survey 2005"

546. The main reason why poor population groups are not registering in the system is the distrust towards it. According to the 2005 IHS results, more than half of the "net" poor and extremely poor families not registered in the PFBS do not believe that they will receive any allowance after applying to the PFBS. The analysis of "net" poor groups suggests that 2.1 percent of the "net" extremely poor families that have not applied to the system were not aware about it, 6.7 percent have faced difficulties in obtaining documents, 53.5 percent does not believe that will get benefit, and around 18 percent considered themselves well-off. Moreover, the "net" poor and extremely poor indicate the difficulties related to obtaining of documents as a reason for not applying to the system more often; i.e., it is more problematic for "net" poor and extremely poor families to obtain relevant documents than for the non-poor.

547. According to the internationally accepted approach, the identification of poverty groups is based on population consumption characteristics. This approach takes into account the improbability of full formalization and documentation of population incomes in transition economies. Usually, consumption characteristics exceed possible incomes; therefore, they more precisely reflect the actual living standards of population and the situation with poverty.¹⁷⁰ If we were to consider the PFBS addressness from perspective of population incomes, then it would turn out that the addressness of the system in 2005 was around 90 percent. It is clear that under current conditions of

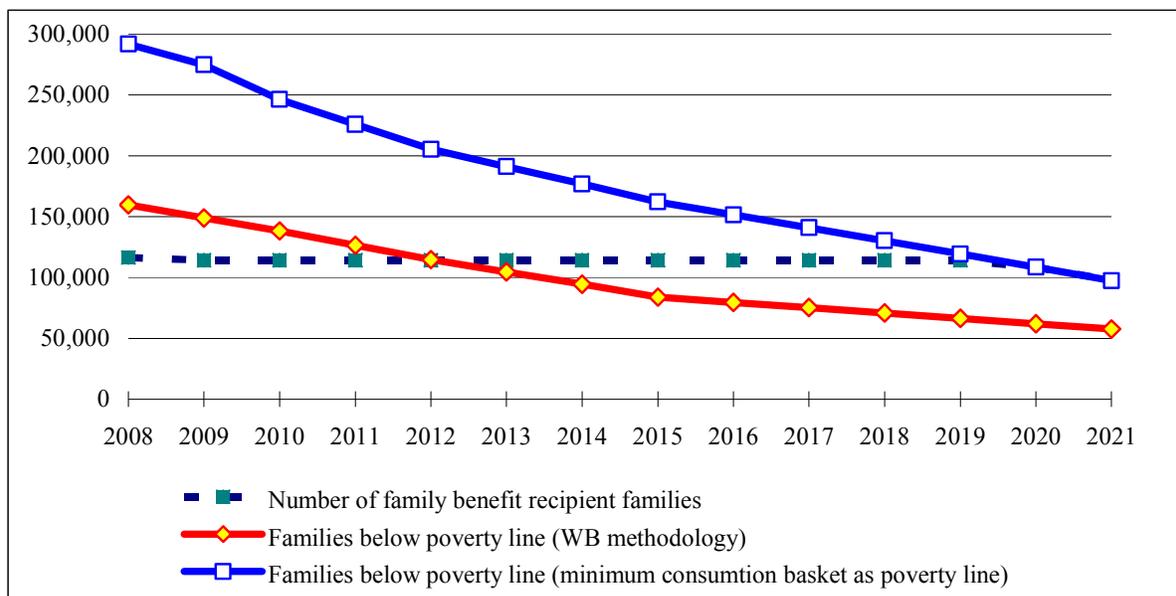
¹⁷⁰ Thus, if the declared monthly income sizes are to serve as poverty criterion, then according to the 2005 IHS results 26.2 percent of the country's population would have been extremely poor and 52.3 percent - poor. While according to the actual consumption, in 2005 only 4.6 percent of the population in the country was extremely poor and 29.8 percent - poor. There is an evident gap between declared incomes and consumption, which exaggerates the incidence of extreme poverty among population by 5.7 times and overall poverty incidence by 1.7 times.

income disclosure, the vulnerability assessment of families could not be based on the size of their income alone.

548. The programmatic superiority of the SDP over the Family Benefit System, as one of the components of social assistance sector, is its more addressed and effective application of the system for increasing the living standards of poor population and, thus, for the purpose of poverty and inequality alleviation in the country.

549. Taking into account: a) that the country's economic growth rates in the recent years by almost two times exceeded the PRSP forecasts which resulted in a sharp increase of the country's financial potential; b) the more rapid reduction of extreme poverty than was expected by the PRSP-I; and c) the objective of overcoming poverty: within the scope of the SDP, in contrast to the PRSP, the family benefit policies should be aimed not only at the extremely poor population but should be aimed at involving the vulnerable groups and the groups with limited capacities in the economic life and support to overcome the poverty independently.

Figure 11.2: Poor and Benefit Recipient Population against the General Poverty Threshold and MCB in 2008-2021



550. According to the PRSP targets, the policy to be implemented in 2009-2012 will be aiming to match the number of benefit recipient families with the number of poor families¹⁷¹ in such a way that the ratio of benefit recipient families to poor families equals to 1 by 2012 (currently this ratio is 0.7). In 2013-2021 this ratio will continue to increase reaching 1.7 in 2021 and, thus, ensuring that the funds will be channeled for

¹⁷¹ Poor families are the families with consumption below the general poverty threshold determined by the WB methodology.

improvement of the living standards of families with consumption below the MCB¹⁷². This approach, according to estimates, will lend an opportunity to constantly increase the ratio between the number of benefit recipient families/MCB and the number of poor families and bring it to 1 by 2021.

551. According to the SDP projections, by the World Bank methodology, the number of poor families and the number of benefit recipient families should gradually decrease after 2019. The objective is to match the number of benefit recipient families with the number of families whose income is lower than the MCB. According to this approach around 97 thousand families will be included in the family benefit system.

552. At the same the public allocations directed towards the family benefit system should increase for 1.8 times by 2012 and for three times and by 2021 as compared to 2007. The GDP ratio of the latter for 2008-2018 should be the same within the range of 0.8 %. After wards it should gradually decrease reaching 0.65% by 2021.

Table 11.8: Family Benefits and Poverty in 2008-2021

Indicators	2008	2009	2010	2011	2012	2015	2018	2021
Public expenditures allocated for family benefits, AMD million	29,761	32,757	36,963	40,927	46,967	62,702	81,827	85,245
Percentage of GDP ratio	0.81	0.79	0.79	0.78	0.80	0.80	0.80	0.65
Number of benefit recipient families	116,204	114,000	114,000	114,000	114,000	114,000	114,000	97,666
Number of poor families according to the WB methodology	159,631	148,743	138,232	126,496	114,702	83,785	70,859	57,469
Ratio of benefit recipient families/poor families according to the WB methodology	0.7	0.8	0.8	0.9	1.0	1.4	1.6	1.7
Number of poor families according to the MCB (families with consumption below the MCB)	291,712	274,790	246,262	225,789	205,216	161,960	130,162	97,392
Ratio of benefit recipient families/MCB and poor families	0.4	0.4	0.5	0.5	0.6	0.7	0.9	1.0

553. This will lend an opportunity to increase the amount of average monthly benefit per family by more than 2 times in 2007-2012 and by around four times in 2021 as compared to 2007, reaching about AMD 72,000. Such an increase of the family benefit

¹⁷² In the SDP document the MCB, calculated by NSS on the basis of the list, structure and nutritiousness of food products developed by the MOH) and the life-supporting minimum budget should be used as equivalents with view the of the fact that the size of the minimum life-supporting budget is not legally stipulated. In the future, after defining the quantitative indicators for the latter, the MCB and the minimum life-supporting budget should become equivalent.

amount will provide in 2021 the beneficiaries with 103 percent coverage of per capita food poverty threshold¹⁷³ as well as 70 percent coverage of general poverty threshold and 30 percent coverage of the MCB by the benefit.

Table 11.9: The Amount of Average Monthly Benefit per Benefit Recipient Family and Its Ratio to Poverty Thresholds and MCB in 2008-2021

Indicators	2008	2009	2010	2011	2012	2015	2018	2021
Amount of average monthly benefit paid per family, in AMD	21,090	23,658	26,695	29,558	33,921	45,285	59,097	71,862
Index, Year 2007 = 100	120.5	135.2	152.6	168.9	193.8	258.8	337.7	410.7
Ratio of per capita family benefit/per capita extreme poverty threshold, %	46.0	48.7	52.9	56.7	63.2	77.2	92.1	102.6
Ratio of per capita family benefit/per capita poverty threshold, %	30.5	32.3	35.1	37.6	41.9	51.2	61.1	68.0
Ratio of per capita family benefit/MCB, %	14.5	15.4	16.7	17.9	19.9	24.3	29.1	32.3

554. The increase of family benefit amount, however, should not restrain the beneficiaries' motivation to be actively involved in economic activities and the labor market. To this effect, the increase of benefit amounts will be paralleled by raises of minimum and average salaries throughout the program life in such a way that per capita family benefit shall range from 18 to 20 percent of minimum salary and shall make around 6-7 percent of average salary.

Table 11.10: Ratio of Family Benefits to Minimum and Average Salaries in 2008-2021

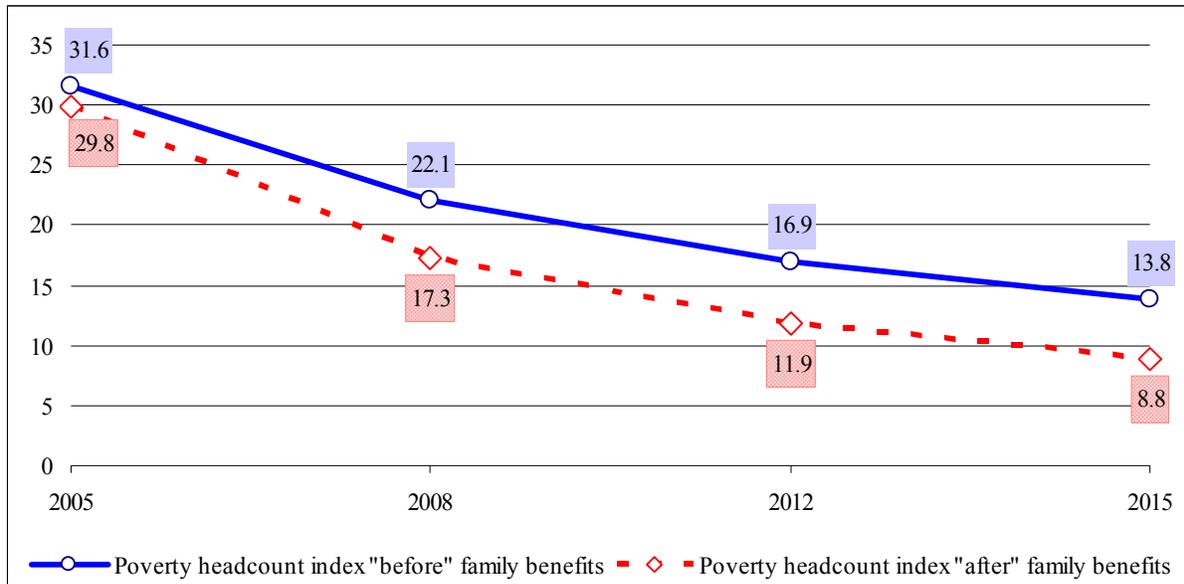
Indicators	2008	2009	2010	2011	2012	2015	2018	2021
Average per capita amount of benefit, in AMD	5,272	5,914	6,674	7,390	8,480	11,321	14,774	17,966
Minimum monthly salary rate, in AMD	25,000	30,000	37,370	41,560	45,400	57,300	72,000	88,300
Average monthly salary, in AMD	90,967	103,313	115,665	128,692	139,792	176,338	218,115	267,534
Benefit per capita /minimum salary ratio, %	21.1	19.7	17.9	17.8	18.7	19.8	20.5	20.3
Benefit per capita /average salary ratio, %	5.8	5.7	5.8	5.7	6.1	6.4	6.8	6.7

555. According to estimates, this policy through the family benefit impact alone will lend an opportunity to reduce the incidence of population in the country with

¹⁷³ A family of four (two adults and two children) is defined as an average family. The food poverty and general poverty threshold for an average family have been calculated on the basis of food poverty and general poverty threshold per adult and relevant projections. The latter was recalculated with a view a family consisting of two adults and two children. The RA NSS methodology for evaluation of consumption per an adult served as a basis for the recalculation.

consumption below the general poverty line: by 4.8 percentage points in 2008, and by average of 5 percentage points in 2012-2015 against 1.8 percentage points in 2005.

Figure 11.3: Assessments of PFBS Impact on Poverty Reduction (according to the general poverty threshold) in 2005-2015



556. According to estimates, the planned policy will help to reduce the poor population against the MCB by 2 times by 2015 and by around 3 times by 2021 as compared to 2007.

557. Though the PFBS vulnerability assessment is not directly based on regional differentiation, it will remain the most effective tool for population of small and medium cities and, especially, for rural areas. According to estimates, in the medium-term perspective (2008-2015), the pre-benefit “net” poverty rate will decline in average by 3.5 percentage points in the small and medium cities of Armenia and by 10 percentage points in rural areas due to the impact of the system. This will support the mitigation of regional inequalities in living conditions of population.

558. Taking into account that the transition to a direct method of vulnerability assessment for beneficiary families, which is based on the income size alone, is unrealistic under the present conditions of income declaration, it is planned to improve the existing indirect method to match it with the poverty correlates as close as possible and to minimize the margin of error for coverage of non-poor groups. At the same time, it will be possible to launch the transition to the direct method when the level of declared household incomes will lend an opportunity to approximate at least 80 percent of the total amount of the country’s managed revenues.

559. It is envisaged to combine the family benefit system and other social assistance programs (education, health services, preferential tariffs and credit interest rates, etc.) based on: a) the implementation of social assistance programs through identification of

the most vulnerable groups from the standpoint of a given project on a case by case basis, rather than solely and predominantly on the basis of benefit recipient families; b) assessment of other social assistance packages provided to benefit recipient families and their impacts.

560. Implementation of the aforementioned goals and reduction of poor and benefit recipient families assume that the PFBS addresses and effectiveness should be raised alongside. The program sets the following priorities to enhance the addressness and effectiveness of system performance:

- **improvement of indirect (score-based) mechanism applied to assess the vulnerability of families registered in the system** aiming to reduce the margin of error for coverage of non-poor groups to 10 percent in 2015 at the latest and, thus, to increase the system addressness up to 90 percent;
- **ensuring high representation of extremely poor and poor population registered in the system by bringing the representation of the poorest 10 percent of population registered in the system to at least 80 percent** through application of proactive methods of awareness raising and identification of population and, specifically, the poor, and provision of simple and accessible arrangements for poor population for collection of documents;
- **introduction of a flexible system for regular monitoring of the system addressness, outcomes and impact assessment in addition to the analysis and application of the IHS results.**

11.1.2. Childbirth One-off Benefit

561. Since October 2003 the amount of the childbirth one-off benefit has increased equaling 35000 drams and stabilized on that level. As a result the number of cases of not registering childbirth has reduced. Below are the numbers of individuals who received childbirth benefits by years.

Table 11.11. The number of individuals who received one-off benefits for childbirth in 2001-2007.

Indicators	2001	2002	2003	2004	2005	2006	2007
Births	32,065	32,229	35,793	37,520	37,499	37,639	40,142
Beneficiaries	25,674	25,707	28,884	30,283	25,237	29,201	38,801
Ratio of the number of beneficiaries/births, %	80.1	79.8	80.7	80.7	67.3	77.6	96.6

562. Given the additional expenses made by the families at childbirth and the growth of their amount the amount of the benefit will increase and differentiate based on the **newborn's sequence in the family.**

563. The necessity for a differentiated benefit amount is preconditioned by the fact that so far the programs aimed at promoting birth rate were being carried out through the system of family benefits, however the number of families registered in that system

is quite limited, while demographic issues of the country continue to remain high on the agenda. Based on the data of the survey on Armenia's demographic and health issues carried out by ROA NSS in 2005 birth rate summary indicator comprised 1.7 per woman. At the same time it should be noted that the mentioned indicator was the same in 2000 and in the recent 5 years has not registered any changes. To ensure natural reproduction the indicator in question should be slightly higher than 2.0. However in ROA in case of an increase of the total number of births after the third birth the number of births registers a decline. In order to have a birth rate coefficient that would be more than 2 it is necessary that the number of families having three children grows. Therefore, the fact of a third and subsequent births in a family should be a matter of special state concern.

564. In the program implementation period it is envisaged to connect the amount of one-off child birth benefit to the size of minimum consumption basket. Moreover it is planned that in case of birth of the first and second child, in a midterm perspective the amount of the benefit will be 50,56, and 58 thousand AMD for the years 2009, 2010 and 2011 respectively. Afterwards it should be calculated by multiplying the minimum consumption basket amount¹⁷⁴ by the 1.5 coefficient for 2012, and after 2012 by 1.75. In 2009 the amount of the one-off benefit in case of third and subsequent births should make 430.thousnad AMD. By 2010-20011 it should equal the mount of the yearly MCB (12 times amount of MCB) and should match the double amount of the yearly MCB after 2012 (24 times amount). Afterwards it will remain on this level; for the whole program implementation period. Also it is envisaged to pay out part of the child birth benefit for the third and subsequent child in a lump sum, and the remaining part will be paid out according to timeline and purposes defined by law (e.g. when the child becomes 3 years old). Families with high incomes (according to Tax Code families that are subject to financial disclosure) will not be included in the program.

565. This approach will allow to provide a one-off childbirth benefit for the first and the second child equaling 64,000 drams in 2012, 81,000 drams in 2015 and 97,000 in 2021. Thus the amount of the one-off childbirth benefit for the first and the second child in 2012 will grow for 1.8 times compared to the same indicator in 2008, in 2015 2.3 times, and in 2021 2.8 times.

Table 11.12. One-off childbirth benefit amount projections for 2008-2021

Indicators	2008	2009	2010	2011	2012	2015	2018	2021
One-off childbirth benefit amount for the first and second child, drams*	35,000	50,000	56,000	58,000	64,000	81,000	89,000	97,000
Index, 2008=100	100.0	142.9	160.0	165.7	182.9	231.4	254.3	277.1
Minimum consumption basket monthly, drams	36,316	38,499	39,977	41,325	42,566	46,509	50,829	55,537
Ratio of benefit /MCB amounts, %	96.4	129.9	140.1	140.4	150.4	174.2	175.1	174.7

¹⁷⁴ Is calculated as the derivative of consumption basket value per month for the last trimester of the previous year and inflation budget projections amount for the current year.

One-off childbirth benefit amount for the third and subsequent childbirths	430	480	496	1,000	1,000	1,000	1,000	
Public allocations directed towards one-off childbirth benefits	...	4.1	4.7	5.1	8.2	9.1	8.6	8.0

* For administrative facility the amounts are rounded to thousands.

566. The program envisages to define the differentiation of the one-off childbirth benefit for the third and subsequent child beginning from 2009. In 2009-2012 the benefit rate will increase continuously and in 2012 will amount to 1 million drams and will remaining on that level until 2021.

11.1.3. Child Care Benefit for Children under 2 Years Old

567. Currently working parent is eligible for the child care benefit for children under 2 to take care of the child while taking a leave until the child gets 2 years old. Below is the number of beneficiaries since 1999.

Table 11.13. Number of Beneficiaries of the Child Care Benefit for children under 2 over 1999-2006.

	1999	2000	2001	2002	2003	2004	2005	2006
Beneficiary	10450	10091	8780	7326	7721	7330	6320	5404

568. Until 2007 the benefit amounted to only 2300 drams, and since 2007 the amount of the benefit equals to 3000 drams, which was raised on the account of the reduced number of beneficiaries within the framework of financial means allocated to this end in RA State budget. Taking into account that the main objective of the benefit is the partial compensation of additional expenses connected with child care the amount of the benefit must be defined based on the amount of possible expenses necessary for acquiring various necessities for children under 2.

569. Based on the circumstance that parallel to poverty reduction employment opportunities have increased, as well as on the assumption that the possible growth of the child care benefit will result in the increased number of persons applying for the mentioned benefit, an increase of the number of beneficiaries is anticipated. In mid term perspective (2009-2011) it is envisaged to set the number of beneficiaries at 6000, after which to raise it and in 2021 to reach 10 thousand people. At the same time it is planned to connect the amount of the monthly benefit to the amount of the minimum salary and beginning from 2009 to adjust it to 60% of the minimum monthly salary. This approach will contribute to the solution of social problems of young families and working women and their children.

Table 11.14. Projections of the child care benefit for children under two over the period 2008-2021.

	2007	2008	2009	2010	2011	2012	2015	2018	2021
Beneficiary	4,262	4,500	6,000	6,000	6,000	9,000	9,500	9,500	10,000
Benefit Amount drams/monthly	3,000	3,000	18,000	22,422	24,936	27,240	34,380	43,200	52,980
Public expenditures on child care benefit for children under two bln. drams	0.2	0.2	1.3	1.6	1.8	3.0	4.0	5.0	6.4

11.1.4. A Benefit to Families Taking Care of Persons with Group I Disability and “Disabled Children”

570. Among disabled people those that need most support are first group disabled people and children under 18 having the status of a “disabled child”. At the same time in case of having a disabled person of this category in the family to organize their proper care an adult member of the family or another person (disabled person’s assistant or social worker) must arrange issues connected with that.

571. ROA governments Decree N. 780 “On approval of classifiers used for social-medical expertise and standards for defining disability groups” dated 13 June 2003 sets that the standard for defining Group I disability is social inadequacy requiring social protection or assistance, which is a result of failure of health reflected through stable, severe abnormalities resulting from diseases, damages or failures, that leads to the limitation of (at least) one or more than one of the below mentioned vital functions: 3rd degree limitation of self -service is equal to incapacity for self-service and total dependence on other people; 3rd degree limitation of movement is incapacity to move without assistance and a total dependence on other persons, 3rd degree limitation of orientation is a total inability to orientate, 3rd degree limitation of communication is inability to communicate and 3rd degree limitation of controlling ones own behavior is a complete inability to control oneself and a need for external control. Subsequently in case at least one of the aforementioned limitations is present it already entails total dependence on an other person; either to ensure the vital functions of the disabled person (or to create special conditions for that purpose) or to organize the care of that person.

572. Thus, in any case a family taking care of a Group I disabled person needs, in other equal conditions, additional financial means providing of which is the objective of this type of benefit that will be introduced beginning from 2012, and the amount of which will also be adjusted to the minimum consumer basket with a corresponding coefficient. SDP envisages starting form 2012 to set the amount of this benefit at 50% of the

minimum consumer budget, subsequently increasing it so that in 2018 it will comprise 80 and in 2021 100% of the MCB. Thus in the period 2010-2021 the amount of the benefit in question will increase by almost two times.

Table 11.15. 2010-2021 projections for the benefit amount for families taking care of Group I disabled person and disabled child

Indicators	2012	2015	2018	2021
Benefit amount , drams*	25,500	32,600	40,700	55,500
Minimum consumption basket, per month, drams	42,566	46,509	50,829	55,537
Ratio of benefit amount/MCB, %	60.0	70.0	80.0	100.0
Public expenditures on the Benefit to Families Taking Care of Persons with Group I Disability and “Disabled Children”	4.6	5.9	7.3	10.0

* For administrative facility the amounts are rounded to thousands.

11.1.5. Other Social Assistance Programs

573. The policy aimed at problems of children in difficult living situations will continue to remain high on the agenda. In the coming years it will be directed towards strengthening the child care and protection system, decreasing the number of children in institutions carrying out child care and protection, as well as preventing their inflow to these institutions, on the other hand improving the institutions themselves and ensuring the integration of the children from those institutions in the society, creating alternative services providing care to disabled children. The program of childcare leave benefit, that is aimed at assisting the parent in taking care of the child while being on leave until the child is 2, will also continue.

574. A new three –level child protection system has been introduced in ROA- on national, regional and community levels. On the public management level the system is meant to ensure a unified and structured child protection policy and on the regional level the implementation of the policy through a specialized system. The establishment of a unified system will allow to make decisions concerning the future life of children in hard living situations based on the results of professional and qualified assessment, a regulated operation of structures dealing with issues concerning children as well as, to creat a unified database comprising information about children in hard life situations.

575. Eight public and 4 charity orphanages are currently functioning in Armenia, in which 935 and 250 children (correspondingly) are taken care of. The surveys show that the children get there mainly due to social reasons that are conditioned by the overall impact of low living standards of the population, expensive medications and medical services, parents lacking skills, as well as absence of child-care services. In order to decrease the number of children in the orphanages and to prevent their accession the programs aimed at easing the overloading, in particular through returning the children to their biological families or finding adoptive families for them, as well as expanding

the system of daycare centers and child-care and protection boarding institutions, which will serve as an alternative for children from orphanages and special general education institutions.

576. The task programs for adult inmates of children's homes aimed at social protection of children left without parental care as well as enhancing their integration in the society will continue ensuring the provision of guarantees stipulated by the ROA law „On protection of children without parental care“.

577. Two public and one charitable specialized orphanages for disabled children are operating in the country, where correspondingly 370 and 60 children are taken care of. The renovation of these institutions aimed at creating favorable conditions for the care, treatment, bringing up, social-psychological rehabilitation and development is an urgent necessity. The issue of organizing alternative services for the social-medical provision of disabled children living in families, which will also contribute to decrease in the number of children in the institutions is a problem having a special significance and requiring an optimal decision.

578. The policy aimed at integration of the persons with disabilities in the society derives from the principles and provisions stipulated by the „Convention on Rights of Persons with Disabilities“ adopted by UN in December 2006 and signed by Armenia on the 30th of March 2007. In the coming years corresponding amendments to the legislation will be made and measures will be taken for the integration of the persons with disabilities in the society, creating equal conditions for them, ensuring accessibility of transport and information as well as enhancing an accessible environment and buildings. The model of eligibility for disability will be revised. In 2009 it is envisaged to shift from the model of defining disability that is currently operating in ROA to the model accepted in the European Union, which instead defines the level of incapacity to work .

579. The issues of creating integrated community rehabilitation centers for people with disabilities, expanding programs of medical and social rehabilitation for disabled persons, and increasing their addressness, as well as ensuring high quality education, including inclusive education for disabled children remain top priorities on the agenda.

580. Programs of providing socially vulnerable families, namely elderly and disabled persons who live alone, as well as persons belonging to other social groups with integrated shelters will be implemented. Self-assistance and integration into the society will be the dominant principles of this programs. To address social problems of homeless persons they will be provided with temporary shelters. Day care and social integration centers will be established for elderly and disabled persons, where they will be provided with care and social services (primary healthcare, social-psychological consultations, etc.) thus promoting their social activity and indirectly contributing to the poverty elimination within that social group.

581. The process of delegation of the mandate for providing social services will continue through supporting NGOs in maintaining and expanding the day-care centers for elderly and disabled people, which were established by them.

11.2. Pension System

582. The pensioners have, perhaps, benefited the least from the results of economic growth of 2002-2006. The raises of pensions in absolute terms, which mainly coincided with the PRSP targets, have significantly fallen behind the growth rates for average salary, which, in turn, have notably exceeded the forecasts. As a result, the insurance pension has shrunk in comparison to average salary from already low level of 21 percent in 2002 and in 2006 comprised 17 percent of an average salary.¹⁷⁵

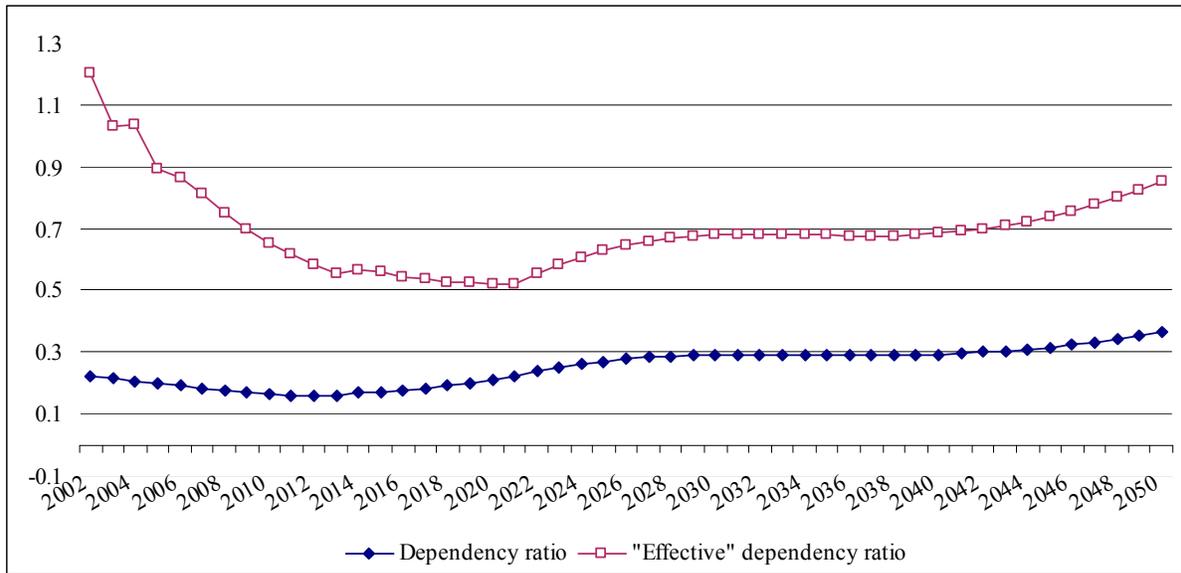
583. In 2006 an average pension was even below the food poverty threshold. At the end of 2006 the average retirement insurance pension comprised AMD 12,059 or only 90 percent of extreme poverty line calculated for 2005. The situation in other pension groups is much more drastic; except for limited number of pensioners, the size of pensions fluctuates in the range of 40 to 80 percent of extreme poverty line and for social insurance pensioners it comprises 40 percent. This situation will not improve in the midterm perspective unless radical measures are taken. Thus during 2008 the ROA Government has undertaken serious steps to this end.

584. At the same time, as suggested by demographic forecasts, in a long-term perspective unfavorable composition of population, i.e., the “aging” of society, will have increasingly negative impact on financial stability of pension system. The international experience shows that the parametric reforms of pension system and the introduction of cumulative system can significantly mitigate fiscal pressures caused by the aging of population.

585. It should be noted that despite the fact that from 2012 on the potential support ratio – the ratio of population above employment age to population of employment age – will constantly grow and will reach around 0.40 in 2050 compared to current 0.18, nevertheless effective support ratio – the ratio of population above employment age to social insurance payers – may significantly improve in the coming 10-15 years, if the tendencies of the last 5 years of increasing degree of employment formalization persist (see Figure 11.4).

¹⁷⁵ As a point of comparison, in the EU (25) the compensation rate in 2004 was 51 percent, in Estonia – 47 percent, in Latvia – 60 percent and in Lithuania – 47 percent (source: Eurostat).

Figure 11.4: Projections of dependency ratio and “effective” dependency ratio for 2008-2050¹⁷⁶



586. Taking into account the above mentioned realities the government will consider the financing of the pension system as one of the top priorities of expenditure policy. The main objective of the state policy conducted in this sphere is the steady improvement of the social condition of pensioners as well as implementation of pension system reforms aimed at ensuring long term financial sustainability of the pension system.

587. In this respect the activities of the Government will be aimed at

- Firstly maximum reduction and then complete exclusion of poverty and poverty risks among pensioners;
- Steady reduction of the grave differences between the living standards of pensioners (including the disabled) and employed population not allowing its further deepening.

588. Principle stand points for the state policy of pension security of citizens are:

- The main tool in the fight against poverty among pensioners is the social pension, which is the minimum life supporting guarantee and is aimed at excluding poverty among these persons;
- Establishment of incentives for involvement in the pension system through clear and distinct differentiation of the amounts of social pensions and employment

¹⁷⁶ It is expected that until 2012 the average annual growth of the degree of employment formalization will comprise 3 percent and in 2012-2021 – 2 percent. The degree of employment formalization – the ration of social insurance payers to non-agricultural sector employees – will reach 82 percent by 2021 compared to 59 percent in 2006. It should be noted that the degree of employment formalization has increased in 2002-2006 by around 10 percentage points; therefore, the scenario presented could be considered as realistic.

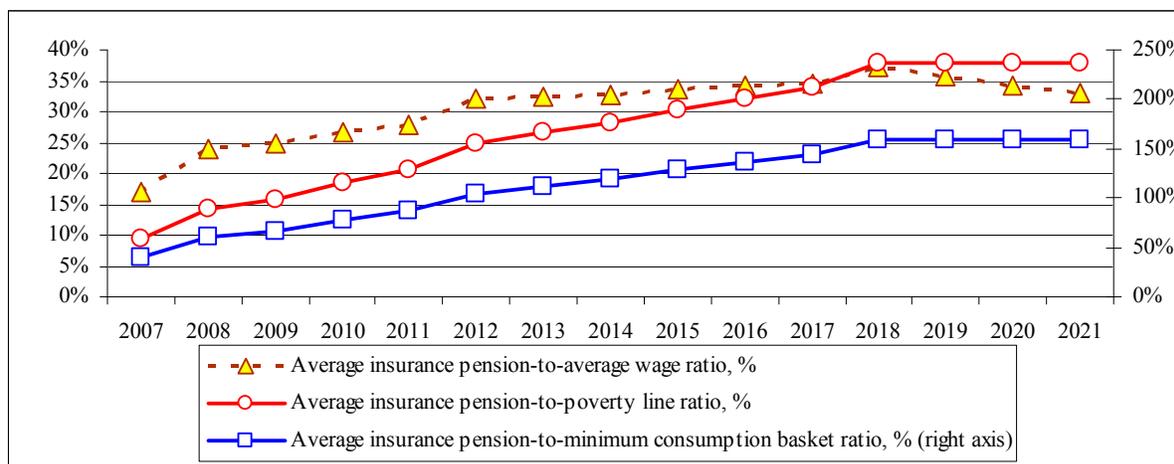
(insurance) pensions, as well as employment (insurance) pensions conditioned by service (insurance) term and amount of the contribution of the person to the generation of state revenue, thus shaping incentives motivating participation in the pension system.

589. Pension system reforms will proceed with reforms of “distributive” parametric system in place and introduction of new cumulative system in parallel.

590. The primary goal in mid-term perspective would be to significantly reduce poverty risks for all pensioner groups. To attain this goal the SDP sets the following targets:

- Bring the level of planned insurance pensions to at least:
 - 100% of the MCB from 2012;
 - 150 percent of MCB from 2018;
- Indexation of insurance pensions on the basis of consumer price index¹⁷⁷ starting 2018 (or after attaining 150 percent of the MCB) (see Figure 11.5).
- Bring the level of planned social pensions to at least
 - Poverty threshold beginning from 2015,
 - 100% of the minimum consumption basket beginning from 2018.

Figure 11.5: Average monthly insurance pension PRSP targets: average pension relative to poverty line, minimum consumption basket and average wage



591. These targets will require significant increase of public expenditures allocated for pensions to bring them to 5.8percent¹⁷⁸¹⁷⁹ of the GDP by 2021, instead of the 3 percent.

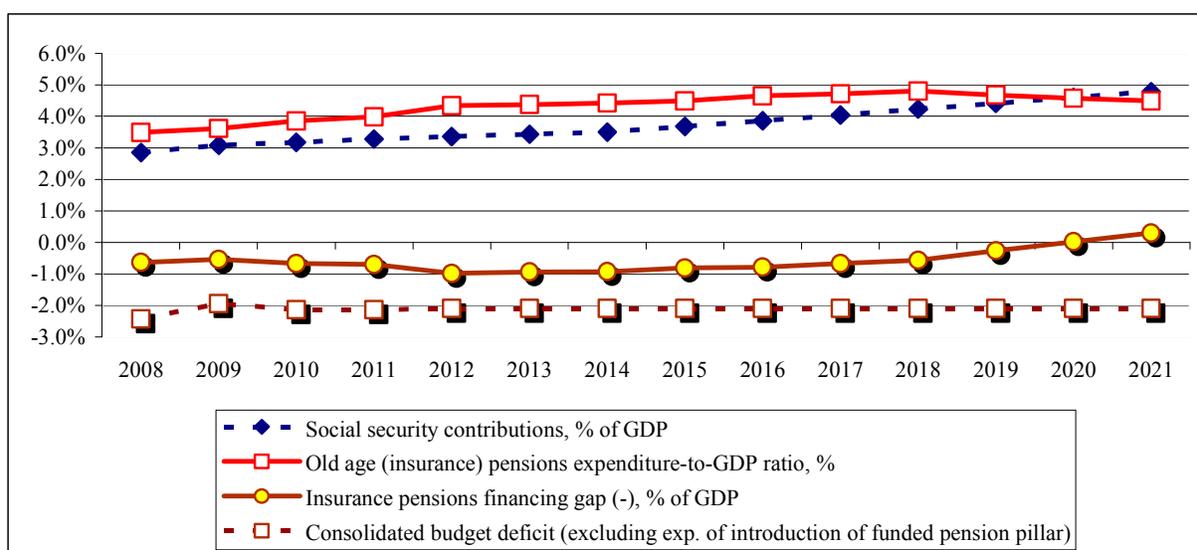
¹⁷⁷ Based on the financial stability indicators of the pension system, there will be an indexation of pensions by applying a combined wage and consumer price index.

¹⁷⁸ It should be noted as a point of comparison, that in 2004 the average figure for the EU (25) comprised 12.3 percent and for the Baltic countries – 6 percent.

¹⁷⁹ The public expenditures allocated for pensions will be brought to 6.3% of GDP by 2018 (without the expenditures on introduction of cumulative system) after which though the nominal expenditures for the pensions

effective for 2007. Required financing will exceed the expected volumes of social insurance payments, which are currently the main source of funding for pensions. According to estimates, during the PRSP this gap will in average comprise 1 percent of the GDP with a growing tendency at the beginning and a declining one at later stages (see Figure 11.6). From this perspective, it is important that the increase of pension expenses is planned under the general budgetary framework of the country, which will lend an opportunity to implement a unified public expenditure policy in accordance with the outlined priorities and without risking the macroeconomic stability. According to budgetary framework estimates of program, these targets will be attainable by maintaining the consolidated budget deficit in a secure range, at the level below 2.5 percent of the GDP.

Figure 11.6: Estimates of Fiscal Indicators for Insurance Pensions



592. It is expected that pensions set forth by the program will help to significantly reduce the poverty level of pensioners (see Table 11.16).

Table 11.16: Programmatic Indicators for Poverty Level of Pensioners

	2005		2008		2012		2015	
	Actual		SDP Forecasts					
	Poor	Extreme . Poor	Poor	Extreme . Poor	Poor	Extreme . Poor	Poor	Extreme . Poor
Pensioners	30.0	3.9	26.5	4.6	5.8	0.6	3.2	0.3
Single pensioners	20.0	0.0	19.2	0.0	8.0	0.0	0.0	0.0
Pensioners, 75 years old and above	30.5	5.2	29.5	4.9	3.6	0.4	2.9	0.2

will continue to increase, however the ratio of the expenditures against GDP will reduce determined by the pension indexation policy adopted in 2018.

593. A number of other parametric reforms of the pension system in place are planned in parallel to the sharp increase of pensions. In general, they will target the enhancement of flexibility, accountability and administration of the existing system and will be implemented under the approved plan for reforms of the existing pension system. By 2012 it is envisaged to

- Make pension eligibility criteria stricter through increasing the minimum term of service allowing to receive employment (insurance) pension, setting it at 10 years;
- To revise the model of recognizing the person disabled by shifting from the model acting in RA, which determines disability to the model adopted in European Union, i.e. the model of determining the level of loss of ability to work;
- Improve the process of registration of person's pension rights through changes of the contents, as well as procedural and technical changes improving the process of individual registration in the system and raising the efficiency of personalized reports aiming at turning the personalized data base into a source of main indicators necessary for making projections and characterizing the pension system (thus ensuring the feasibility of pension policy and carried out programs), as well as to use the information of the data base for the exercise of pension rights of citizens excluding the possibility of applying invalid data;
- With the help of self-working (automatic) information exchange systems and improving the governance system to ensure accessibility, efficiency and high quality of providing package social services;
- Reform the system of pensions on preferential terms through paying this type of pensions through the employer;
- Introduce a mandatory insurance system for cases of industrial accidents and professional diseases, within the framework of which pensions will be paid in cases of disability or loss of the bread-winner that were caused by an industrial accident or a professional disease;
- Set up a connection between personal incomes of the person and the amount of employment pension, which will allow for making the system attractive for social security payments and involving larger population groups in the pension system.

594. In parallel to reforms of the existing system, new obligatory cumulative pension system will be introduced with the main objective to ensure financial stability of the pension system in a long run and the highest possible compensation level of pensions. The launching of the cumulative system is planned in 2010. Additional fiscal burden generated by the introduction of cumulative system is envisaged to amount to 0.2-0.4 % of GDP and will be compensated by general fiscal revenues of the consolidated budget, rather than by increasing the tax burden of labor force.

12. Human Development and Human Poverty Reduction

12.1. Health

12.1.1. Overview of Major Developments in 2003-2006 and Current Situation

595. The Poverty Reduction Strategy Paper emphasizes the role of healthcare in terms of investment in the human capital and stresses, among its priorities and objectives, the increased access to and quality of medical services. Within PRSP framework, primary healthcare is the top priority, while on the programmatic level the mother and child health protection, as well as the prevention of contagious diseases are of special priority. For the purposes of reaching the established priorities, considerable role is assigned to increased public spending in the healthcare sector, redistribution of spending within the sector in favor of the primary healthcare system, as well as increased efficiency of the sector management reform.

596. Armenia is doing relatively well among countries with comparable income levels in terms of the population health indicators. Compared to the developed countries, however, there are significant gaps especially in such areas as maternal and child mortality (see Table 12.1.).

Table 12.1. Population Health Indicators and International Comparisons

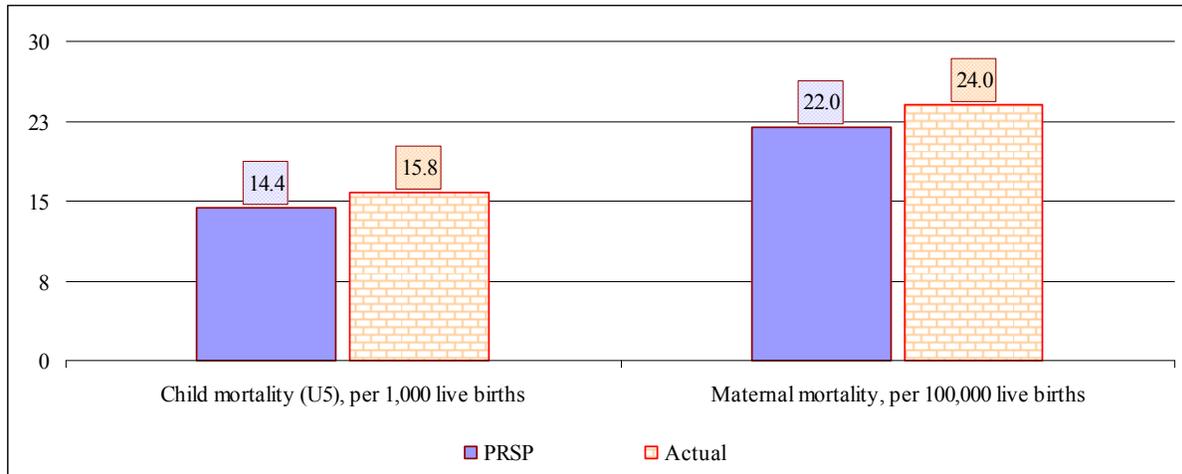
Indicators	ARM	EU	EU-15	EU-12	CIS
	2006	2005			
Life Expectancy at Birth, years	73.3	78.5	79.7	74.0	67.0
Child Mortality (0 – 1 years), per 1,000 live births	13.9	5.1	4.3	8.3	13.4
Maternal Mortality (3 years average), per 100,000 live births*	24.0	6.4	5.4	10.4	29.3
Level of Mortality (all causes), per 100,000 population**	844.5	678.1	606.2	945.1	1,394.3
Mortality due to Cardiovascular Diseases, per 100,000 population**	421.8	272.7	213.8	493.1	799.8
Mortality due to Malignant Neoplasms, per 100,000 **	160.5	179.5	173.6	201.9	159.2
Mortality due to Respiratory Diseases, per 100,000 population**	62.3	47.5	47.9	46.1	63.4
TB, newly registered cases, per 100,000 population	49.0	17.1	10.0	44.1	91.1
HIV, newly registered cases, per 100,000 population	2.05	5.48	6.89	2.21	18.73
AIDS, newly registered cases, per 100,000 population	1.43	1.68	1.96	0.63	1.85
Prevalence of Diabetes, % of the total population	1.2	...	...	3.5	1.5

* Armenia 2004-2006 EU, EU-15, EU-12 and CIS states, 2004

** Indicators for EU, EU-15, EU-12 and CIS states are presented by mortality SDR cause(s)

Source: RA NAS, RA MOH, Health for All Database (HFO), WHO/Europe, 2007

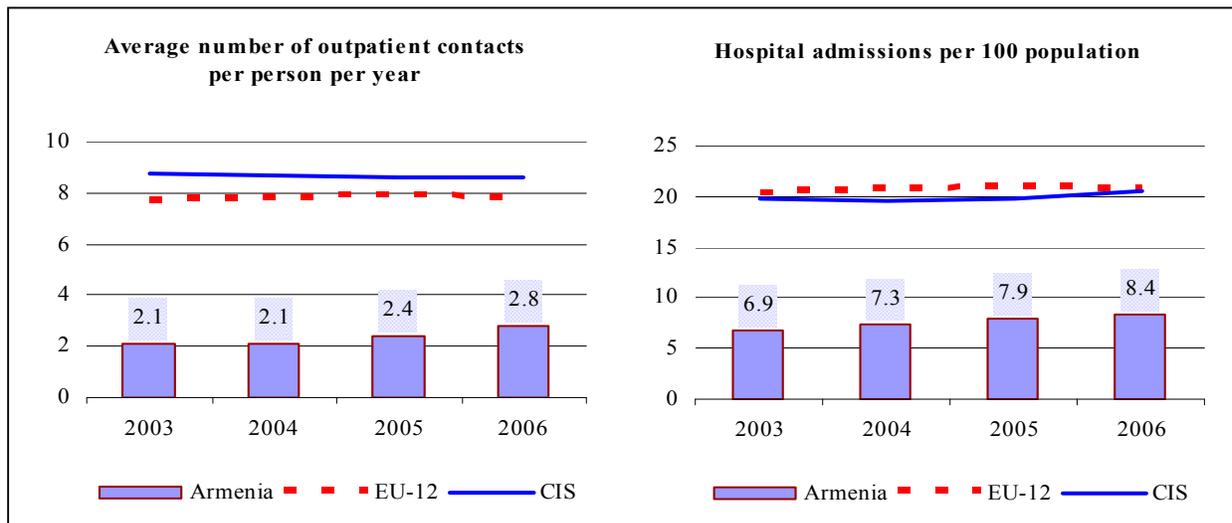
Figure 12.1. Child and Maternal Mortality in 2006, actual indicators vs. PRSP targets



Source: PRSP targets and RA NSS

597. At the same time, child mortality (under 5 years of age) and maternal mortality indicators for 2006 were higher than PRSP targets (see Figure 12.1)¹⁸⁰ and appropriate policy in this area should help improve the situation and reduce the difference of these indicators from those registered in developed countries.

Figure 12.2. Utilization of ambulatory-outpatient and hospital care services



Source: RA NSS, RA Ministry of Health, Health for All Database (HFO), WHO/Europe, 2007

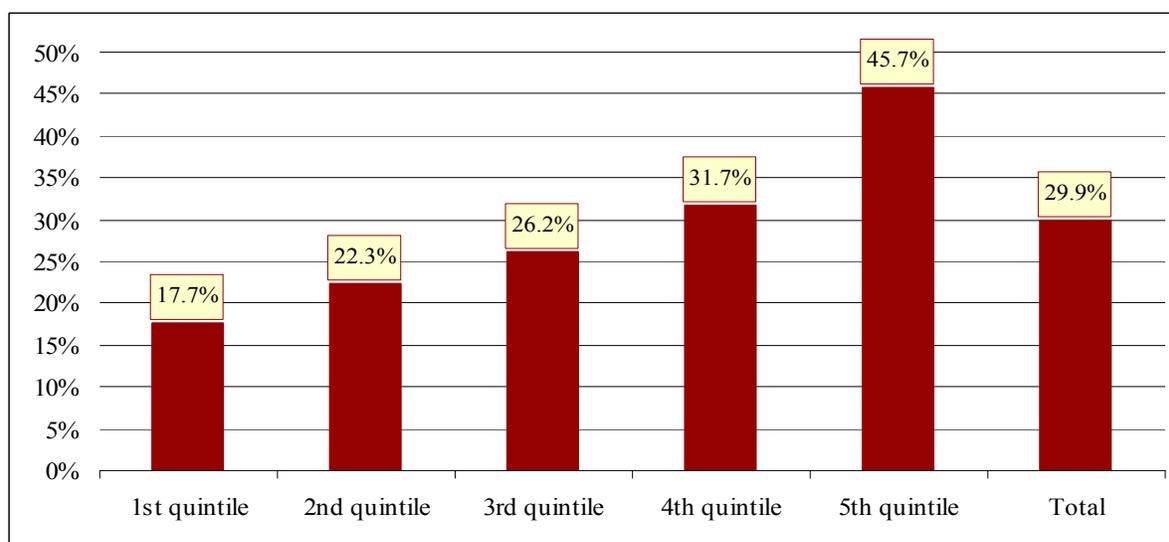
598. Positive trends registered in 2003-2006 in utilization of both ambulatory-outpatient and hospital care services. Specifically, in 2006 the average number of visits to ambulatory-outpatient clinics per patient was 2.8, against 2.0 visits in 2003, and the number of patients admitted to hospitals per 100 population was 8.4 vs. 6.9 respectively. At the same time, the level of utilization of medical services continues to remain generally low both at outpatient and inpatient care institutions, and the respective

¹⁸⁰ Relatively high child mortality indicator is partially due to the changes in the calculation procedure.

indicators are 3 times lower than the average for CIS and EU new member states (see Figure 12.2.).

599. Household surveys also attest to the relatively low level of utilization of healthcare services. At the same time, household survey results identify significant differences in the level of consumption of healthcare services between different population groups depending on the income level. According to the findings of a 2005 RA NSS Integrated Survey of Living Conditions, while the population quintiles registered health-related problems similar to those typical of the universe¹⁸¹, there are significant differences across the quintiles in terms of the frequency of referrals to healthcare institutions. On the average, only about 30 percent of the population with health problems referred to a medical institution, and in the first (the poorest) quintile the frequency of referrals was about 2.5 times lower than in the fifth (the richest) quintile (see Figure 12.3.). These findings mean that accessibility of healthcare services, especially for the most vulnerable, continues to remain a priority in spite of the fact that the physical access to the services (esp. in the primary healthcare system) is universal.

Figure 12.3. Frequency of referrals to healthcare institutions, by consumption quintiles (% of the population with health problems)



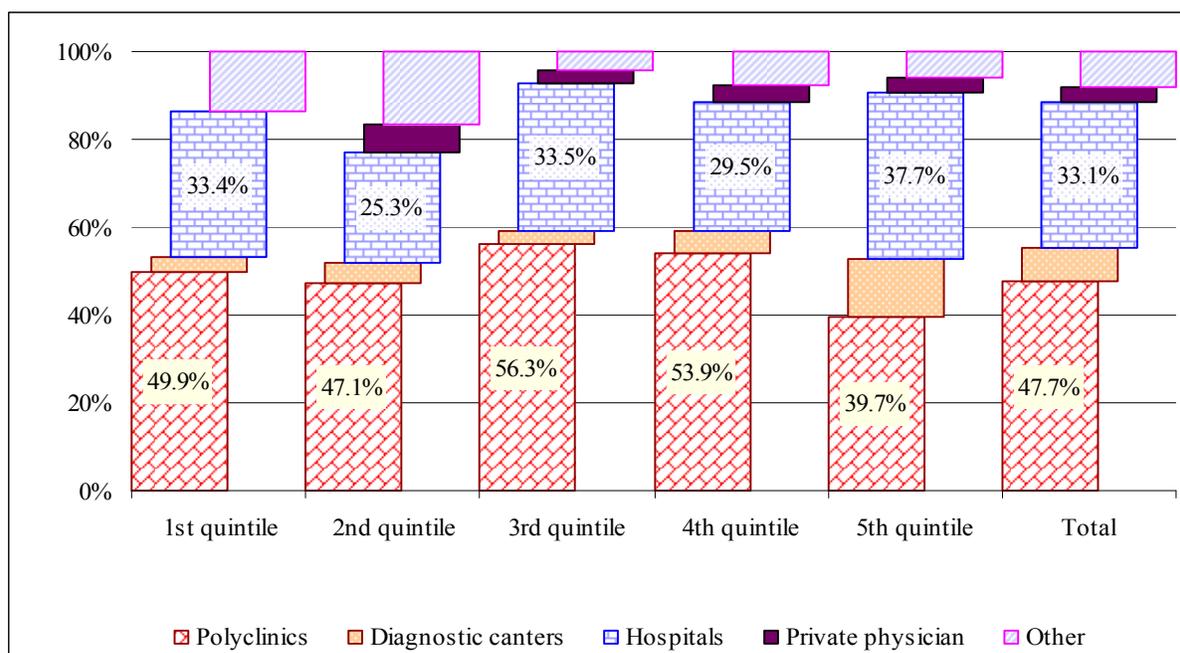
Source: RA NSS, Integrated Survey of Living Conditions, 2005

600. The findings of 2005 integrated household survey also indicate that the choice of the type of healthcare institution does not vary significantly across the population groups; overall, 48 percent of referrals were to ambulatory-outpatient clinics, and 33 percent to hospitals. (see Figure 12.4). There were significant differences characterizing the fifth (the richest) quintile of the population, where the number of referrals to outpatient clinics was relatively low (about 40 percent) vs. relatively high number of referrals to hospitals (about 38 percent) and diagnostic centres (13.3 percent). The comparison of 2005 data with the findings of a similar household survey conducted in

¹⁸¹ In the month preceding the survey, 14.7 percent of the population in the first (poorest) quintile experienced health problems, against 20 percent in the fifth (richest) quintile.

1998/1999 indicates that there has been a significant decrease in the structure of variations characterizing the choice of healthcare institutions (by types) between different, in terms of income status, population groups. In 1998/1999 survey, 60 to 65 percent of the population in the first four quintiles referred to ambulatory-outpatient clinics, while the number of those referring to hospitals was between 20-28 percent. The changes registered since 1998/1999 may be attributed, on the one hand, to increased accessibility of healthcare institutions for the relatively poor population groups and, on the other hand, to the structural changes whereby some services formerly provided at the primary level were transferred to hospitals.

Figure 12.2. Referrals to healthcare institutions by population groups with different income levels, by service providers (percent)

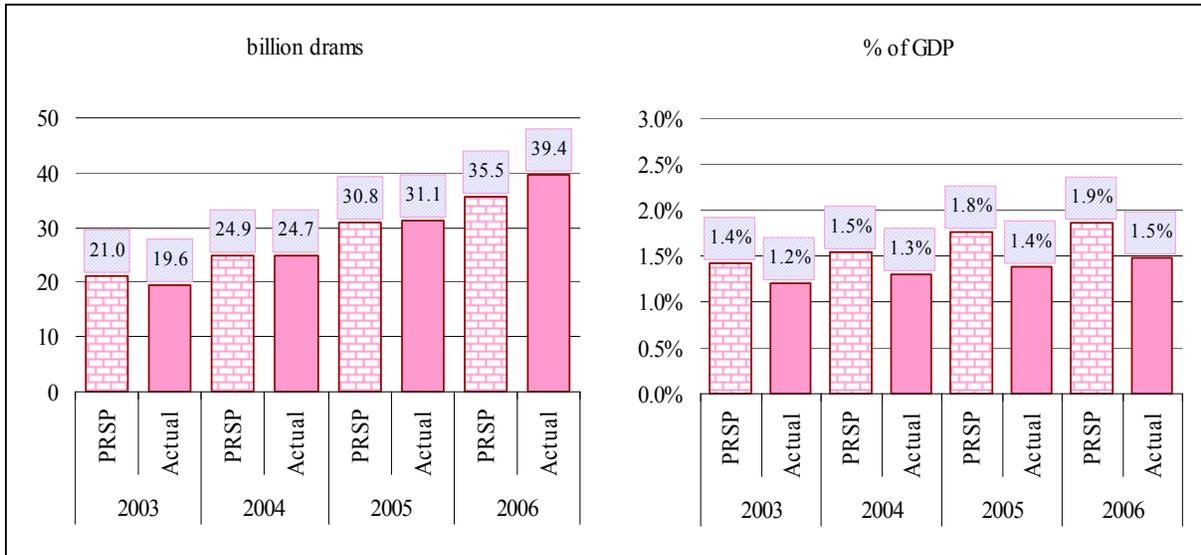


Source: RA NSS, Integrated Survey of Living Conditions, 2005

601. The key factor precluding the development of the healthcare sector was the low level of public spending. Between 2003 – 2006, the situation improved considerably compared to the previous years both in terms of the nominal expression of the public spending, and improved implementation. Specifically, the 2006 spending amounted to AMD39.4 bln, i.e. the double of 2003 figures, and the budgets for 2003-2006 were implemented in full, at the level of 100 percent.

602. The comparison of 2003 – 2006 actual results and PRSP targets indicates that the actual nominal budget expenditure in the healthcare sector was close to or exceeded PRSP targets, while the actual public spending as % of GDP was below the PRSP target level (see Figure 12.3.).

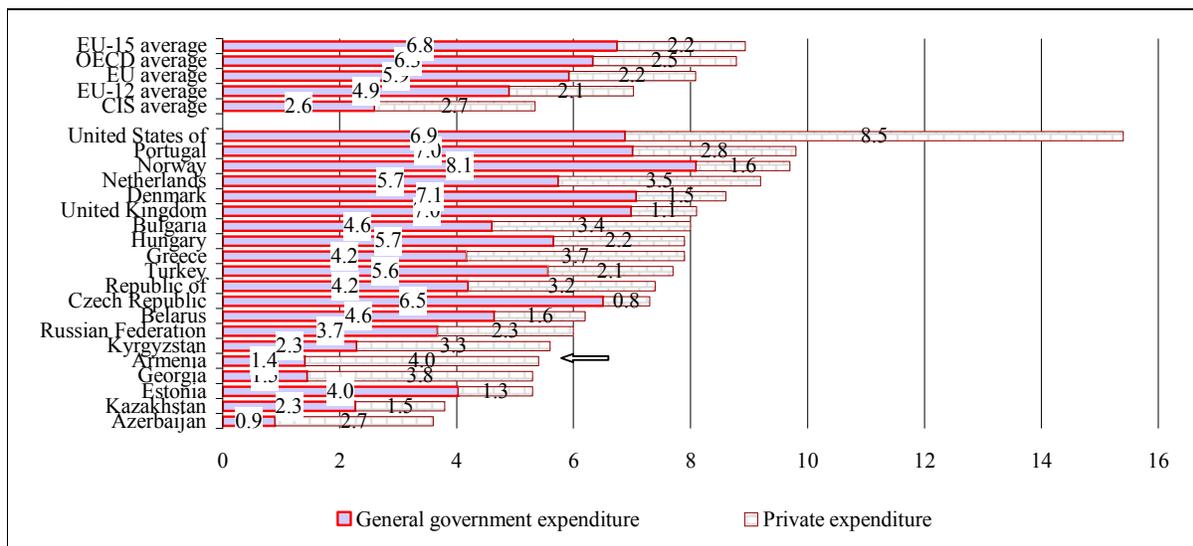
Figure 12.5. State Budget Expenditure in Healthcare Sector, 2003-2006, actual vs. PRSP targets



Source: PRSP targets, RA NSS, RA Ministry of Finance

603. Although public spending in the healthcare sector (in relation to GDP) somewhat increased, the level of such spending continues to remain low (about 1.5 percent). International comparisons demonstrate that such level of public spending is among the lowest in the world and is about 4 times below EU and OECD average indicator and about half of the CIS average (see Figure 12.6.). International comparisons reveal yet another factor; according to WHO estimates, the level of private spending in the healthcare sector (about 4% of GDP) is higher than in developed countries, except USA and Switzerland. At the same time, considering the issues of accessibility and quality of healthcare services, as well as high prevalence of unofficial out-of-pocket payments, the growth of public spending in the medium to long term shall be among the top priorities of the national policy in the sector.

Figure 12.6. Health sector expenditure in Armenia and CIS, EU and OECD member states, 2004 (% of GDP)



12.1.2. Health Sector Priorities

604. The analysis of PRSP implementation progress as well as specialized and public discussions in the framework of PRSP review process indicated that the conceptual framework of priorities under SDP has not changed significantly compared to the PRSP and will continue to guide the national policy at least in the medium term.

605. Within Sustainable Development Program framework, the national policy priorities will continue to include increased access to and quality of healthcare services, with an emphasis on increasing such access to basic services across the regions of the country and mitigating the disparities in the rate of utilization of healthcare services across population groups with different income levels. Development and adoption of healthcare policy will take into account the demographic situation in the country and current trends focusing, particularly, on such issues as accessibility of healthcare services for children, mother and the aged.

606. According to WHO approaches the problems of primary health care should be emphasized with the purpose of improving health and general living standards of the public. The scope of activities aimed at assuring and improving public health should include measures aimed at prevention and control of contagious and non-contagious diseases, assuring favorable conditions for vital activities, protection of the health of public from various risks and negative impact of hazardous factors as well as increase of public awareness over the latter and propagation of healthy behavior and healthy life-style. The intersector issues related to public health care are considered in relevant chapters of the program

607. The further development of the primary healthcare system, at least in the medium term, will continue to remain among the key targets of the government policy. At the same time, increasing the access to and quality of healthcare services across the regions requires modernization of regional hospital network.

608. Augmenting budget appropriations in the health sector and increasing the efficiency of utilization of these appropriations will be the core actions undertaken towards the attainment of the sector priorities. At the same time, and especially when it comes to indirect interventions, some steps will be taken to optimize the country's healthcare system and increase its efficiency. In terms of improving the efficiency of the healthcare system, special attention will be paid to streamlining the roles of primary and hospital care systems and reducing, to the extent possible, duplication of services.

609. Transparency and accountability of healthcare system, as well as measures aimed to improve financing mechanisms in order to diminish the level of informal payments (especially in the sphere of hospital services) will be regarded as priorities.

12.1.3. Programming Budget Expenditure in Health Sector

610. Further development of healthcare sector, increased access to and improved quality of care, along with improved health status of the population are, to a large extent, dependent on the public spending dynamics in the sector.

611. Throughout the programming period, healthcare will remain among the priorities of the public spending policy. Considering the relatively low level of public spending and in view of the threats and risks posed by such low level of spending (these threats and risks may potentially undermine the welfare of the population, deplete the human potential and opportunities for socio-economic development), the government will consistently increase the annual budget funding of the sector. It is planned to bring the public spending on healthcare to 1.7% of GDP in 2010, 2.2% in 2012, 2.5% in 2015 and 3.5% in 2021, against 1.5% in 2006 (see Table 12.2). In the coming years, healthcare spending to GDP ratio will be the dominant factor shaping the nominal public spending in the sector.

612. The implementation of this program scenario will result in 2.4-fold increase of real public spending in healthcare sector in 2012 compared to 2006, 3-fold increase in 2015 and about 7-fold increase in 2021. Should this scenario materialize, real per capita public health spending will increase as much.

613. The priority of increasing the public spending in the health sector will translate into the increased share of healthcare spending in the total public spending structure, due to higher, compared to consolidated budget expenditure, increase in healthcare spending. It is planned to bring, by 2021, the share of healthcare expenditure to 12% of consolidated budget expenditure, against 6.8% in 2006.

614. As for the distribution of expenditure within the sector, in the short-term (next 5 years) it is planned to allocate 7-11 percent of public spending to capital programs; the share of these program in the total structure of sector spending will consistently decrease and will stabilize, towards the end of the program cycle, at the level of 5-6%.

Table 12.2 Program Indicators of Consolidated Budget Expenditure

Indicator	2006	2007	2008	2009	2010	2011	2012	2015	2018	2021
	Actual		Budget	Program						
Consolidated Budget Expenditure in Healthcare Sector, AMD bln	39.5	46.9	54.6	66.1	81.2	103.3	126.4	193.8	296.6	459.0
including capital expenditure vs. total, %*	11.4	8.5	14.8	(9-11)	(9-11)	(9-11)	(7-9)	(7-9)	(6-7)	(5-6)
% of GDP	1.5	1.5	1.5	1.6	1.7	2.0	2.2	2.5	2.9	3.5
% of Consolidated Budget Expenditure	6.9	6.2	6.3	6.6	7.1	7.9	8.5	9.2	10.3	12.0
Change from the previous year, %	26.8	18.8	16.4	21.1	22.9	27.2	22.3	15.3	16.6	15.0
Real public spending (index, 2006 = 100)**	100	114	122	139	164	202	240	337	472	669

<i>Per capita real public expenditure (index 2006 = 100)**</i>	100	113	121	138	163	200	236	327	453	637
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* Projected enabling environment indicators

** Inflation adjusted

12.1.4. Public Policy Intersector Priorities in the Health Sector

615. Within the health sector, in mid-term perspective, priority will be given to the **primary healthcare**, which, in the medium term, will absorb 40-45 percent of budget appropriations for the sector. At the same time starting from 2015, when the level of public spending in the health sector will reach 2.5% of GDP, further increase in public spending will be distributed between the primary healthcare (30%) and in-patient treatment (70%) in favor of the latter.

616. The national policy for primary healthcare will be aimed at the completion of transformations aimed at introducing the family medicine and further strengthening of newly established structures.

617. In view of consistent promulgation and development of individual and group medical practice in primary healthcare system, the government will further define the framework of relations with service providers in healthcare sector and will streamline the mechanisms of public and capital spending.

618. In the medium term perspective, the access to healthcare services in rural areas will continue to remain high on the government's priority list; actions taken in this area will be aimed at improving the resource base (both human and technical) of rural health posts. At the same time, there will be modernization of primary healthcare institutions (polyclinics) in urban areas, including Yerevan. In this latter case (and especially in Yerevan) the scope of government financial interventions (especially in the form of public capital expenditure) will greatly depend on the results of reforms that are currently underway in the system.

619. For increase of accessibility and effectiveness of health care services in rural areas highly prioritized is the development of mobile and distant health care services (e.g emergency care) which will enable to provide health care services particularly to the population of remote and bordering areas.

620. In **hospital care**, parallel to the optimization of the system, one of the top priorities will be the modernization of the regional hospital network. This will be partly implemented in the framework of a WB-financed project, which is currently underway¹⁸². The government intends to complete, in the next 7-8 years, the modernization of regional hospitals, which will considerably increase the access to and quality of the services these hospitals provide. Parallel to renovation of hospital buildings and modernization of their technical base, the Government intends, if

¹⁸² In the framework of this programme, it is planned to modernize ten hospitals in the regions of Armenia.

required, to take certain measures aimed at staffing regional hospitals with highly qualified medical personnel.

621. At the same time, taking into account the fact that the hospital system in the country is currently underloaded and the potential for increase of efficiency is quite high measures aimed at motivating the hospitals to undertake activities aimed at increase of efficiency should make the core of the state policies.

622. Measures should be taken also promote and deepen the hospital management system reforms and introduce corporative management system. By the latter management system through established relevant boards is, design of relevant development programs for the upcoming 3-5 years of health care institutions and approval of the latter by the board is envisaged by the above-mentioned model. It is planned that by 2015 all public hospitals should have management boards.

623. The obligatory requirement of conducting annual independent financial audits (regardless of type of property) in the health care institutes and publication of the results should be put into effect with the purpose of increasing the accountability of health care institutions, especially of hospitals

624. The next factor to have a considerable impact on budget expenditure patterns in the hospital system is the government's intention to gradually bring the level of compensation for the services in conformity with their real cost. Such approach will contribute to improved quality of service and will help decrease the financial burden of socially vulnerable population groups (which, as a rule, consists of informal out-of-pocket payments for hospital services) thus increasing the level of access to such services. Bringing the level of compensation in conformity with the real cost of the services will be primarily ensured for socially significant services (e.g. obstetric and gynecological) and will then apply to all other services financed from the state budget.

12.1.5. Specific Program Priorities

12.1.5.1 Mother and Child Health Care

625. The government policy in the health sector will continue assigning top priority to mother and child health protection and improving reproductive health. The planned actions (by means of relevant budget redistribution these, specifically, will aim at providing quality antenatal care for pregnant women, promoting exclusive breast feeding for preventing lack, early diagnosis and prevention of high-risk diseases, increased immunization coverage and elimination of regional disparities) will result in significant increase of accessibility and affordability of health care services for children and decrease of maternal and child mortality rate, in line with UN Millennium Development Goals. Taking into account the above-mentioned fact, that in the structure of child mortality the neo-natal mortality has the largest share and considering the tendencies of the last years the problems of intensive neonatal therapy are highly

prioritized. Besides, additional activities are being taken to increase the level of awareness about the issues related to child care, child feed.

Table 12.3 Targets for Maternal and Child Mortality

Indicator	2006	2008	2009	2010	2012	2015	2018	2021
	Actual	Program Indicators						
Child mortality (0-1 years), per 1,000 live births	13.9	12.0	11.5	10.9	10.3	8.2	7.9	7.6
Child mortality (1-5 years), per 1,000 live births	15.8	14.1	13.5	12.8	12.1	9.6	9.3	8.6
Maternal mortality (3 year average), per 100,000 live births	24.0	18.5	14.5	14.0	13.4	10.3	8.4	7.0

12.1.5.2 Diseases of Special Social Significance

626. Government program priorities in the health sector include the prevention of diseases of special social significance, some contagious and non-contagious diseases, their early diagnosis and effective treatment.

627. As non-contagious diseases such as cardiovascular and chronic respiratory diseases, diabetes as well as malignant neoplasms show increased spreading rates poor and socially vulnerable population groups become those that are mostly at risk.

628. Given that the spreading of non-contagious diseases in many cases can be prevented by effective implementation of corresponding measures, the government in long and medium term perspectives intends to make special efforts in that respect, in particular:

- Develop and continuously improve the national policy and plan for prevention of and control over non-communicable diseases;
- Integrate the prevention and control of non-contagious diseases in the policies of Government in other related sectors;
 - Through appropriate budget reallocations to expand the financing of corresponding programs, thus improving the accessibility and quality of delivered services;
 - Assist activities aimed at decreasing risk factors of non-contagious diseases (anti-smoking and anti-alcohol campaigns, promoting healthy nutrition and physical activity);
 - Take targeted steps both in the public and private sectors to establish and develop an infrastructure, which will include elements necessary for the effective management and treatment of chronic diseases. in particular:
 - Corresponding policy;
 - Qualified medical personnel;
 - Accessibility of basic medications and technologies;
 - Primary health care standards, guidelines;

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- Effectively operating referral mechanisms.
 - assist in carrying out periodic surveys aimed at preventing and controlling non-contagious diseases as well as introducing an efficient progress monitoring and evaluation system.

629. The poverty reduction strategy will strive to increase the efficiency of interventions aimed at combating such socially dangerous and high risk diseases for socially vulnerable population groups as malaria, TB and HIV; it will try to prevent the spread of TB and HIV, eradicate mortality from malaria and drastically decrease mortality from HIV/AIDS and TB thus reaffirming Armenia's commitments for attaining WHO targets.

630. In this context, there will be an increased attention paid to HIV/AIDS. While Armenia is doing quite well in this respect compared to the most of European countries, international experience indicates that against the backdrop of globalization and relatively high mobility of the population, failure of states to apply appropriate measures or delays in applying these measures may reverse the situation considerably and cause problems both in the social and, in the longer term, economic development domains. The main emphasis will go to increased public awareness on HIV/AIDS, prevention of the spread of the infection and increased efficiency of treatment. These measures will require strengthening and deepening of regional and international cooperation and efficient use of technical assistance provided by specialized organizations.

12.1.6. Ensuring the access to medicines

631. Ensuring the access of the population to medicines is one of the main goals of reforms undertaken in healthcare system. As for the physical accessibility of medicines, it should be mentioned that the situation has significantly changed for the better. However, the economic accessibility is still at a low level due to the low purchase power of the population. Despite the government efforts to establish a system of reimbursement to cover particular vulnerable groups of the population, in fact it is not operating at its full capacity and therefore, requires further improvement.

632. The existing reality require appropriate legislation and regulation documents. In this respect the RA Law "On medicines" can be regarded as the first step, which would make it possible

- to ensure appropriate regulation at all stages of medicines circulation – beginning from their creation and up to their consumption;
- to approve, introduce and keep under state control a set of requirements to be met by all units functioning in the field of the pharmaceutical service including laboratories, clinics, pharmacies, as well as importers and manufacturers of pharmaceutical production. New pharmaceutical manufactures will be developed in compliance with approved standards; existing units will undergo corresponding reforms until 2010;

-
- to improve and simplify the drug registration system;
 - to improve the process of drug import including the introduction of new licensing regime for the importers, according to which merely the manufacturers or their representatives will be licensed to import pharmaceutical products;
 - to regulate and clarify the activity of pharmacies; small pharmacies (kiosks) should be allowed to sell only the medicines without prescription. This will make it possible to establish pharmacy kiosks in small, particularly rural areas and provide the population with essential pharmaceutical products.

12.2 Education

12.2.1 Accessibility of Educational Services and Poverty: A General Overview

633. The education sector in Armenia is currently prioritized as one of the prerequisites of stable development of the country as well as preservation and reproduction of human capital. Reform projects at all levels of education are being implemented in the country to ensure universally accessible quality education and to increase efficiency of the education sector. Therefore, the development of this sector is a top priority of the country's development. The sector development policy shall be inline with the Strategy of "Education for Sustainable Development" of the UN European Economic Committee, aiming at reform results that have significant impact on economic growth of the country, poverty reduction, mitigation of inequality and human development processes, assuring ecological sustainability, both in short- and long-term perspective.

Table 12.4: Dynamics of Public Expenditures in Education Sector in 2000-2006, percentage of GDP

	2000	2001	2002	2003	2004	2005	2006	Average for ECA and FSU countries, 2004	Average for OECD countries, 2004
Consolidated budget expenditures for education, % of GDP	2.9	2.5	2.2	2.2	2.3	2.7	2.8	4.1	5.4
of which:									
Preschool education	0.23	0.23	0.22	0.20	0.23	0.22	0.23	0.6	0.4
Elementary, basic and general secondary education	1.98	1.69	1.37	1.42	1.53	1.98	1.96	1.9	3.7
Special secondary education	0.13	0.14	0.14	0.12	0.13	0.15	0.16	...	...
Professional educational programs ¹⁸³	0.45	0.41	0.38	0.34	0.29	0.29	0.30	0.8	1.3
Consolidated budget expenditures in education sector, AMD million	29,545	29,931	29,746	35,241	43,067	61,675	73,075	...	...
Public expenditures in education sector, % of total expenditures of consolidated budget	11.3	11.8	9.9	9.7	10.9	12.6	12.7	...	13.4
Memorandum articles									
State budget expenditures for education, AMD million	27,176	27,271	26,809	31,953	38,740	56,703	66,976	...	...
State budget expenditures for education, % of GDP	2.6	2.3	2.0	2.0	2.0	2.5	2.5	...	...
State budget expenditures for education, % of State budget expenditures			10.2	10.2	11.6	13.6	13.9	...	...

¹⁸³ According to the ROA Law "On Education" vocational programs include preliminary and secondary vocational educational institutions, and tertiary and post-graduate education.

Source: The ROA Ministry of Finance and Economy, Transmonnee Database 2007, UNESCO, "Global Education Digest 2006" UNESCO Institute for Statistics, Montreal, 2006, Education at a Glance 2007, OECD:

634. The analysis of public expenditure dynamics in the education sector suggests that, despite the fact that public expenditures in the education sector in nominal terms have doubled since 2003 (see Table 12.4), the share of Armenia's educational expenditures in the GDP in 2006 was still 1.6 times lower than the average for the ECA and FSU countries in 2005 and 2 times lower than the average in the OECD countries in 2004.

635. The majority of public expenditures on education (around 71 percent) is allocated for elementary, basic and general secondary education (and around 77 percent for secondary and special secondary education), while preliminary and secondary vocational education gets 3.8 percent and higher and post-graduate education – 7.2 percent of funds. As compared to 2003, the share of public expenditures for general education in the total educational expenditures has been raised by 5.8 percentage points to enhance the quality and accessibility of general education. Instead, the share of public expenditures for vocational programs in the same period has declined by 4.4 percentage points. Due to such developments, the enrolment of the high school in the recent years has grown. Around 35 percent of expenditures envisaged under the vocational programs are channeled to preliminary and secondary vocational education and 65 percent to tertiary education.

Table 12.5: The Structure of Public Expenditures in Education Sector in 2000-2006

Indicators	2000	2001	2002	2003	2004	2005	2006	Average for OECD countries, 2004
Total public expenditures of education sector, %	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
including:								
Preschool education, %	8.0	8.9	9.9	9.3	10.0	8.1	8.3	8.0
Elementary, basic and general secondary education, %	68.9	66.3	62.8	65.3	67.9	72.0	71.1	68.4
Special general education,%	4.4	5.5	6.5	5.7	5.6	5.6	5.8	...
Overall professional programs, %, of which:	15.8	16.3	17.3	15.5	12.7	10.4	11.0	23.1
Preliminary vocational (craftsmanship) education, %	1.5	1.4	1.2	0.9	0.8	1.1	1.3	...
Secondary vocational education, %	3.8	3.6	3.8	3.3	2.8	2.3	2.5	...
Tertiary and post-graduate professional education, %	10.5	11.2	12.2	11.4	9.0	7.0	7.2	...
Other expenditures	2.9	3.0	3.5	4.2	3.8	3.9	3.8	

Source: ROA Ministry of Finance, Education at a Glance 2007, OECD:

636. Despite the positive trends of the recent years, reduction of public expenditures for this sector in the first post-Soviet years led to significant negative changes in quality of education, while a relatively lower enrolment of poor population in the high school and extremely low enrolment at the vocational education level is partially explained by their impacts. This generates some risks of poverty reproduction.

637. At the three levels of general education – elementary, secondary and high school – annual per student public expenditures have constantly grown since 2003 and in 2006 have exceeded the 2003 level by 2.4 times. However, their significantly lower (by around 8 times) than the average for the OECD countries in 2004. In 2006 the annual per student public expenditures comprised around 13.5 percent of per capita GDP against 9.1 percent in 2003 and were by 10.5 percentage point lower than the average for the OECD countries in 2004.

638. Under vocational programs, the public expenditures per student enrolled in the tertiary education system under the basic benefit package (so-called state order) have also increased in 2003-2006; though about 1.5 times slower. Owing to this development, the gap between public expenditures per tertiary educational institution student studying free of charge and per school student was reduced by around 2 times and came closer to international standards. In 2006 the public expenditures per tertiary educational institution student studying free of charge have exceeded the public expenditures per school student by 2.2 times (against 4.5 registered in 2003, and in 2004 this ratio for the OECD countries comprised 1.3). This development did not have a negative impact on the gross enrolment at tertiary educational institutions, which has grown by 5.4 percentage point in 2003-2006 and comprised around 28 percent (in 2005/2006 academic year the enrolment at the tertiary level was 101,200 students against 80,400 in 2002/2003 academic year). In 2006 the annual public expenditures per tertiary educational institution student comprised around 30 percent of per capita GDP (41 percent in 2003) reaching the 2004 average for the OECD countries.

639. There is a significant difference in public expenditures per student in the preliminary and secondary vocational education system and the secondary school. The public expenditures per student at this level of vocational school studying under the basic benefit package are 3.5 times higher than expenditures per school student, despite the fact that in 2000-2006 they have been reduced by around 2 times. They are even by 1.6 times higher than the respective figure for the tertiary educational institution. At the same time, the enrolment by poverty groups at this level of education is quite homogeneous.

640. Analysis of the 2005 IHS results suggests that the enrolment of the 6-16 years old in the educational system (preschool, general secondary school and vocational) permanently remains quite high comprising, in average, 92 percent. The indicator for the 6 years old enrolment is relatively low (50.3 percent), which suggests a delayed admission of children to the school and low enrolment in the preschool. On the other hand, starting with the age 15, the enrolment indicator begins to decline. This speaks

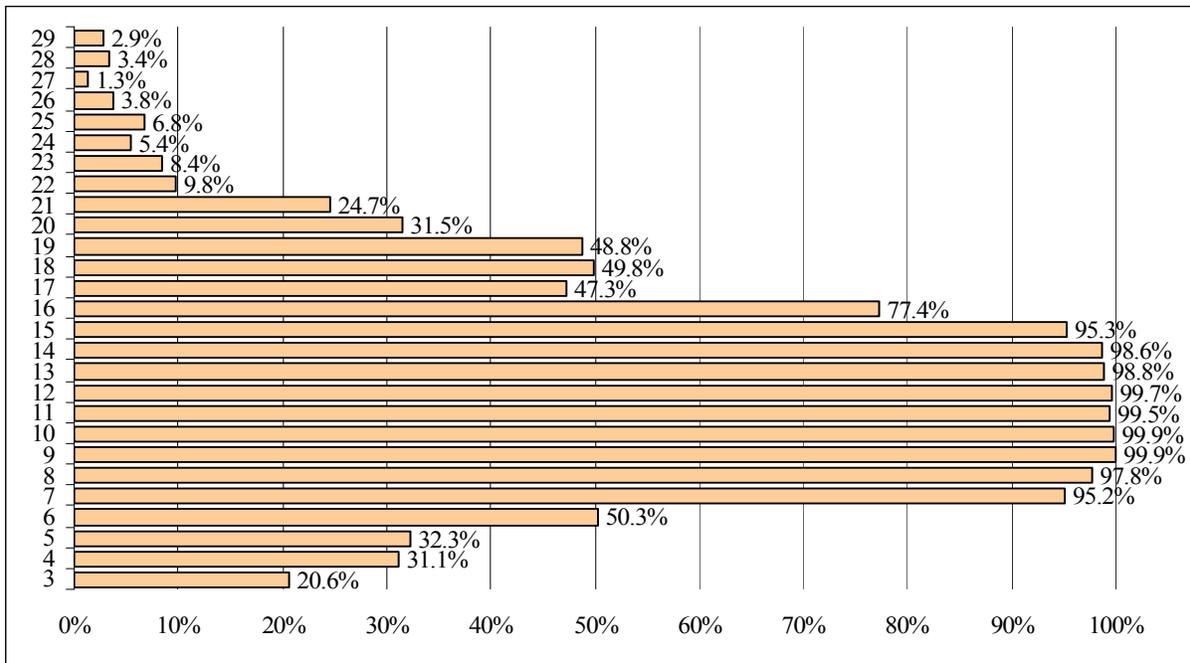
about a decline in enrolment first at the high school level, then about much drastic dropping of enrolment in professional programs as well. If the average figure for enrolment in the educational system at the age of 7-14 is 98.7 percent and at the age of 15 is 95.3 percent, among the 16-year old it comprises 77.4 percent. For the age of 17-21 this figure in average is 40 percent.

Table 12.6: Public Expenditures per School Student and Student in 2000-2006

	Average annual public expenditures per student at elementary, secondary and high schools, AMD	Average annual public expenditures per student, % of per capita GDP	Average annual public expenditures per student enrolled in the tertiary educational institution under the basic benefit package, AMD	Average annual public expenditures per student enrolled in the tertiary educational institution under the basic benefit package, % of per	Average annual public expenditures per student enrolled in SVEI/PVEI under the basic benefit package, AMD	Average annual public expenditures per student enrolled in SVEI/PVEI under the basic benefit package, % of per capita GDP	The ratio of average annual public expenditures per student enrolled under the basic benefit package to average annual public expenditures per school student	
							TEI	SVEI/PVEI
2000	36,629	...	178,242	...	220,013	...	4.9	6.0
2001	37,045	10.1	191,927	52.4	213,778	58.4	5.2	5.8
2002	35,730	8.4	194,055	45.7	243,057	57.3	5.4	6.8
2003	45,884	9.1	208,558	41.2	259,381	51.3	4.5	5.7
2004	59,870	10.1	197,275	33.2	253,738	42.7	3.3	4.2
2005	92,879	13.3	216,997	31.1	315,666	45.3	2.3	3.4
2006	111,667	13.5	245,303	29.8	388,331	47.1	2.2	3.5
OECD average, 2004*	...	24.0	...	31.0	...	16.0	1.3	0.7

Source: ROA Ministry of Finance and Economy, Education at a Glance 2007, OECD:

Figure 12.7: Enrolment of the 3-29 Year Old in the Educational System by Age, percentage



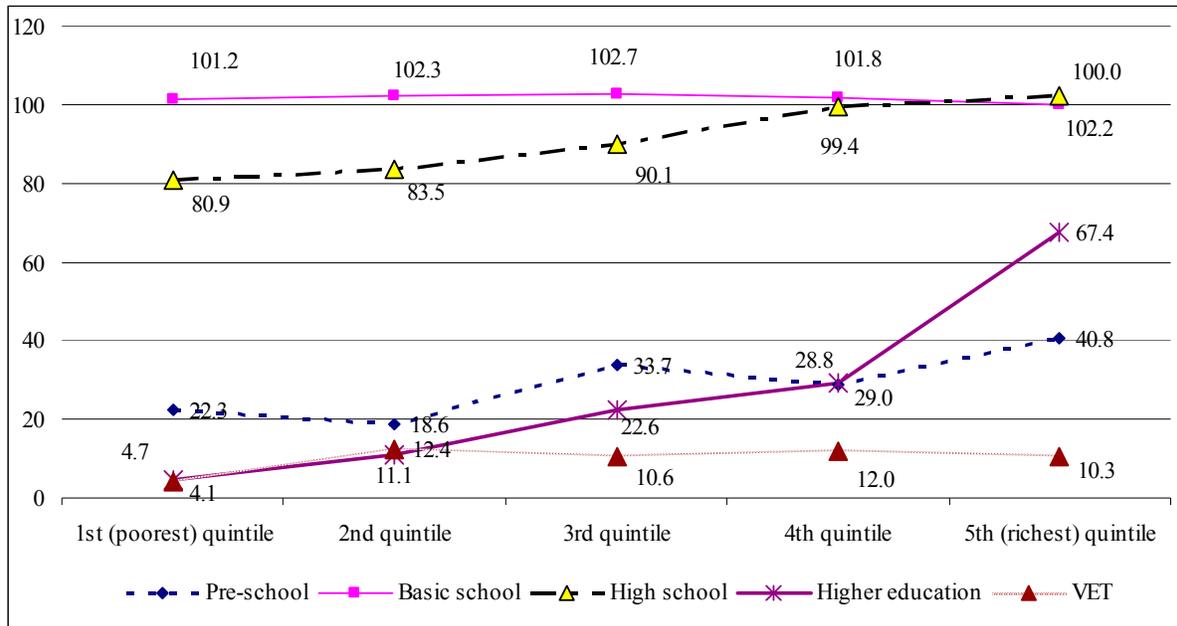
Source: 2005 IHS data

641. The summary of enrolment indicators at different levels of education is as follows:

- Gross enrolment in the general secondary education in Armenia is quite high and comprises around 90 percent. There are some differences by the secondary education levels.
- Net enrolment indicators at basic education level are also stably high – around 96 percent. Both net and gross enrolment indicators at the basic school are quite homogeneous in terms of regional, gender and poverty groups. In general, it could be stated that the basic education is universally accessible to all population groups.
- After 2002 the gross enrolment at the high school has grown reaching around 80 percent in 2005/2006 academic year against 74 percent in 2002; however, it still remains quite low (as a point of comparison, in 2004 the average for the ECA and FSU countries comprised 87 percent). The enrolment indicator distorts the fact of completing secondary education at the level of basic school due to the dispersion of age at which the schooling starts. According to the ROA NSS data, only 6 percent of the 8th grade graduates had left the school in the 2004/2005 academic year. During 2003-2005 this indicator has constantly improved comprising 10.4 percent in 2003 and 9.3 percent in 2004. Nevertheless, those who leave the educational system after graduating from the basic school are mainly the poor.

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- Compared to the average of the ECA and FSU countries, the indicators of gross enrolment in preschool and professional programs remain low, despite the fact that in 2003-2005 was noted an increase of this enrolment. In particular, the gross enrolment at the preschool in 2005 comprised 27.5 percent (the average for the ECA and FSU countries was 50.1 percent) against 26 percent in 2003; while the gross enrolment at the tertiary and post-graduate education level was around 28 percent (the average for the ECA and FSU countries was 43 percent) against 22.9 percent in 2003.
 - Despite the fact that the indicators of enrolment in vocational programs and tertiary institutions have constantly grown since 2001, they still remain quite low compared to the average of the ECA and FSU countries and extremely polarized in terms of income groups and regions (in favor of non-poor, urban population and, specifically, Yerevan).
 - There is significant inequality in the enrolment levels of poor and non-poor groups in the preschool and later in the 9th-10th grades of the secondary school, while the enrolments of different groups in the basic education are quite high and homogeneous (the ratio of enrolments for the richest and the poorest quintiles are 1.8, 1.3 and 1 respectively). The inequality becomes sharper at the level of professional programs. The accessibility of professional education for the poor youth is incomparably lower.
 - The gross enrolment of population of the relevant age with different income levels is the most unequal in the tertiary education system (where the enrolment indicator in the richest quintile is about 15 times higher than the same figure for the poorest quintile and 2.5 times higher than the country's average), while at the level of secondary and preliminary vocational education it is quite homogeneous.

Figure 12.8: Gross Enrolments in Different Levels of Education System by Consumption Quintiles, %



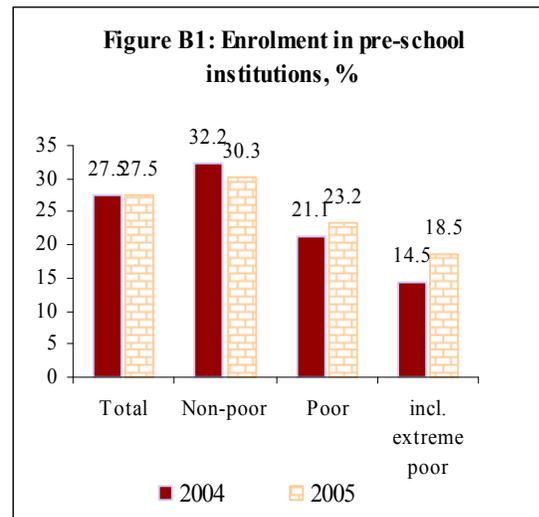
Source: 2005 IHS data

642. Due to general education sector reforms, the indicators characterizing the system effectiveness have shown positive tendencies. The student/teaching position ratio in 2006 comprised 13.7 (10.6 in 2003), while the actual student/teacher ratio was 10.9. Thus, the actual student/teacher ratio is still well behind the international standards, however, in comparison to the teaching positions, this ratio is close to the OECD average (the average student/teacher ratio in the ECA and FSU countries in 2005 comprised 13, while in the OECD countries in 2004 it was 15.1). Respectively, the density of classrooms has also grown and in 2005 comprised in average 22 students against 20 students in 2003, reaching the average for the OECD countries. The student/non-teaching workload ratio has also increased and comprised 22.5 in 2006 (20.2 in 2003). However, the ratio of non-teaching positions to teaching positions is stable and fluctuates around 0.6, which suggests that the reforms of the general education system governance (the policy of self-governance of institutions and balancing of public-society supervision) are yet to bring the desired outcomes. Taking into account the anticipated decline in demographic composition of the school age children, these indicators will require constant improvement in the years to come, even if the expected introduction of the three-year high school and the transition to the 12-year secondary education are accounted for. Despite the fact that the average monthly wage for a teaching position has grown by around 3 times in 2003-2006 and comprised AMD 58,000 in 2006, approaching the average salary rate, it still remains quite low. In 2006 the ratio of an average salary for the full-time teaching position to per capita GDP was 0.85 against 0.43 in 2003. While in 2004 this ratio in the OECD countries comprised 1.3 and it was differentiated by the length of service as well as the teaching level (elementary, middle and high schools). All of the above indicators suggest that the efficiency of the general education has certainly increased but still requires significant improvement.

Attachment 1: Enrolment at Different Educational Levels

Preschool Education:

The gross enrolment in the preschool in 2005 comprised 27.5 percent, including 38 percent for urban population against rural population's 11 percent. The accessibility of preschool education is specifically important for the poor population. The analysis by poverty groups suggests that the gross enrolment indicator shows essential differences. Thus, it was 23.2 percent for the poor population group against 30 percent of the non-poor. Among the extremely poor population this indicator is even lower (18.5 percent). However, though in 2004-2005 the national indicator for preschool gross enrolment did not change, it declined by 1.9 percentage point for the non-poor, while for the poor it has grown by 3.6 percentage point, including 4 percentage point increase among the extremely poor, which suggests that the projects being implemented in this sector are relatively more favorable for the poor. Both net and gross preschool enrolment indicators do not display significant differences in boy-girl proportion.



Source: RA NSS, IHS for 2004 and 2005.

Basic School: According to the 2005 IHS data, the gross enrolment in the basic school (elementary and middle schools), which provides the minimum mandatory educational level was 101.1 percent, which suggests that the enrolment in the basic school is sufficiently high (the average for the ECA and FSU countries is 95.7 percent). However, for the extremely poor groups this indicator is 5.4 percentage point lower than the national average and it remains around 96 percent mark. Nevertheless, the share of those who are left out of the elementary and middle schools is very small. Thus, in the 2005/2006 academic year there were only 227 people among the 1st to 3rd grade students that remained in the same grade and 1,219 students among the 7-9 year old

that left the school. In the total number of the 1st – 3rd grade students (121,502 people) the former comprised 0.19 percent and the latter around 1 percent (non-survivors to the 4th grade). These indicators are somewhat lower than the international indicators. The share of non-survivors at the 4th-8th grades is a bit higher (1.6 percent) However the additional surveys conducted by UNICEF testify to the aggravation of the situation in the recent years.

High School: Both gross and net high school enrolment indicators are decreasing. According to the ROA NSS data, the gross enrolment at the high school in 2005 was approximately 80 percent (in 2004 the average for the ECA and FSU countries comprised 87 percent). The indicators are displaying significant differences by poverty groups, showing lower enrolment of the poor. The enrolment indicators distort the picture due to uncertainty of upper and lower age thresholds. Actually, only 6 percent of the 8th grade graduates in the 2004/2005 academic year did not continue its education in the high school. This is proved by the 2005 IHS data: 6.3 percent of the 18-19 year old (who, taking into account the late admission to the school and possible remaining at the same grade, should have

Table A1: Gross and Net Enrolment in the Basic School

	Gross enrolment in the basic school, %	Net enrolment of the 7-14 year old in the basic school, %
Total	101.1	96.1
Non-poor	100.5	95.5
Poor	102.5	97.3
of which: Extremely poor	95.7	90.6
Yerevan	102.2	96.4
Other urban	100.5	95.2
Rural	100.9	96.4
Boys	101.5	96.1
Girls	100.8	96.0
ECA and FSU countries, average, 2004^A*	95.7	...
US and Western Europe, average, 2004^A*	107.6	...

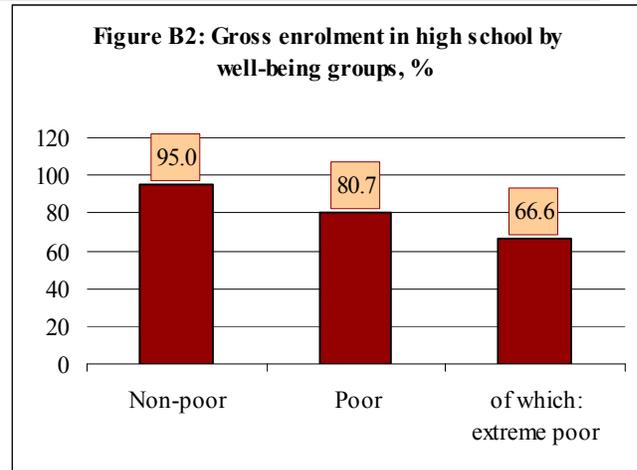
Source: 2005 IHS data, *'Global Education Digest 2006', UNESCO Institute for Statistics, Montreal, 2006

been completed their schooling at the secondary school) has a complete basic general education as the highest education received. Mainly the poor leave the educational system after graduating from the basic school.

Thus, only for 2.8 percent of the non-poor 18-19 year old the basic education is the highest education received, while 16 percent of the poor of the same age has left the educational system after graduating from the basic school. Among the extremely poor this indicator comprises 35 percent of the 18-19 year old.

Professional Education Programs: Gross enrolment in the professional programs comprised 38.4 percent, while in the tertiary system alone – around 28 percent. The enrolment indicators for professional educational programs demonstrate sharp differences in terms of both regions and poverty groups. If the SVEI/PVEI enrolment indicators are quite homogeneous in terms of poverty groups, the picture at the tertiary level is drastically polarized.

Here the enrolment indicator of the poor is 5.4 times and of the extremely poor around 8 times lower than the same indicator for the non-poor. The enrolment indicators for professional programs and at tertiary levels have accentuated regional inequalities in favor of Yerevan. In Yerevan the enrolment in professional programs is 1.8 times higher than in other urban areas and 3 times higher than in rural areas of the country. The differences are even sharper at the tertiary level, where the above ratios comprise 2.1 and 4.3 respectively. As a result, 49.8 percent of the 25-34 year old youth has some professional education, of which 27.2 percent has secondary and preliminary vocational education and 22.6 percent - tertiary education. This figure is close to the average for the OECD countries, though the gross enrolment indicators are evidently lower than in many ECA and FSU countries. At the same time, in contrast to the OECD countries, the difference in representation of professional potential between the generations is small and during the last 20-30 years it remained in the vicinity of 22 percent, which speaks about problems in reproduction of the country's professional capital.

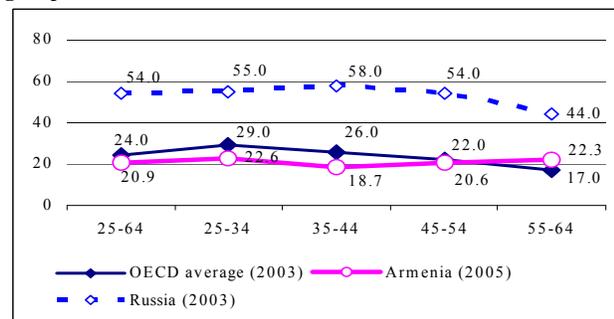


Source: RA NSS, IHS for 2004 and 2005.

Table A2: Gross Enrolment in Professional Programs, and Tertiary and Post-Graduate Education, %

	Gross enrolment in professional programs, %	Including gross enrolment in tertiary and post-graduate education only, %
Total	38.4	28.5
Non-poor	48.8	37.3
Poor	12.9	6.9
of which: Extremely poor	6.2	4.8
Yerevan	64.1	53.0
Other urban	35.7	25.0
Rural	20.4	12.2
Boys	37.7	30.3
Girls	38.9	27.2
ECA and FSU countries,		

Figure B3: Share of population with higher education by age group, %



Source: 2005 IHS data, UNESCO-UIS/OECD 2005 "Education Trends in Perspective – Analysis of the WE Indicators"

12.2.2 Primary Goals, Targets and Priorities

643. The primary goal of the SDP for the education sector is the general education. Under the envisioned reforms, a complete secondary school, including the three-year high school, is called to ensure the preparedness of graduates to enter the labor market and the opportunity to receive vocational education relevant to their inclinations and capacities.

644. In the area of general education, the program aims to improve the quality of complete secondary education, to establish and introduce an efficient unified system for its supervision and knowledge assessment, to make the quality of education relevant to the tertiary educational and international criteria, to ensure the equal accessibility of complete quality secondary education at all levels of secondary school (especially at the high school level) for **all population groups**, and constant improvement of the system's effectiveness as well as further enhancement of governance bodies and institutions.

645. Based on the above description of the situation, the following is outlined as the priority in the area of general education for the coming years: ensure an equal enrolment of all population groups in the elementary, basic and, especially, high school levels, and increased enrolment of the poor in the high school. The latter, in the context of currently envisaged high school reforms is even more important. The establishment and separation of the three-year high school contains the risk of reducing the enrolment of the poor, which makes the youth of poor families vulnerable in terms of preparedness to enter the labor market equipped with needed primary knowledge and sufficient grounds and competitiveness to receive vocational education. Due to this reason and based on the mission of the reformed high school, the issue of setting the school (instead of the elementary, basic school and vocational education) as the minimum educational level stipulated by the Law becomes important.

646. Another priority is the zoning of the high schools based on the principle that the population of relatively vulnerable communities (those are mainly small, remote, high mountainous, bordering and isolated rural communities) shall be provided with the equal opportunities to enroll in the high school without additional expenses for the population and under the most efficient arrangement and to receive complete quality secondary education. In particular, the introduction of distant learning and inclusive education systems (which, in turn, presume the introduction of communication and information technologies) in the communities without a high school, as mechanisms ensuring the aforementioned, is a priority.

647. Steps aimed at introduction of distant learning system, and expansion of the e-network of schools shall be undertaken, with the purpose of involving secondary schools in distant learning system by 2012. This target in its turn supposes introduction and enhancement of telecommunication and IT.

648. The training of teachers (especially, high school), the compliance of their career development criteria with the new curricula and the increase of the salary/per capita GDP ratio to 1.5 and stabilization at that level are priorities based on the requirements of the school reforms.

649. The replenishment of material-technical and didactic bases of the schools and the introduction of modern technologies (laboratory equipment, hardware, internet connection, etc.) are priorities for increasing the quality of general education and ensuring the mission of the high school.

650. In order to create equal starting opportunities for children from all population groups with regard to general education it is of prior importance to improve the quality and accessibility of preschool education services through setting the issue of increasing the number of children from vulnerable population groups in preschool education as a matter of state concern.

651. Highly prioritized is the improvement of health care related and consulting activities in the educational settings with the aim to develop healthy life-style principles among the school age children and teenagers continuously. This can be achieved by means of providing school students with knowledge related to healthy life-style, HIV/AIDS, STDs, psychic, sexual and reproductive health. The concept of the “Healthy Life-Style ”course is aimed at the discussion of problems related to the health and safety of the students, as well as defining the ways of solving the latter. The purpose of the course is to develop among students an ability to appreciate their own and other’s health as a basic value, as well as build up healthy behavior.

652. From the point of view of creating equal opportunities for children from vulnerable population groups in general education introduction and development of an inclusive education system is another priority.

653. The implementation of programmatic goals in the general education area will serve as a basis for the success of reforms being carried out in the area of professional education and for the implementation of second level targets of the program related to professional education.

654. At the level of professional education, the program aims to ensure equal opportunities for able youth of **all population groups** to study at vocational educational institutions, to increase the enrolment through introduction of programs raising the accessibility of professional education and to mitigate its huge inequality.

655. At the same time, it is important to carry on the reforms aiming to increase the quality of professional education and to bring it into compliance with labor market demands, strategic educational and development objectives of the country, international standards and provisions of Bologna Treaty. In this respect it is planned to have at least two internationally accredited higher education institutes by 2015.

656. To achieve these objectives, the program plans to increase the state budget allocations for the education bringing them as close as possible to the level of developed countries. At the same time, it is planned to carry on the implementation of intra-sector reforms targeting the increase of the system's quality and efficiency.

12.2.3 The Program Indicators for Public Expenditures in Education and the Expected Outcomes

657. The consolidated budget expenditures for education will permanently increase during the program period. In 2010 they will comprise 2 times of the 2006 level, in 2015- 4-fold and in 2021 will exceed it by 7.5 times.

658. In 2007-2021 the average annual increase of the consolidated state budget expenditures for education will comprise 14.5 percent. In 2007-2009 their annual average growth rate will exceed the above average by 1.6 times taking into account the anticipated process of introduction of the three-year high school. Thereafter, the growth rate of education expenditures will gradually decrease and after 2015 will be sustained in the vicinity of 9-10 percent. This decrease will be explained by expected demographic changes of the country's population, i.e., by the decreasing number of beneficiaries.

659. The implemented policy will also ensure a constant increase of the share of consolidated budget expenditures for education. Throughout the program, the share of education expenditures in the consolidated budget will grow by 2.2 percentage point, from 2012 on stably exceeding 14% and in 2021 exceeding 15%. In 2008-2012 the share of education expenditures will demonstrate a higher growth rate than the overall expenditures of the consolidated budget. Such ratio is explained by the demands of successful implementation of reforms in education and, specifically, in the area of general secondary education.

Table 12.7: Program Indicators of the Consolidated Budget Expenditures in Education Sector

Indicators	2007	2008	2009	2010	2011	2012	2015	2018	2021
Consolidated budget expenditures allocated to education, AMD billion	95.4	110.9	135.1	156.0	179.1	211.4	313.5	419.4	590.2
Changes in percentage against the previous year	30.5	16.3	21.9	15.4	14.8	18.0	15.4	11.7	10.9
Index, 2007=100	100.0	116.3	141.7	163.5	187.8	221.6	328.8	439.8	618.6
Education sector expenditures, % of the GDP	3.0	3.0	3.2	3.3	3.4	3.6	4.0	4.1	4.5
Education sector expenditures, % of the consolidated budget expenditures	13.2	12.6	13.5	13.6	13.7	14.3	14.9	14.6	15.4

660. Due to increase of public expenditures in education sector, their share in the GDP will steadily grow and will reach 4 percent of the GDP in 2015 and 4.5 in 2021. Thus, in 2021 this indicator will increase by 1.7 percentage point as compared to 2006 and will approach the 2005 average for the ECA and FSU countries. However, in nominal terms, this growth will ensure approximately 7-time increase of annual public expenditures per beneficiary compared to 2006.

661. Taking into account the reforms in general education area, the share of general secondary education in the public expenditures of education sector will fluctuate around 75 percent in 2007-2012 (and for general secondary and special education 78 percent). After 2012 it will gradually decrease ensuring an increased share of professional program expenditures, and will stabilize around 70 percent in 2021 approaching the 2004 average for the OECD countries (around 68 percent).

662. The share of expenditures allocated for professional educational programs in the total educational expenditures will increase by 5 percentage points throughout the program life and will reach 16 percent in 2021.

Table 12.8. Intra-Sector Structure of Expenditures in Education Sector, % *

Indicators	2007	2008	2009	2010	2011	2012	2015	2018	2021
Total public expenditures in education sector, %	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
including:									
Elementary, basic and secondary general, special education, %	81.9	76.6	78.4	78.4	78.2	78.0	75.0	73.0	73.0
Sector expenditures, % of the GDP	2.5	2.4	2.6	2.6	2.7	2.8	3.0	3.0	3.3
Professional programs, %	9.6	13.0	11.3	11.3	11.6	11.7	14.1	15.8	16.0
Sector expenditures, % of the GDP	0.29	0.40	0.37	0.38	0.41	0.42	0.56	0.65	0.72

* Consolidated budget expenditures

663. The increase of public expenditures with such proportions will lend an opportunity to double the 2006 per student public expenditures in 2009 and exceed it by around 7 times in 2021. On the other hand, the ratio of annual per student expenditures to per capita GDP will also grow and in 2021 will comprise approximately 20 percent of the latter.¹⁸⁴ According to estimates, such policy will help to raise the gross enrolment in general secondary education to 96 percent in 2012 and to 98 percent in 2021 increasing, at the same time, the high school enrolment of poor population.

¹⁸⁴ Such developments are also stipulated by demographic forecasts that predict the decrease of population of relevant age. Even in event of the introduction of the three-year high school in 2009 and the expansion of the student base, only in 2018 the number of students will recover to the 2006 figures for school age population.

Table 12.9. Per Student Public Expenditures in Elementary, Secondary and High Schools

	Average annual per student public expenditures in elementary, secondary and high schools, AMD	Index, 2006=100	Average annual per student public expenditures in elementary, secondary and high schools, international dollar	Average annual per student public expenditures in elementary, secondary and high schools, % of per capita GDP	Estimates of school age population numbers, thousand people	Index, 2006=100
2007	166,494	149	1,284	17.1	432.7	94
2008	194,114	174	1,558	17.5	405.8	94
2009	228,803	205	1,744	18.2	430.0	106
2010	248,351	222	1,807	17.6	457.7	106
2011	295,995	265	2,064	19.0	443.4	97
2012	341,252	306	2,299	20.1	433.8	98
2015	480,166	430	2,922	21.8	432.5	102
2018	586,281	525	3,232	20.7	468.8	103
2021	736,460	660	3,683	20.4	524.1	104
OECD average, 2004	...	...	6,875	24.0	...	...

664. Expenditures for professional education, by specific programs, will be aiming at progressive increase of the tertiary education share. The latter will help to reduce the gap in per student public spending between secondary vocational and tertiary education levels. At the same time, taking into account the increase of public spending in the general secondary education, it would be possible to retain the average 1 to 2 ratio of per school student and per tertiary student annual public expenditures.

Table 12.10: Intra-Sector Structure of Public Expenditures in Professional Programs, %

	2007	2008	2009	2010	2011	2012	2015	2018	2021
Share of spending for professional programs in education expenditures, %	9.6	13.0	11.3	11.3	11.6	11.7	14.1	15.8	16.0
of which:									
Share of preliminary and secondary vocational education, %	3.7	6.8	4.6	4.4	4.2	4.2	4.5	4.9	5.0
Share of tertiary and post-graduate education, %	96.9	179.9	121.1	115.8	110.5	110.5	118.4	128.9	131.6

665. Public expenditures in the general education area will be mainly target the increase of current spending share. Around 21.5 percent of 2005-2006 spending for general education was capital expenditures and this figure is essentially higher than the international standards. Taking into account the need for capital expenditures related to development of the high school, the share of capital expenditures will grow by additional 3-4 percentage point in 2008-2009, then will reduce to 15 percent in 2012 and stabilize around 8-9 percent after 2017.

Table 12.11: Structure of Public Expenditures in General Education, %

	2007	2008	2009	2010	2011	2012	2015	2018	2021
Public expenditures in general education, %, including:	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Current, %	74.7	74.5	75.0	80.0	85.0	85.0	90.0	91.0	92.0
Index, 2006=100	95.2	94.8	95.6	101.9	108.3	108.3	114.7	116.0	117.2
Capital, %	25.3	25.6	25.0	20.0	15.0	15.0	10.0	9.0	8.0
Index, 2006=100	117.5	119.0	116.1	92.9	69.7	69.7	46.5	41.8	37.2

666. Such financing will help to increase teachers' wages and, at the same time, continue their training and, thus, support the improvement of general education quality. The policy will aim to bring by 2007 the average salary of teachers to per capita GDP level and then continue to increase it: in 2009-2011 the average salary of teachers to per capita GDP level will rise from 1.1 to 1.3 points. It is envisaged that in 2012-2021 the teacher's salary will stably exceed per capita GDP level by 50-60 percent. It is estimated that in 2007 to an average monthly salary for teaching position will raise to AMD 74,000; in 2012 this amount will increase by 2.8 times and in 2021 by around 6.5 times of the 2007 level.

667. To ensure these developments, the effectiveness of general education system will continue to improve. Particularly, it is estimated that the student/teacher ratio in 2009-2012 will be brought to 14.55-14.56 and will be maintained at this level. In 2009-2011 the student/non teacher ratio will significantly increase and reach 24.11, 24.12 and 24.14 respectively. Then it will gradually increase up to 26 in 2021. The latter will help to reduce the non-teaching position/teaching position ratio from 60% in 2006 to 52 percent in 2012 and to 50 percent in the following period.

668. In the first phase of program implementation (2007-2012), the salaries will in average comprise 78 percent of current spending of education, which will help to make other required current expenditures.

669. It is planned to continue special government support to the training of teachers from rural, bordering and mountainous communities and to the replenishment of their teaching staff with qualified specialists as well as to carry on the policy of providing the elementary school students with textbooks and literature.

670. The policy in the professional education area will be aiming at the competitive education, the encouragement of higher educational achievements, the implementation of public financing arrangements that will be based on abilities and educational merits of the youth assessed by unified criteria with an objective to ensure the accessibility of professional education and to mitigate the inequality of enrolment of different social groups at this level of education. In particular, some schemes (as a supplement to the basic benefit package) for provision of public subsidies (scholarships, student loans and grants) to the most talented graduates and students that have displayed high academic progress will be developed and introduced. Specifically, these schemes will envisage

more friendly terms and conditions for the youth from vulnerable families. The application of such approaches shall be aiming to increase the enrolment at the professional education level of the poor as well as the youth living far away from the tertiary educational centers and to mitigate the inequality of enrolment of different social groups at this level. It is expected that the implemented policy will increase the gross enrolment in the tertiary education reaching 33 percent in 2012 and 42 percent in 2021. At the same time, it is anticipated that the gap in the enrolment of poor population compared to the non-poor will be reduced at least by 2 times.

12.3 Poverty Reduction: Culture Concept

12.3.1 General Overview

671. The culture concept of poverty reduction is based on the following approaches:

a) While the causes of poverty are linked to economic, political and social transformations, the cultural components (national identity, prevalence of traditional national system of values, historical and cultural heritage, specific national world outlook) also have an impact on the level of poverty.

b) The goals and objectives of the culture sector emanate from the belief of the society that cultural activity should first and foremost be aimed at the preservation, presentation and promotion of the system of national and cultural values, the shaping of the citizen and formation of a cultural milieu of a newly independent state, enhancement of social and psychological environment of the society and ensuring the cultural security of the nation.

c) The state is one of the main actors in ensuring realization of the citizens cultural activities, their access to education, cultural services and benefits, in safeguarding their right to make use of the latter, as well as providing for the reproduction and development of the cultural potential of the society.

672. Social and historical transformations cause changes in the national mentality and value system (that is primarily reflected through culture), affecting the society's social and economic development. After the independence, the quest for new ideas to the point of relinquishing traditional values and unjustified rejection of material and spiritual values created in the past, and the import of foreign "mass" culture resulted in the diminished significance of the national culture. The unjustified decentralization of the cultural policy, lack of cultural strategy and inaction or closure of cultural institutions due to financial reasons, lack of demand for the services of artists and cultural workers and their dire financial straits also played a negative role. All these developments brought about an outflow of artists and culture professionals from the country, deteriorated the quality of cultural education and services, while many artists had to change their professional occupation. The situation is even more deplorable in the regions of the country, where the collapse of the cultural infrastructure resulted in the disillusionment of culture professionals, looming poverty and lack of hope for a better future. Culture clubs and centers (where most of the community cultural life took place) closed down en masse, making numerous culture professionals jobless and depriving the communities of access to and participation in cultural life. Artisans, craftsmen and folk ensembles that were the bearers and keepers of the national intangible culture, also lost opportunities to work and create. The community libraries, the main sources of information for the community population, also appeared in dire straits. Institutions of cultural education (music and arts schools, art centers) experienced organizational, staffing and material problems. Cultural education became beyond reach for children from socially vulnerable households, which, in its turn, brought to a drastic decrease in

the number of children attending such institutions. Remuneration of teachers, due to a combination of objective and subjective factors (shortcomings of the legal framework, poor economic conditions of the communities, uncertainty of the status of teachers), is the lowest in the country, equaling the minimum salary level; all this resulted in drastic decrease in the number of teachers and their total lack in some of culture disciplines. The area that suffered the most was the folk music education. These developments could not but have negatively affected the human resource situation in the culture sector. The salary levels of the still functioning community culture institutions are among the lowest; their material base is extremely meager and obsolete, while their premises have not been renovated for decades.

673. **3.** The conclusions drawn from the developments described above are as follows:

a) In a free market economy, non-interference of the government in the cultural life resulted in the substitution of real cultural values with a “fake” culture, which promotes values that do not contribute to the enhancement of the social and psychological environment of the society, are often perilous in terms of the preservation of national identity, and promote spiritual values that are detrimental in terms of the establishment of a free national state; such values further aggravate the sense of disappointment and despair among vulnerable population groups. Chaotic and poor cultural market is a precluding factor for the promotion and popularization of the true national culture. In this sense, the investments made often promote cheap art in pursuit of short-term gain, but seldom create lasting values. Such cheap art, in its turn, creates distorted perception of culture and consolidates uneducated and undemanding audience. The creation of true cultural values requires serious investment on the part of the artists; such investment, however, has not yet been required. Such investment can only be made in the framework of a sound national policy for culture. The creation of a real market for cultural products and services is one of the priorities of the national culture policy, which could play a crucial role in reduction and elimination of poverty.

b) Recently, the national cultural life concentrated in the capital, which preserved the opportunities for engaging in cultural activity; therefore, many artists from the regions migrated to the capital thus contributing to the further impoverishment of cultural life in the regions. There has been a drastic decrease in the cultural exchange between the capital and the regions.

c) The lack of professional training and education system precluded successful integration of a considerable number of culture professionals in the new system of relations. On the other hand, the demand for new cultural professions is not adequately met due to the lack of qualified professionals.

d) The cultural factor, along with economic, political and social ones, plays an important role in the poverty assessment criteria; so far, however, this factor has not been duly taken into account. Sometimes, this factor is even more important for reducing poverty as it provides a basis upon which the system of actions aimed at reducing poverty may be built.

674. The cultural concept of poverty reduction includes, as an important component, the protection and utilization of cultural heritage, both tangible and intangible. The popular belief in this country is that Armenia, as a country of ancient civilization, has a unique and significant contribution to the development of human civilization as such. Armenia's cultural heritage is considered as an integral part of the country's image. On the one hand, one of the priorities of a newly independent state is to protect and to use its cultural heritage, which, in its turn, will contribute to the strengthening of the nation's self-esteem and recovery of the national traditions and way of life. The recovery of national beliefs, habits, family traditions, morality and social behavior norms and traditional lore may contribute to the improvement of the morale of the society. This will implicitly transform the people's perception of poverty and create a sound basis for poverty reduction. On the other hand, putting the cultural heritage to use in other fields (e.g. in tourism) may help create jobs and increase incomes of culture professionals. One of the potential avenues of intervention is the development of national arts and crafts, incorporation of restored historical and cultural monuments in travel itineraries and destinations, creation of ethnographic or arts and crafts centers in the vicinity of historical and cultural monuments, recovery of national festivities and lore, etc. The involvement of the local population may become an important undertaking in terms of poverty reduction.

675. NGOs, mass media and other stakeholders will be actively involved in the implementation of the provisions of the cultural component of the poverty reduction strategy.

676. Advocacy of such national values as prudence, entrepreneurship and industriousness, tolerance and other cultural values will contribute to the promulgation of the ideology stating that these values have always been and continue to be the building blocks of any equitable and prosperous society. In this respect TV and radio programs, lectures and training programs, as well as the creation of respective outreach centers could be an effective way of reaching this goal.

677. The cultural policy of the government of RA aims to improve the social conditions of culture professionals, provide increased access to cultural services and cultural education and establish a sound cultural environment in general. These issues are addressed in a draft program on the development of cultural life in the regions of Armenia, an action plan for the protection and sustainability of intangible cultural heritage, as well as the country's mid-term expenditure framework.

12.3.2 Objectives

678. The objectives of the culture component of the poverty reduction strategy are as follows:

a) Improvement of social conditions of artists and culture professionals;

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- b) Participation in cultural life, increased access to cultural services and formation of a sound cultural environment in general;
 - c) Increased access to cultural education;
 - d) Enhancement of a healthy social and psychological environment; ensuring the nation's cultural security;
 - e) Making the cultural life in the regions of Armenia more active, involvement of regional artists in the regional cultural life.

12.3.3 Key components of the culture concept of poverty reduction

12.3.3.1 Preservation of cultural heritage

679. **Research, protection, conservation, restoration, recovery and utilization of stationary cultural monuments.** The research, protection, conservation, restoration, recovery and utilization of stationary cultural monuments (especially in the border regions), as well as the implementation of a balanced policy for the protection and utilization of such monuments across the regions will contribute not only to the protection and sustainability of cultural heritage for future generations, but will also help boost tourism development and the creation of local artisan centers. Favorable conditions will be created for the local population to engage in lucrative activities and have jobs. Participation of local population in archaeological excavations (for jobs that do not require special professional skills) will also secure more employment. Incorporation of cultural and historical monuments in travel itineraries and tourism destinations and organization of various events along with the creation of artisan centers are deemed as the key priorities under this component.

680. To this end, it is planned to identify and study historical and cultural monuments and include them in the National Register of Cultural and Historical Monuments; there will be 5 to 10 such newly discovered monuments, with 1 unit subject to protection by the state, to be included in the Register annually. Archaeological research of these monuments and other archaeological sites (with archaeological works commissioned at 20 to 30 sites annually) will be carried out, as well as analyses (monitoring) of the conditions, suitability and feasibility of operation, layout and accuracy of protective zones.

681. Between 2008-2013, from 1,000 to 1,500 monuments and archaeological sites will be thus monitored, to result in the formulation of proposals for the format and procedure of operation of these sites, development of prioritized scoping plan for the recovery (reinforcement, conservation) of the monuments, design of protective zones for 400 to 600 monuments; designs of such zones for additional 200 to 400 monuments will be reviewed and updated. Recovery (reinforcement and conservation) works will be undertaken for 10 to 15 monuments annually. Between 15 to 20 historical monuments and archaeological sites will be annually included in tourist travel destinations and itineraries. A procedure for management of a cadastre of historical and cultural monuments will be established.

682. **Development and implementation of an integrated program for conservation of cultural values.** The implementation of an integrated program for conservation of cultural values will enable the conservation of the country's rich cultural heritage and will help in making it more accessible for the population. Such an integrated program will enable the citizens to communicate with national cultural treasures and will increase access to cultural services and benefits, will help develop a civil society that is more understanding about the role and significance of culture and will ensure the protection of cultural values.

683. A series of actions are envisaged to fulfill the abovementioned objectives; these actions mostly aim at conservation and eventual use of museums, libraries and archive collections. In particular, it is planned to implement an integrated program on Armenian museums and libraries, in the framework whereof systems will be developed, procured and installed to improve conditions for storage and management of art collections and archives; it is also envisaged to introduce a system for surveillance/monitoring of museum and library collections.

684. Another aspect of conservation of Armenia's cultural values comprises the protection of intangible cultural heritage. The priorities in this area include:

- a) Promoting interest of population at large towards intangible national cultural values and involvement of the population in various cultural undertakings.
- b) Implementation of specific program in the area of conservation of intangible cultural values (ethnographic heritage, traditional arts and crafts).

685. The conservation and development of intangible cultural heritage will contribute to the presentation of traditional culture to the public and its transfer to future generations, and will enable integration of its elements in modern art and modern interpretation of traditional values. Supporting organization of national festivities, celebrations and games will also contribute to the reversal of trends threatening national identity and moral values. For the purposes of addressing the above issues, a program on conservation of intangible cultural values will be implemented, including:

- Support to the development of traditional arts and crafts;
- Establishment of family artisan workshops, as well as training on national arts and crafts, development and publication of training materials and guides;
- Compiling lists of intangible cultural values both in Armenia and abroad and publication thereof;
- Government support to artisans and national arts and crafts development;
- Training on folk music and dance;
- Establishment of folk theatres;
- Conducting national traditional festivities and writes and production of respective films.

686. Samples of non-material cultural values will be collected and studied, an assistance program will be developed and implemented in support of organizations engaged in collection and dissemination of national non-material cultural values, materials, research and textbooks will be commissioned and published, a program will be developed for research and conservation of Armenian non-material values abroad, an inventory of non-material cultural values will be undertaken.

687. **Promotion of and increased access to cultural values.** The promotion of cultural values and their increased accessibility for the population are among the key components of the culture concept of poverty reduction strategy. Increased access of the population to cultural values implies a set of actions that will result in efficient and balanced distribution of cultural institutions across the country and ensuring that socially vulnerable population has access to the services they provide.

688. Establishment of criteria for efficient distribution of cultural institutions (including number of institutions/population ratio) and the development and implementation of a program to ensure such distribution would require the following actions:

- Defining of criteria for efficient distribution of cultural institutions, including number of institutions/population ratio;
- Mapping of efficient distribution of cultural institutions;
- Development of a system of subsidized access to paid cultural services and establishment of new rates of such access;
- Implementation of a distribution program
- Monitoring of efficient distribution of cultural institutions.

689. Even distribution of cultural institutions implies, besides their efficient distribution, proper planning with regard to their services and staffing. The number of cultural institutions in the regions is extremely disproportionate to the size of the population of these regions. One of the key issues is to establish the required number of cultural institutions to enable universal access to the services they provide. In this sense, situation is more favorable in Aragatzotn, Shirak, Vayots Dzor, Syunik and Tavush regions, while the number of such cultural institutions in Lori, Kotayk, Ararat and Armavir is extremely limited. Even distribution of cultural institutions implies, besides their efficient distribution, setting proper frameworks for their operations and services, as well as adequate staffing.

690. Recovery of regional culture clubs should become a priority, since these play an important and multi-dimensional role at the community level; they host community libraries, recreation centers, folk ensembles, artisan workshops and studios and, in general, provide a venue for all types of cultural activity. The recovery of culture centers in the border communities should be a priority, since these centers will help address a whole range of issues including the creation of new jobs, decreased outward migration,

promotion of national and cultural values among the youth, etc. Such approach is also well justified in view of national security considerations.

691. A national program for the promotion of national cultural values will be commissioned to address the following issues:

- Ensuring access to museum and library collections in hard copy and electronic formats;
- Increased access of the local population and tourists to the museums by means of publication of museum maps and guides;
- Branding and local and international advertising of Armenian culture for the purposes of creating increased awareness about Armenia and building a positive image of the country.

692. Besides, it is planned to annually produce 3 to 5 documentary films and TV program and publish 2 to 5 publications on Armenia's cultural monuments.

693. For the purposes of increasing access to the national cultural heritage, new IT and communication technologies and electronic information management systems will be developed and introduced, including:

- Online storage of museum, library and archive collections, creation of websites and a unified portal;
- Development of multimedia programs for libraries and archives;
- Development of virtual museums and audio guides;
- Development of a project for the creation of a consolidated database on Armenian libraries, museums and archive collections;
- Creation of a consolidated database on Armenian libraries, museums and archive collections;
- Development of a project for the creation of an electronic data management system;
- Establishment of wide area network between cultural institutions;
- Creation of a central hub connecting all cultural institutions;
- Testing and deployment of the wide area network connecting all cultural institutions;
- Increasing access to information in Armenia's border, high alpine and remote communities.

12.3.3.2 Promotion of modern art, development of cultural infrastructure; promotion of cultural processes

694. The promotion of modern art, development of cultural infrastructure and promotion of cultural processes will be carried out through support to debut and pilot program, implementation of grant projects and creation of conditions necessary for the development of various fields of art including fostering cultural interaction, integration of traditional non-material cultural values in the modern art, promotion of competitive modern art.

695. It is planned to provide government assistance to cultural and art programs undertaken by cultural institutions; such assistance will be provided on competitive basis. A system for public support to the consumers of cultural services will also be in place. The deployment of such a public support system will aim to ensure increased access of the population to culture and works of art. A new pricing policy and subsidies for socially vulnerable population groups will also contribute to this objective.

696. The provision, on a competitive basis, of government assistance to projects undertaken by cultural institutions is also extremely important in terms of promotion of cultural processes. Continued implementation of a 'Debut' grant programme to support young talented artists will also help reach the objectives of this component.

697. For the purposes of the above, it is planned to implement a program on Support to Theatre and Dance Companies whereby state funding will be provided, on a competitive basis, to projects undertaken by these cultural institutions; mechanisms for the earmarking and allocation of such priority-based support will be improved and implemented.

698. For the purposes of improving the social conditions of culture professionals and creation of favorable conditions for creative activity, the government will continue its support to and promotion of performing arts by means of commissioning and sponsoring socially oriented performances and works of performing art (this process started in 2001). This process will pursue two major objectives – to introduce modern plays and performances in the repertoire of theatre companies and improve the social conditions of actors and performers.

699. For the purposes of the development of modern art infrastructure, it is planned to renovate the buildings and premises of cultural institutions and provide them with technical and material base, including:

- Design of a program for the renovation of buildings and premises of cultural institutions and upgrade of their material and technical base;
- Assessment of the needs of cultural institutions in terms of buildings, premises, equipment and supplies;

-
- Registration and classification of cultural institutions in small, medium and big communities;
 - Implementation of an integrated program on supplying cultural institutions with modern equipment;
 - For the purposes of the development of modern art, inter-regional cultural exchange program and guest tours of performing companies will continue to include guest performances of Yerevan and regional theatre companies, as well as deployment of mobile movie theatres and libraries (Bibliobus).

700. The key objectives under the component on art development and promotion of cultural movement and interaction include:

- Implementation of a state grant program in the arts sector (music, theatre, visual arts, cinematography, dance, circus, literature, etc.);
- Ensured protection of copyright;
- Increased opportunities for cultural institutions to engage in entrepreneurial activity.
- Broader opportunities for promotion of works of art, including through the mass media and online.
- Establishment of a public fund for art promotion.

12.3.3.3 Human resource policy in culture sector and culture education

701. On November 18, 2004, the Government endorsed, by its decree No. 47, the Agenda for Cultural Education. Pursuant to the programme of the agenda, government subsidies will be provided, as of 2007, to children from socially vulnerable households studying in music and art schools. It is envisaged that after proper research and as appropriate, such subsidies will be provided in other fields of art as well. In order to increase access to cultural education, reference school centres will be established across the regions of Armenia to provide more in-depth specialised cultural education, ensure high quality and accessibility of such education. The top priorities of the Agenda include the provision to art schools of modern facilities and equipment, new instruments and supplies, renovation of their buildings and premises.

702. The human resource policy in the culture sector will be aimed at the development and implementation of a comprehensive programme of professional training and re-training, research and analyses of human resource situation in the regions, development of workable schemes for distribution of culture professionals across regions, improved mechanisms for government funding for the training of culture professionals, as well as:

- Preparatory works for introduction of curricula to train professional in new fields;
- Introduction of a flexible mechanism for free of charge musical education;

- Establishment of subsidized quotas for students of secondary and higher cultural education institutions;
- Increased access to art education for the socially vulnerable population groups;
- Training of professionals in new fields of art education.

703. 2008-2021 will see further promulgation of a system of training for managers in the culture sector. This framework envisages training of managers in the culture field both in Armenia and abroad, regulation of human resource issues in the culture sector, streamlining of professional and service requirements for culture professionals, staffing of culture institutions with properly trained managers, deployment of managers of culture institutions, proper professional staffing of culture institutions functioning in border, mountainous and remote communities.

12.3.3.4 International cultural interaction and cooperation

704. Development of cultural ties with foreign countries is an important component of the cultural dimension of poverty reduction since cultural exchange, involvement in international specialized structures, expansion of cultural dialogue, the promotion of Armenian cultural heritage and involvement of the Diaspora may have positive impact on Armenia’s cultural development and the creation of a competitive modern art infrastructure. These developments will also contribute to the resolution of numerous challenges in the culture field.

705. This component envisages implementation of coordinated programs aimed at strengthening of the ties that link Armenians to their motherland and conservation of the national cultural heritage, the establishment of a pan-Armenian cultural information database, creation of guarantees for conservation and protection of Armenian cultural heritage, protection of Armenian national identity and strengthening of ties with the motherland, preservation of the Armenian Diaspora and its involvement in the international cultural exchange, professional presentation and dissemination of information on Armenia and Armenians worldwide, countering disinformation and negative propaganda.

12.3.4 Funding of programmes in the culture field for 2008-2021

706. The general timeline for the implementation of programmes set forth in the cultural agenda for poverty reduction covers 2008 – 2021. The measures will be implemented in two phases, with the first phase covering 2008-2013, and the second one spanning the period between 2013 and 2021. Upon completion of the first phase and as necessary, programme assessment and revision will be undertaken and new priorities will be set.

Table 12.12. State Budget Funding of Key Components of the Culture Sector, 2006-2021

Titles of Expenditure Operational Classification subgroups	2006	2007	2008	2009	2010	2011	2012	2015	2018	2021

	Actual	Actual	Assumptions							
Total, AMD bln including	8.7	10.1	9.2	10.4	10.8	11.3	12.4	16.5	220	29.2
Libraries	0.76	0.88	0.92	1.16	1.1	1.0	1.1	1.5	2.0	2.6
Museums and exhibitions	1.88	1.40	1.26	1.51	1.42	1.42	1.56	2.06	2.7	3.5
Culture clubs, centres	0.77	0.026	0.023	0.034	0.035	0.035	0.034	0.051	0.07	0.092
Other culture institutions	0.61	0.57	0.57	0.668	0.58	0.59	0.653	0.88	1.2	1.56
Art	2.99	4.28	3.27	3.74	4.49	5.011	5.53	7.0	9.34	13.0
Cinematography	0.48	0.58	0.6	0.7	0.62	0.62	0.686	0.88	1.20	1.51
Restoration of monuments and cultural values	0.77	0.055	0.056	0.074	0.76	0.76	0.84	1.12	1.54	1.97
Political parties, NGOs, trade unions	0.18	0.2	0.18	0.17	0.179	0.179	0.20	0.31	0.40	0.53
Capital reconstruction of cultural sights and restoration of monuments		2.1	2.3	2.3	2.3	2.3	2.5	3.13	4.5	5.1

707. Funding of the culture sector in 2008-2021 will be provided from the consolidated state budget, as well as from the private sector and other sources. Table 12.12 reflects state budget funding projections for 2008-2021. In the long term, priority will be given to libraries, museums and exhibitions as a reflection of importance of consolidation of cultural values and increased access of the population to these values. The operational to capital expenditure ratio in the culture sector funding will remain stable at the level of 20 to 80 percent respectively.

12.4 Youth Policy

12.4.1 Situation Overview

708. Like in all other transition societies, the vigorous formation of various social groups and strata in Armenia was mostly self-regulated. Youth organizations that emerged following the collapse of the Soviet Union involved only a small part of the nation's youth and were not even aware of each other's existence. These organizations took over some functions related to the implementation of a youth policy spontaneously, without coordination and targeted assistance from the state. In socio-economic and political domains, the youth had to grapple with both the society's and their own specific problems.

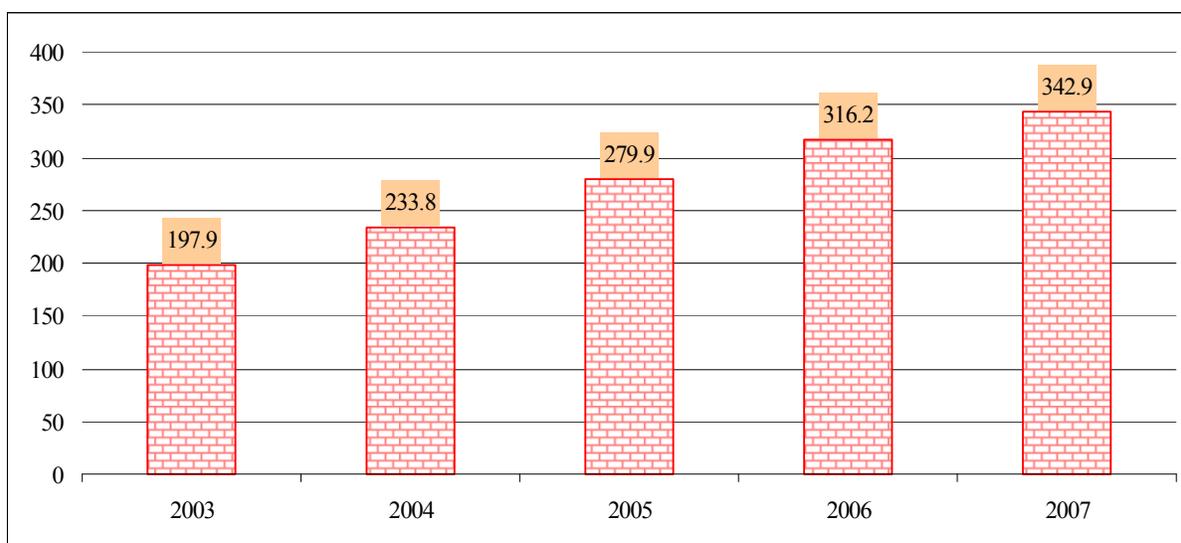
709. Armenia started implementing a coordinated national policy for youth since 1995, when a department of youth issues (subsequently youth policy) was created in the Ministry of Culture and Youth Issues. This was in itself a serious accomplishment by and for the youth. Structural reforms of the Ministry in 1998 resulted in re-naming and re-orientation of the youth issues department into a youth policy department in 2002. Since 2007, the Ministry of Sport and Youth Issues is the state authority in the area of youth policy development and implementation. Structural reforms were accompanied by the creation of new state structures for the implementation of the national youth policy.

710. Armenia's youth policy is guided by a government decree No. 798 of December 14, 1998, which spelled out the core principles of the national youth policy. The document establishes the beneficiaries of the national youth policy, its key principles goals and objectives.

711. Investment in human resource development is extremely important for resource-poor Armenia. The youth (16 – 30 years of age) comprises, according to 2005 Statistical Yearbook of the National Statistical Service, 821,600 persons, or 25.6% of the population, and is an important resource for the society.

712. The state budget appropriations for national youth programmes increase annually. The dynamics of youth programme funding in 2003 – 2007 is presented below.

Figure 12.9. State Budget Funding of Youth Programmes, 2003 – 2007, AMD mln



713. Since some portions of the state budget appropriations for education, health, social protection, sports and other sectors also target youth, it may be stated that the real size of state funding for youth is even greater.

714. Besides state budget appropriations for youth policy programme implementation, there are also alternative sources of funding, including local and international NGOs, international organisations, community budgets, charity organisations, etc.. The biggest such source of funding is All Armenian Youth Fund.

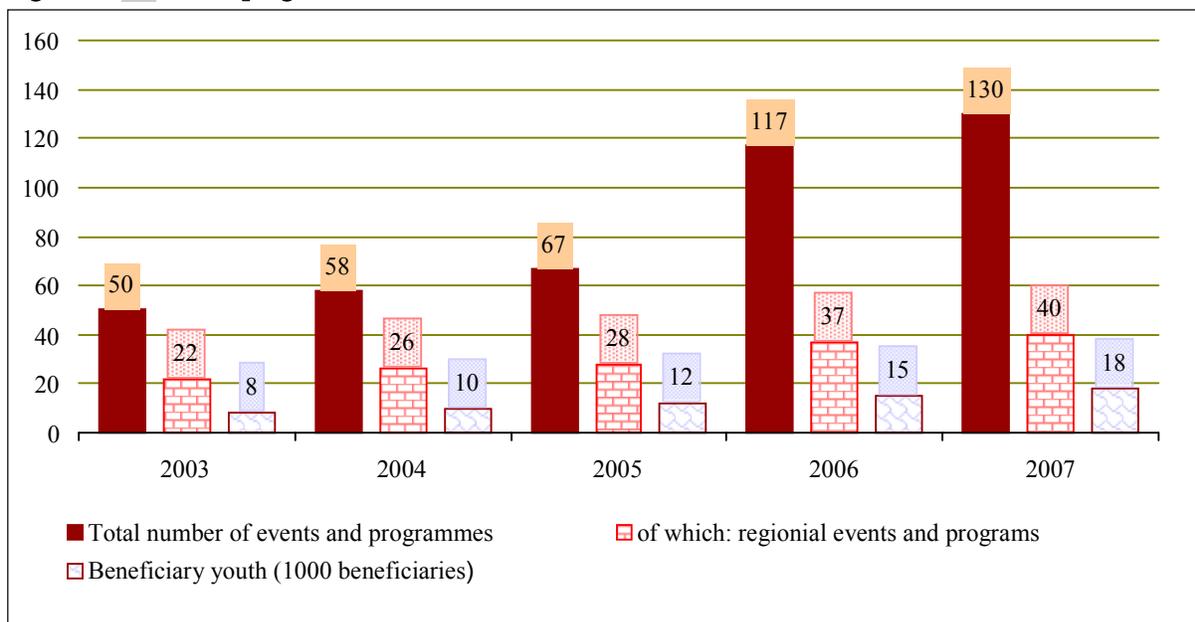
715. Youth programmes implemented between 2003-2007 mostly addressed the following objectives of the national youth policy:

- Contribute to increased spiritual, cultural and education level of the youth, enable meaningful leisure, analyse and address the current socio-economic challenges and encourage talented youth, devise and implement environmental, health, sports,

employment, professional orientation, education and training and other initiatives with active participation of the youth themselves.

- Implement projects aimed at patriotic education of the youth, ensuring their more proactive stance in the society, sensitising and developing cooperation with international youth structures, creating an enabling environment for information exchange, establishing regional youth centres, implementing initiatives for rural youth development and creating an enabling environment for their self-fulfillment (see Figure 12.10).

Figure 12.10. Youth programmes and events, trends in 2003-2007



716. The National Youth Strategy for 2007 developed by the Ministry of Culture and Youth in the beginning of 2005 and endorsed by the Government in 2006 is also instrumental in the process of the national youth policy implementation.

717. The Strategy defined an unprecedented, in terms of its nature and scope, programme, which was implemented in 2006; representations of Youth Programmes Implementation Centre public non-commercial organisation were established across the country, Regional Youth Centres were created and operationalised in cooperation with local administrations, regional NGOs and international organisations. The mission of these structures is to ensure the outreach of the national youth programme at the regional level, raise the awareness of the youth in the regions about the programme. The Regional Youth Centres will be governed by boards composed of representatives of the above partner institutions. They will function as resource centres where the youth will have an access to various needed services (legal and health counseling, computer service,s library, reading halls), will attend training courses to acquire new skills and professional orientation, and will learn to properly manage their free time.

718. Regional Youth Centres will actively cooperate with regional centres of the State Employment Service to help resolve employment issues of regional youth.

719. In order to increase the competitiveness of young people in labor market and to help them gain the skills needed to meet the market requirements a „Center for professional orientation of young people” SNCO is established within the RA Ministry of Labor and Social Issues, which provides 14-30 (35) year-old people with information concerning the labor market and relevant consultancy. The SNCO activities include also training programmes aiming to help the youth adapt to new working conditions.

720. Since the end of the 1990s, youth organisations played an active role in the formation of Armenia’s civil society and democratisation. About 3,000 NGOs are registered at the Ministry of Justice of the Republic of Armenia. About 50 percent of these NGOs are either youth organisations or work for and with the youth.

721. The development strategy of this very important component of the national youth policy contemplates further promotion of civil initiatives, increased engagement and empowerment of the youth at regional and local levels. The strategy assigns priority to implementation of comprehensive and multi-disciplinary studies and surveys of the youth sector. The preparation of Armenia’s National Youth Report was completed at the end of 2006; the document was prepared with technical and advisory support of the Council of Europe and UNDP. The National Youth Report is a comprehensive document that describes the current situation of Armenia’s youth and provides a foundation for the development and implementation of the national strategy.

12.4.2 Key Principles and Objectives of National Youth Policy

722. The Government of Armenia believes that addressing the youth problems is a policy priority. The government actions in the field are informed by the real needs, challenges and interests of the youth. The youth should have full-fledged and proactive participation and an opportunity to freely express their opinion on issues of their concern and vital interests. Their voice should be heard at all levels of public administration either directly or through representation.

723. In implementing the national youth policy for the coming years, the Government of the Republic of Armenia will

- (i) Strengthen the social partnership with civil society and youth organisations,
- (ii) Ensure an interagency dialogue on youth issues,
- (iii) Develop European and international cooperation in youth and related fields,
- (iv) Develop a legal framework based on international criteria,
- (v) Continuously promote the national youth policy and action plan and adapt them to the changing environment.

724. The National Youth Policy and Government actions in the field should be based on the following:

- (i) Integration of legitimate interests, rights and obligations of the state, society, citizens and youth;
- (ii) Equity of all beneficiaries of the national youth policy;
- (iii) Publicity;
- (iv) Access to state support mechanisms;
- (v) Program approach to the implementation of the national youth policy;
- (vi) Ensuring equal opportunities for the youth and youth organizations to participate in the development and implementation of the national youth policy.

12.4.3 Priorities for Action

725. In the framework of PRSP, the national youth policy envisages coordinated actions aimed to ensure that the challenges facing the youth are properly addressed in education, healthcare, spiritual, culture, sports, legal and social protection and employment fields.

726. The objectives of the national youth policy in the framework of PRSP include promotion of youth participation in decision making (at community, regional and national levels), development of human and institutional capacities of the youth, contribute to poverty reduction and decreased unemployment among youth, ensure mentally and physically healthy, educated and patriotic youth.

727. The priorities of the national health policy include

- Promotion of participation in national life,
- Increased opportunities for employment,
- Promotion of healthy lifestyle.
- Increased level of coordination in the implementation of initiatives under the national youth policy and promotion of spiritual, cultural and patriotic education of the youth.

728. **Priority 1. Promotion of participation in national life.** The youth are not sufficiently involved in the decision making process. This, however, does not mean that they are not interested in issues affecting them. Neither it means that the youth are not ready to identify solutions to their problems. Insufficient involvement of the youth in the decision making results in lack of awareness. They are somewhat detached from the national and political life and the decision making process. The youth should enthusiastically participate in the national, political, economic and cultural life. The state and the society should ensure enabling mechanisms for making such participation meaningful. To exercise their rights and to fulfill their duties, the youth should have

access to sufficient income opportunities, participation in the decision making on issues affecting them, information, labor and housing market, healthcare, education, clean environment, freedom of movement and recreation opportunities.

Expected Results

- State governance bodies and local administrations will ensure the participation of the youth in the policy development and implementation process.
- The youth will have greater access to recreation, information, skill and capacity development opportunities.

729. **Priority 2. Increased opportunities for employment.** The level of unemployment among Armenian youth is rather high. The education system does not prepare the youth for volatile labor market requirements. The government should fill this gap by ensuring such professional education that would develop the required skills and capacities. There should be an enabling environment for entrepreneurship and employment of the youth. There should be stronger cooperation between education and training institutions, employment centres, private sector and other interlocutors at the local and national levels. Empowerment of the youth should become the key principle of the policy in the employment sector.

Expected Results

- Youth centres will have information databases and will provide advisory services and opportunities for professional orientation.
- The youth will have access to information on small and medium entrepreneurship, training and credit.
- Rural youth will acquire skills and capacities for implementation of innovative ideas for more productive agriculture.

730. **Priority 3. Promotion of Healthy Lifestyle.** The last decade saw the emergence of some new physical and mental health risks, which affect the Armenian youth as well. An increased number of young persons start smoking, substance abuse and other harmful practices at a younger age. Insufficient knowledge offered in school causes physical and mental deficiencies, spread of detrimental practices, ignorance about the sex life, unprotected sex and, consequently, the spread of STIs (primarily HIV/AIDS), as well as unplanned pregnancies. Poverty makes the youth even more vulnerable in the face of these risks. Therefore, the level of awareness of the youth concerning healthy lifestyle should be considerably increased, they should have receive knowledge and services for protecting themselves from such risks.

Expected Results

- The youth will have access to appropriate healthcare services.

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- The youth will be informed about healthy lifestyle and will have an opportunity to benefit from reproductive health services.
 - Vulnerable youth will have access to information on how to prevent HIV/AIDS.

731. **Priority 4. Increased level of coordination in the implementation of initiatives under the national youth policy and promotion of spiritual, cultural and patriotic education of the youth.** There will be coordinated action to respond to the interests of the youth and to involve them in national, economic, political and cultural life. Youth leaders and people working for the youth should receive appropriate and quality training. Ensuring more access to creative activity is one of the key factors that help protect and develop the creative potential of the nation. Therefore, there should be a system for supporting and encouraging talented youth. The state considers the sound spiritual, sports and patriotic education among key prerequisites for the national development and an important value. The state also attaches priority to the incorporation of the youth component in the formulation and implementation of initiatives at the local, regional and national levels (including national minorities). For this purpose, the state should help and support civic initiatives and programmes aimed at education and development of the youth.

Expected Results

- Public administration bodies will have resources and information to respond to the needs of the youth and help them exercise their rights.
- A more advanced level of cooperation between government, private sector and youth NGOs.
- The coordination in the implementation of the national youth strategy and policy will be carried out in a better way.
- The level of spiritual, cultural, patriotic education of the youth will increase.
- The cooperation between the youth in Armenia and in the Diaspora will deepen, and will contribute to the development of Armenian culture, protection and promotion of national values, strong national morale.

12.4.4 Key Objectives of National Youth Policy

732. The key objectives of the national youth strategy and policy for 2008 – 2021 include:

- (i) Increased level of coordination in the implementation of the national youth policy and development of an appropriate legal and regulatory framework;
- (ii) Advanced cooperation with youth organizations and provision of state support to such organizations;

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- (iii) Increased education level of the youth, creation of healthy and sound recreation opportunities;
 - (iv) Analysis of socio-economic problems and implementation of actions to address these problems;
 - (v) Implementation of initiatives for patriotic and civic education;
 - (vi) Development of the national youth policy at the regional level (operationalisation of regional youth centres and creation of community youth centres, implementation of initiatives for the rural youth and those living in border areas);
 - (vii) Creation of enabling environment for self-fulfillment of the youth, state support to gifted and talented youth;
 - (viii) Ensured access of the youth to the required information;
 - (ix) Development of international and pan-Armenian youth cooperation.

733. The state authorized body envisages the implementation of a set of measures and actions aimed at the development of the youth sector in Armenia.

12.1.5. Implementation, Monitoring, Evaluation and Funding

734. The authorised government body should ensure the daily implementation of the national youth strategy and policy in the framework of two programmes. The first should cover the period between 2008 – 2012, while the second one should cover the period up to 2021. Various ministries, primarily those of education and science, culture, sports and youth issues, health, labor and social issues, foreign ministry, defense, as well as regional and local administrations should have their contribution to the strategic implementation of the national youth policy by sharing information and coordinating and harmonising their actions.

Coordination and monitoring should take place at the deputy minister level, through regular interagency and working meetings. Regular reviews of the strategy implementation should also take place to develop programmes for youth and civil society development.

12.5. *Environmental Protection*

735. Environmental protection and natural resource management issues set forth in the Poverty Reduction Strategy enacted in 2003 pursued the following objectives to provide guarantees for the implementation of the poverty reduction policy:

- (i) efficient use of forest resources;
- (ii) eliminate the extreme air pollution
- (iii) mitigate the negative consequences of global ecological changes
- (ii) prevention of soil degradation, limiting human activity that causes desertification;
- (iii) improvement and effective utilization of meadows;
- (iv) efficient management and use of water resources, restoration of the Lake Sevan ecological balance and relevant conditions to ensure preservation natural balance;
- (v) municipal waste treatment and management of hazardous industrial waste;

736. In the conditions of stable economic growth, the current approach of national environmental policy should focus on ensuring availability of natural resources for future growth, their balanced use and establishment of guarantees for prevention of environmental pollution. Armenia's integration in regional and international cooperation frameworks poses new requirements in terms of environmental management, including the creation of sound mechanisms for monitoring of trans-boundary impact of movement of hazardous and toxic waste and genetically modified organisms. Today's challenges of environmental management require stronger regional and international cooperation in the domains of setting up sound environmental management mechanisms and institutional structures, inter-sector cooperation, environmental impact assessment and mitigation and prevention of risks. In the last 15 years, Armenia has mostly completed the development of the national environmental policy and legislation in the framework of international environmental protection instruments and European regional processes. The national policy and legislation for environmental protection pursue the following objectives:

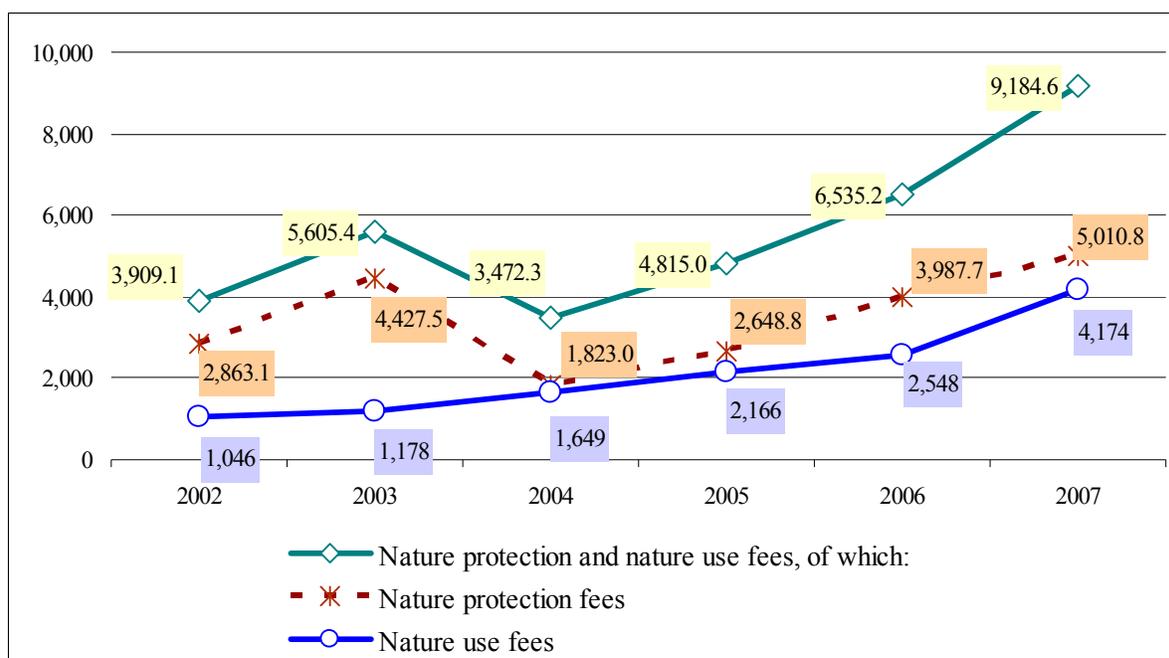
- Prevent or limit detrimental impact on human health and environment;
- Protect biodiversity;
- Ensure adequate rate of recovery of renewable natural resources;
- Ensure rational and efficient use of non-renewable natural resources.

737. The objectives of the environmental component of European Neighborhood National Policy (2006) include harmonization of the national environmental legislation, especially in terms of developing secondary legislation, regulations, technical requirements, standards and methodologies and instituting appropriate institutional reforms.

738. In the last five years, the country has undertaken an impressive legal reform in fulfillment of these objectives; several strategic laws and programs were enacted and approved. These, inter alia, include the new Forest Code of RA (2005) and the National Forest Program (2005), the law on Key Provisions of National Water Policy (2005), the law on Waste (2004), the laws on Special Protected Areas (2006) and on Environmental Monitoring (2005), on Ozone Depleting Substances (2007). Efficient regulation of the sector, however, requires workable mechanisms and professional institutions that are still lacking and pose serious obstacles for future development and have limited capacities.

739. Budget revenues generated from environmental and resource use fees and levies have grown consistently in line with increasing efficiency of monitoring and inspections and economic growth; these developments are also due to the enforcement of the law on Environmental Monitoring, technical upgrade and improved professional quality of human resources in the field. Collection of fees for exploitation of natural resources in 2006 increased by 50.5% or by 1,338.9 mln drams compared to 2005, thus enabling gradual increase of budget appropriations for relevant environmental protection interventions (see Table 12.11).

Figure 12.11. Dynamics of Environmental Fee Collection, 2002-2007, AMD million



740. Some progress was also registered in terms of improving mechanisms for collection of financial resources and their spending; the law on the Budget System of RA was amended (09.11.2006, HO-174-N entering into effect since 2011) to stipulate that “Annual environmental expenditure earmarking shall be no less than the sum total of actual budget revenues from environmental and natural resource usage fees collected in

the previous budget year”. Besides, a Forest Restoration and Development Fund was established by a Government Decree No. 891 of 2004, and effective 2005, Environmental Protection Fund (special account at the Central Bank of RA) started accumulation of security funds generated from licensing of mining activity.

741. However the progress can not be assessed as sufficient taking into account that based on the spendings for activities of environmental protection/ by GDP indicator (GDP 0.2-0.3 %) Armenia is one of the last among countries of Eastern Europe, Caucasus and Central Asia (source` EDRC, data of 2005).

742. In order to ensure targeted spendings of financial resources collected for environmental protection the country

- must gradually (or stage by stage) draw closer the ratio of the environmental protection spending`s specific weight (excluding foreign assistance) to the GDP to the level of European countries (2.0 % of GDP) directing those spendings to the fulfillment of national environmental priorities,
- public environmental expenditure management (PEEM) based on the best international practices will contribute to the improvement of the PEEM system.

743. The mid-term development program of environmental protection sector has duly taken into account the regional disparities of the country`s economic development, whereby more than one third of the population is concentrated in Yerevan. Therefore, environmental management priorities are different for Yerevan and other settlements of Armenia; such approach is also relevant in the framework of the SDP.

744. In terms of poverty reduction, the current environmental challenges may be classified according to the following areas:

745. **Improved instruments for the implementation of environmental policy.** In view of Armenia`s GDP growth trends, the negative environmental impact of economic activity and exploitation of natural resources will continue to grow. To counter these negative aspects of the economic growth, it will be necessary to promote the promulgation of best and environmentally safest economic management tools and resource-efficient technologies to ensure that obsolete and hazardous technologies are eventually ruled out. In environmental management area, mitigation of corruption risks requires simplification and streamlining of management and introduction of e-management. Improved administration should be coupled with the development of mechanisms of incentives for environmentally benign practices based on public-private partnership principles and comprising mechanisms for rating of enterprises in terms of environmental impact of their operations; international ISO standards should also be put in place.

746. The necessity to create enabling conditions for economic development required that rates of environmental and resource use fees be established at a rather low level; these rates, however, do not cover the value of the resources and economic costs of the

damage incurred and therefore do little to modify the behavior of the business in terms of use of natural resources and protection of the environment. At the current stage of development, serious analysis will be undertaken to improve the system of environmental impact assessment and its phased implementation.

747. The development of enterprise environmental management plans and internal monitoring and control systems is also important. Environmental compliance of production is important for export-oriented economy considerations.

748. The development of the mining industry requires augmenting of geological surveillance works. The methodology for environmental impact assessment due to pollution and mining waste is still non-existent, due to lack of qualified professionals, structures and funding. At the same time, economically sound system of environmental payments should ensure efficient operation of new mining sites. Particularly, until the end of 2008 environmental payments will be revised in order to bring them in line with international pricing trends of. The concept for exploration of earth entrails will also be developed. Other priorities include tailing dam management and reclamation of abandoned and idle mining sites, particularly important in terms of prevention of pollution of land, water and ecosystems. Involvement of the private sector, international assistance, including clean production mechanism under Kyoto Protocol requires creation of enabling conditions and development of appropriate programs.

749. Formulation of a national environmental policy, as well as design and implementation of sound decisions and programs require a thorough review of environmental information collection and public monitoring systems. In 2006, the Government endorsed a national agenda for environmental monitoring; the implementation of this agenda will require serious institutional and legal reform.

The increase in the ecological fees shall be used primarily for creating relevant incentives among enterprises that pollute the environment to change the behavior towards the level of environmental pollution and these fees shall not merely as a source of increasing the tax revenues of the budget.

750. Along with data collection, electronic environmental databases should be developed, modern information collection, communication, processing and dissemination technologies should be developed and deployed, and environmental hazard rapid response system should be put in place.

751. Sound environmental management requires strengthened interaction between the capital and the regions, but the latter still lack resources and capacities required for decentralized system of environmental management. Increased attention will be paid to the identification of regional environmental concerns and support to the development of local environmental protection programs.

752. **Land conservation challenge** will become even more pressing in the long term in view of the current scope of national land resource degradation. Agriculture sector is the

principal user of land resources, but the current land use practices result in diminished productivity, erosion, salination and alkalization of soils. Overexploitation and unbalanced use of pastures and hayfields result in depletion of animal feed stock and threaten biodiversity thus causing land degradation.

753. The environmental challenge of land degradation should be addressed to ensure sustainable agriculture development, reduce outward migration of rural population and reduce poverty. Land conservation requires the development of criteria for land quality and productivity, quality monitoring, regulation of land use, registration and supervision systems. Recovery of affected agricultural lands and natural landscapes, development and deployment of economic incentives.

754. **Lake Sevan** issue is a top priority on Armenia's environmental agenda. Conservation and replenishment of the lake's water resources due to consistent efforts and favorable weather conditions of the last several years enabled stable rise of the water level, but 247 cm between 2001-2007. Activities including the Lake Sevan water-level issues remain urgent, since they are associated with another significant problem concerning restoration of natural balance. The increased level of the lake waters has made the issue of improved management of the shoreline areas even more urgent, required removal of vegetation in flooded areas, dismantling of illegally built structures and buildings, redesign of infrastructures and roads in particular.

755. The current level of the Lake Sevan fish stock is alarmingly low. Failing accurate estimates, it is difficult to tell what measures and systems will be required to ensure the recovery of the fish stock, i.e. the biodiversity conservation should be viewed as a way to ensure food security and poverty reduction in the region. It is necessary to review the fishing licensing system currently in effect introducing the principle of cooperation between the private and public sectors .

756. In the framework of an EBRD loan provided in 2007, sewage treatment facilities will be built in 5 towns of the Lake Sevan basin; proper treatment of the lake waters and inflowing rivers, however, will require commissioning of such facilities in all settlements and industries in the lake basin.

757. In order to decrease the pollution of the basin waters with chemical pesticides and manure, it is planned to promote organic agriculture and use high quality organic fertilizer generated, as a byproduct, at biogas stations.

758. **Forest management and biodiversity conservation.** Mass logging that started during the energy crisis years and continues to date and under-funding of forest recovery initiatives resulted in shrinking of forested areas. Remaining forests are characterized by depletion of species and structural transformations, loss of natural reproduction capacity and reduced productivity.

759. Notwithstanding, the sector has recently registered some positive shifts. Pursuant to the provisions of the new Forest Code, management plans have been developed for 7

forestries and 2 specially protected forest areas (with a total area of 188,827 hectares), an interagency task force and Forest Monitoring Centre were established to monitor illicit logging. Forest Recovery and Development Fund was established back in 2004. The development of community forest management plans is underway, pilot projects are designed to inform future community forest management scope and models. This process should be carried out with application of innovative cooperation mechanisms involving local administrations, the private sector and NGOs. The government is committed to encouraging community and private forest management and pest management projects in line with Clean Development Mechanism under the Kyoto Protocol and Global Environmental Facility.

760. A new category of industrial forests was established, but the mechanisms of planting and management of such forests have not yet been fully developed. In any case, forest use and management actions will definitely follow the environmental priority of forest biodiversity conservation, since further degradation of forest resources will result in both environmental and economic and social losses.

761. Management plans were developed for Sevan and Dilijan National Parks, biodiversity monitoring and assessment were carried out in Khosrov, Shikahogh and some other protected areas, new specially protected areas were established; sound management of specially protected areas and habitats, however, requires, on top of increased public funding, some efforts to establish income generation mechanisms as well as community and trust management arrangements. In the framework of Armenia's international commitments, cooperation with special funds and mobilization of third party funding for biodiversity conservation should gain further momentum.

762. **Protection of Water Resources.** Parallel to the development of agriculture and hydro energy sectors, it is planned to ensure rational use of water resources. In view of the vulnerability of the country's water resources caused by the global climate change, programs will be developed to protect national water resources, regulate river flows and ensure availability and rational use of the water to prevent possible conflict among water users and ensure that the amount of water and water take regimes are adequate for natural regeneration and recovery. To ensure adequate quality of water resources, it has become a priority to reconstruct water treatment facilities (out of 21 available facilities only Yerevan water treatment facility is currently operational and provides for mechanical treatment of wastewater). The establishment of initial treatment facilities at the enterprise level will considerably reduce the basin pollution load.

763. The creation of river basin management bodies was initiated in 2007 as the first experience in decentralized environmental management. Full-fledged operation of these bodies, however, will require more representation of communities, civil society and professional training on basin management.

764. **Industrial and municipal waste management.** Industrial and municipal waste management (collection, sorting and organized treatment) both in Yerevan and in other

communities of Armenia has become a priority in terms of short-term environmental impact mitigation, as well as in terms of considerable investment that will be required to counter the pollution and the urgent problem of adverse impact on land and water resources. Industrial and construction waste is disposed, together with solid municipal waste, in municipal and rural disposal sites. Without proper regulatory framework, the potential negative impact of solid waste disposal sites poses a serious risk for the health of the population and environmental resources and land resources in particular.

765. At present the waste management measures, particularly those concerning waste disposal, are inadequate. There is a significant disproportion between the quality and capacities of decentralized services being provided by local municipalities in cooperation with a number of public and private enterprises. Both the methods used to dispose the waste and corresponding infrastructures do not meet required standards, and this lead to accumulation of waste and as a result, to creation of unfavorable sanitary and hygienic conditions. It is expected that in order to improve the waste management process in Armenia, a strategic program of system modernization will be developed; the infrastructures will be reformed and management techniques will be refined so that the population requirements be satisfied.

766. There has been some progress registered in the creation of a system for waste hazard assessment and inventory development; however, introduction of cost-effective treatment and disposal technologies continues to remain an issue.

767. The issues of treatment, recycling and safe disposal of radioactive waste generated by Armenian nuclear power plant and other industrial facilities should be effectively resolved in the coming years, taking into account the considerable amount of liquid and solid radioactive waste that will be generated in the course of imminent decommissioning of the nuclear power plant and construction of a new one.

768. **Mitigation of negative impact on human health.** According to the findings of atmospheric pollution monitoring, the most polluted cities of Armenia are Alaverdi (sulphur dioxide emissions from copper-molybdenum extraction and processing facility), Ararat and Hrazdan (cement factory dust emissions) and Yerevan (mostly automobile emissions). Automobile emissions account for more than 90% of total emissions in Yerevan; reducing these emissions requires an integrated and consistent approach. The government, by its decision No. 1033-N of 14.07.2005, approved a program on measures to reduce harmful automobile emissions, to be implemented between 2005-2013. Yerevan master plan envisages the development of the public transportation system, increased number of bigger public buses, by 31.6% by 2010 and by 45% by 2020, as well as the development of electric public transportation means. Prohibition on leaded petrol, enforced since 2000, created favorable conditions for enforcing the use of exhaust emission control systems. As a first step, it has been prohibited to import to Armenia vehicles without such systems.

769. Long-term reduction of emissions from stationary sources requires the development of a national policy conducive for import and promulgation of environmentally friendly technologies. Improved public health and quality of life considerations require proper management and development of urban park and recreation zones, which gain additional significance during summer months, as they help urban dwellers cope with thermal stress.

770. Negative impact on the health of population can have the tailing dumps (e.g. in Akhtala, Dastakert, Agarak etc). it is necessary to develop and implement a project aimed at improvement of ecological situation of tailing dumps.

771. A sound environmental protection and management system requires adequate participation and involvement of the society and the private sector in the decision making process; such participation, in its turn, should be based on proper access to environmental information and transparent decision making practices.

12.6. Urban Development

12.6.1. General Overview

772. Urban development is the most dynamic sector of Armenia's economy; between 2001 -2996, the total volume of construction grew by factor of 4.5. Sustainability of such dynamic growth requires consistent improvement of both quantitative and qualitative indicators.

773. The importance and urgency of ensuring quality guarantees of urban development systems is also informed by an unprecedented urban population growth worldwide, which urbanized many a challenge faced in various fields¹⁸⁵.

774. Poverty levels in Armenia's cities and towns (except Yerevan) is the highest in the country. Out of 29 thousand homeless persons in Armenia, more than 19 thousand are urban dwellers deprived of basic amenities, living in temporary shelters, dormitories, public buildings.

775. The priority of sustainable urban development is to ensure favorable living conditions for the present and future generations and improve their quality of life.

776. Such comprehensive coverage addresses the vital interests of the state, the society and the individual and, therefore, an adequate response to the challenges of urbanization requires a whole set of measures aimed at balancing the development of settlements and areas, rehabilitation of historic urban areas, ensuring safe and affordable housing and access to utilities, protection from natural and manmade disasters, earthquake resistance and safe operation of structures, as well as efficient, safe and guaranteed management of

¹⁸⁵ 2007 was an interesting milestone; in that year, half of the world's population lived in urban areas, while Armenia reached this level back in 1959. The city network of Armenia comprises Yerevan and 48 cities, whose population, according to 2006 figures, was 64.1% of the country's total population.

capital investments¹⁸⁶. These areas are closely interrelated and, therefore, should be viewed from the point of job creation, access of all population groups to social, engineering and other infrastructures, i.e. in terms of efficiency of poverty reduction efforts.

777. The role and significance of urban development functions gain even more priority in terms of overcoming the current regional development disparities. Within this framework, consistent introduction of principles of multi-polar area development has to do with the creation of more balanced settlements, neutralizing the threats of uncontrolled urbanization in seismically active zones, and prevention of undesirable growth of population density in the capital.

778. To fulfill the objectives described above, the following priorities are proposed for urban development:

- (i) Spatial development and planning;
- (ii) Earthquake resistant design and construction;
- (iii) Reduced impact of geological hazards;
- (iv) Improved housing conditions.

12.6.2. Spatial Development and Planning

779. International community believes that spatial development and planning with their vector of functionings for ensuring proper organisation of the country's unique strategic resource – its territory, are essential elements of sustainable human development.¹⁸⁷ Long-term spatial planning at the national, regional and central levels is informed by socio-economic development plans; the implementation of these plans, on the other hand, is impossible without comprehensive approach to spatial planning and identification of priorities based on the peculiarities of the area.

780. The economic model used in the Soviet period, coupled with complex relief and challenging climate conditions, resulted in lopsided spatial planning¹⁸⁸ characterized by

¹⁸⁶ This is closely linked to urban development issues covered by provisions of the National Security Strategy enacted by President's Decree No. NH-37-N of February 7, 2007 and a Government programme adopted by Decree No. 695-A of June 21, 2007 and endorsed by the National Assembly.

¹⁸⁷ These approaches are reflected in some Council of Europe Documents, including Recommendations N Rec(2002)1 and N R(84)2 of the Committee of Ministers on Guiding Principles for Sustainable Spatial Development of the European Continent and European Charter for Spatial/Regional Planning, as well as Declaration on the Territorial Dimension of Sustainable Development (Ljubljana Declaration) and other documents.

¹⁸⁸ About 56 percent of Armenia's territory is suitable for habitation. The remaining areas are over 2,200 meters above sea level and are not suitable. Highland communities comprise about 40 percent of the total number of communities (about 16.5% of the total population) and represent the underdeveloped areas of the country. These areas are mostly located at an altitude of 1700-2200 meters above sea level, have enough territory, resources and environmental potential, but are also characterised by insufficiently developed engineering and transport infrastructures, limited housing stock, abandoned settlements and low population density.

unipolar development. The dangerous trends, whereby only the capital and, to some extent, other cities are involved in dynamic development while small and medium-sized towns and villages, with some exceptions, remain isolated, still prevail. Such development is unfavorable both for the center and the periphery. The urban environment becomes increasingly eroded; the density of construction in the centre increases, along with social stratification and emergence of prime and low-grade districts.

781. Harmonious and safe habitats need to be based on urban development plans developed with broad participation of the society. Therefore, the creation of proper national, regional and local spatial development plans is essential for a country's sustainable development anchored in realistic projections and correct assumptions about current conditions.

782. Implementation of spatial planning functions requires an integrated landscape planning process which, specifically, includes urban and cultural landscapes, degraded landscapes, environmentally valuable and vulnerable areas, as well as makes proper references to development challenges and impact factors typical of urban and rural areas. Armenia ratified the European Landscape Convention on March 23, 2004 thus taking certain commitments to this end.

783. Another important component of spatial development is preservation and recovery of architectural heritage and historic city areas to protect the identity and appeal of cities and promote local development for job creation and welfare of the population. Implementation of initiatives for preservation and recovery of historic city areas requires public-private partnership based on best international practice.

784. Spatial development and planning require the following priority actions:

- (i) Development of Master Plan of Armenia's Spatial Organisation (based on an analysis of Habitation Master Plan);
- (ii) Drafting of regional spatial development plans;
- (iii) Development of master plans and zoning maps for all communities;
- (iv) Development of spatial planning documentation for Sevan Lake catchment area;
- (v) Development of building and distribution plans for territories around national highways;
- (vi) Development of rehabilitation plans for historic areas, architectural and natural monuments;
- (vii) Implementation of provisions of European Landscape Convention and the principles of the UN "Habitat" process;
- (viii) Deployment of the national urban cadastre;

-
- (ix) Improvement of urban development legal and regulatory framework¹⁸⁹.

12.6.3. Earthquake resistant design and construction

785. Seismic characteristics of the whole of Armenia's territory was reviewed after the devastating 1988 earthquake; earthquake hazard and risk assessment was raised by 1-2 points and more than 80 percent of the country's territory appeared in 7 and above magnitude area. The issue becomes even more important considering the fact that in the last 15 – 20 years, mostly due to lack of financial resources, there was no systemic approach to safe operation and maintenance of buildings and the scope of major renovation was extremely limited, which resulted in deterioration and considerable physical wear of housing of more than half of the country's population. About 89.4 percent of apartment blocks was built before 1990 and after the review of the seismic characteristic these buildings no longer meet the current prudential norms for earthquake resistance. Damaged apartment blocks are no longer reliable in terms of earthquake resistance and may not ensure the people's safety in the event of an earthquake. These apartment blocks include buildings where delays with regular maintenance and repair (damaged water or sewerage pipes, roof and drainage systems, etc) may result in irreversible technical damage and, consequently, loss of an important national resource. Therefore, it is extremely important to ensure consistent implementation of measures aimed at enhancement of control of the urban norms, ensuring earthquake resistance and safety of the country's housing stock.

786. Data on national housing stock is provided below.

	Housing stock	Area	% of the total
1	Total area of housing stock (thousand square meters)	76,173.3	-
2	Total area in apartment complexes, including Yerevan	26,554.1 13,979.5	34.9 52.6
3	Total number of apartment complexes	21,778	-
	- in Yerevan	4,709	21.6
	- built before 1990	19,235	89.0
	- dilapidated and emergency (2003)	581	2.7

787. In view of the above and considering the high level of earthquake hazard in Armenia, earthquake resistant design and construction of residential houses in Armenia becomes an utmost priority. Therefore, it is important to have a systemic and coordinated approach to the issue, to be greatly facilitated by the creation of technical documentation packages for apartment block buildings and parallel creation of a consolidated database on the technical conditions of the housing stock, which together will offer a basis for estimating the level of hazard for each building, justify and increase

¹⁸⁹ The development of the national urban cadastre, urban information system^α, as well as the reform of the legal and regulatory frameworks are linked with all priorities of the sector.

the efficiency of rehabilitation projects, which is rather important from the social protection point of view as well.

788. As for the safety of other public buildings (shopping malls, sports facilities, stations, etc.), the national policy in the field should be based on the creation of an inventory of such buildings within deadlines established by the law, development of required action plans and their effective monitoring.

789. Creation of an inventory of apartment blocks should be implemented based on an approved program and implementation plan, with priority assigned to hazardous and damaged buildings.

12.6.4. Reduced impact of geological hazards (combatting landslides)

790. The inclusion of combating landslides within the framework of the Poverty Reduction Strategy has to do with a disastrous situation caused by landslides in some communities in Tavush, Vayots Dzor, Syunik, Lori, Kotayk, Gegharkunik, Ararat and some districts of Yerevan. Out of all geological hazards, the landslides are the most devastating due to their prevalence and impact. The landslides caused and continue to cause considerable damage to houses, infrastructure, important facilities, industrial facilities, ecosystems, threaten the life and health of the people living in affected areas and operation of roads linking Armenia with neighbor states. They cause depopulation of mountain and border communities, destruction of historic and cultural sites, impoverishment, displacement and emigration of the population, and impede economic and population growth in the communities.

791. In 2004, a group of JICA experts analyzed space photos of Armenia's territory and identified 2,504 landslides¹⁹⁰. The data on the area of landslides and their impact on communities and infrastructure is presented below:

Number of landslides in Armenia	2,504
Total area of all landslides	1,216 km ²
Number of settlements in landslide areas	233
Number of border settlements in landslide areas	113
Length of roads damaged by landslides	238 km
Length of railways damaged by landslides	4.05 km
Agricultural lands in landslide areas	10,819 ha
Historic sites in landslide areas	6

792. In view of the above, combating landslides becomes one of the priorities of urban development sector. Deployment of a landslide hazard management system with

¹⁹⁰ As of August 2004 data on 145 landslide sites, the total damage was estimated AMD21.3 bln, while the potential damage totaled AMD26.8 bln.

consistent implementation of engineering works will reduce the economic damage caused by the landslides thus contributing to economic development and creating favorable conditions for increased investment.

793. The program priorities in the urban development sector will include surveying and regular monitoring of most hazardous landslide sites, as well as identification of hazardous houses and accommodation of relocated residents. Some particularly hazardous areas may require engineering solutions.¹⁹¹

12.6.5. Improvement of Housing Conditions

794. Housing conditions of the population, i.e. access to safe and affordable housing, are among the most basic requirements. From a perspective of poverty reduction this issue gets a special emphasis since housing conditions are among the key factors in assessing the household poverty level.

795. Since the first days of independent Armenia, the government faced, along with other challenges, the problem of accommodation of victims of natural and manmade disasters (earthquake, landslide, military conflict, etc.), as well as the challenge of maintaining and managing the housing stock inherited from the Soviet Union. The challenges of the housing sector should be reviewed within the framework of the respective national policy.

796. Based on the surveys of housing needs of households that lost their shelter due to disasters, the government devised a program approach based on a set of priority actions and, in the framework of specific projects within this approach, during 2000 – 2006 about 16 thousand households received an opportunity to improve their housing conditions. In spite of these actions, the demand for housing in the country continues to remain high, with about 43 thousand households, of which 26 thousand are homeless, in need of housing. It should be mentioned that the solutions proposed in the framework of approved projects cover all the remaining households in need of housing; there are some issues, however, that need to be regulated in relation to the poor households, which live in temporary shelters and cannot afford even basic amenities¹⁹².

797. As for the maintenance and management of apartment blocks, the reforms in this area resulted in the creation of a new institutional framework with prevalence of private

¹⁹¹ In 2007, the government endorsed a concept of landslide disaster management for the creation and deployment of a management system to combat landslides and formulation of a national program in the field. One of the targets of the program is to ensure the survey, forecasting and prevention of landslides for safe and uninterrupted operation of buildings, facilities and infrastructure, protection of the population, provision of full and adequate information on landslide areas.

¹⁹² Based on the review data on homeless households covered by the family benefit system (household status and their housing conditions; dormitory, makeshift house, due to the disaster or otherwise) it was estimated that in order to reach the Millennium Challenge target indicators (MCA, 11 objective) by 2015, it would be necessary to improve the housing conditions of about 16 thousand homeless households.

ownership; about 95 percent of housing stock is now privately owned¹⁹³. This institutional framework is generally favorable for ensuring further development of the sector. There is a regulator framework in place, the general framework of rights and obligations of the participants is defined, and the elements of participatory management of the housing stock are gradually taking roots. At the same time, the functions of servicing, maintenance and modernization of apartment blocs are not yet fully implemented on the one hand due to the lack of funding and, on the other hand, gaps in the institutional framework precluding development.

798. The spending on maintenance of collective ownership of apartment blocks in the last 15 years was fragmented and more oriented towards current or emergency repair. The mandatory renovation works pursuant to the maintenance norms of collectively owned apartment blocks were not carried out either. This resulted in the accumulated wear of apartment block buildings and the need for considerable investment, which the owners (residents) alone cannot realistically afford. It may consequently be stated that the likelihood of further deterioration of the situation with maintenance and management of apartment blocks in terms of ensuring their safe operation is rather high due to the current socio-economic reality.

799. The developments of the housing sector will mostly target people, including poor households, that became homeless due to a variety of reasons, and will ensure their access to their constitutional right to adequate housing, by means of provision of guarantees and further clarification of actions to be taken in the field. One of the ways to ensure the constitutional right to access to housing is the creation of social housing, to facilitate social and community integration of the population. A respective legal framework is planned to be created, a program for improvement of housing conditions will be designed and steps will be taken for its implementation.

800. Along with housing provision, another priority of the housing policy will comprise issues related to the management and maintenance of apartment blocks. To decrease the burden and deepen the reforms in the sector, it would be necessary to adjust and streamline the scope and mechanisms of government involvement based on a well designed program and aimed at the safe utilization of an important public asset, the housing stock. Priority will be given to communities characterized by high vulnerability (poverty risk).

801. Government support will be provided in the following two main areas:

¹⁹³The findings of a comprehensive survey of apartment blocks conducted in 2007 based on a questionnaire developed by the Ministry of Urban Development indicate that 65.6 percent (7,812 buildings) of apartment blocks are managed by condominiums, while 34.4 percent (4,098 buildings) are managed by the communities. In 31 (65 percent) out of 48 cities condominiums are not established at all, and apartment blocks are managed by the communities. At the same time, the survey identified the need for renovation of some elements of collectively owned buildings.

- (i) Support for maintenance and modernization of infrastructure of apartment block buildings;
- (ii) Support to the improvement of the institutional framework and capacity building of apartment block management bodies.

802. Within the framework of the second assistance area, funding will be provided for the establishment and sustainable operation of mechanisms for the management of apartment blocks and sensitization of owner participation and activity. Further measures will target the creation of an information register on apartment blocks.

803. The government support to the management bodies will be provided in a centralized way. In the first phase, based on the principle of co-financing it will be provided to the local administrations, to be followed by the management bodies of apartment blocks. The community poverty level will be one of the priority factors in determining the level of government support.

804. Estimates for public funding of the urban development priority areas in 2009-2012 are presented below.

Table 12.13 Public funding estimates for urban development sector, SDP framework, 2009 – 2012 (AMD mln)

Urban development sub sector	2009-2012
TOTAL	9,672
<i>Including by priorities</i>	
1. Spatial development and planning, total	1,802
<i>Of which</i>	
1.1. National, regional and local urban development documents and designs	1,053
1.2. Planning of specially regulated urban development objects	209
1.3. Historic buildings, architectural and natural heritage conservation and recovery program development	100
1.4. Implementation of a project on deployment of national urban cadastre	170
1.5. Legal reforms in urban development sector	270
2. Earthquake resistant construction and design	1,065
<i>Of which</i>	
2.1. Formulation of a program for preparation of apartment block technical documentation package	5
2.2. Apartment block technical documentation packages for 10,000 buildings *	1,060
3. Reduced impact of geological hazards, total	960
<i>of which</i>	
3.1. Prospecting and monitoring of most hazardous landslide areas	811
3.2. Review of technical conditions of housing	140
3.3. Development of a national program to combat landslides **	9
4. Improvement of housing conditions, total	5,845
<i>Of which</i>	
4.1. Development of a project on provision of housing for homeless households ***	70

4.2. Measures for management, conservation and maintenance of housing stock ****	5,775
<p>Comments</p> <p>* The project implementation will be sustainable and during 2013 – 2016 will cover the remaining 12 thousand buildings.</p> <p>** Implementation of measures of the national programme to combat landslides will start in 2013.</p> <p>*** The final size of public funding for provision of housing to homeless households will be based on the developed project.</p> <p>**** AMD5,250 mln will be used for maintenance and modernisation of building infrastructure, while AMD525 mln will be used for improvement of institutional framework and strengthening of capacities of management bodies.</p>	

13. Program for Sustainable Development Budget Framework

Key Developments in Fiscal Area in 2003-2006

805. Between 2003-2007, the macroeconomic environment, which was more favorable than envisaged by PRSP, had its positive impact on consolidated budget indicators. The nominal growth of **budget revenues** throughout 2003-2007 totaled AMD 399.1 billion, i.e. twice the amount projected within PRSP framework (see Table 13.1). The growth of budget resources (mostly informed by the increase in budget revenues) during the same period totaled AMD 43.5 twice exceeding the projected amount. It should be mentioned, however, that the consolidated budget deficit in 2003-2004 was about AMD29 bln below PRSP projections, effectively ruling out additional public spending opportunities.

Table 13.1. Consolidated Budget Framework 2002-2007

Indicators	2002	2003		2004		2005		2006		2007
	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>Actual</i>
<i>AMD bln</i>										
1. Total revenues and grants	305.6	339.9	349.3	346.2	369.2	383	456.1	422.9	540.3	704.6
Total Revenue	258.1	279	297.6	312.9	355.5	349.6	444.5	390.7	525.7	680.1
Tax Revenue	242.3	269.4	279.5	302.2	326.5	338.8	394.8	379.8	472.1	606.8
Non-tax and capital revenue	15.7	9.6	18.1	10.7	28.9	10.1	49.5	10.9	53.674	73.2
Grants	47.5	61	51.5	33.3	13.7	33.4	11.6	32.2	14.516	24.5
2. Deficit financing (net)	12.1	36.5	20.9	41.9	31.9	39.2	40.3	38.6	34.4	48.5
3. Total available resources (1+2)	317.7	376.5	370.2	388.1	401.1	422.2	496.4	461.5	574.7	753.0
4. Total expenditure and net lending	317.7	376.5	370.2	388.1	401.1	422.2	496.4	461.5	574.7	753.0
Current expenditure	243.5	279	277.2	294	325.2	335.6	401.1	366.7	440.7	524.9
Capital expenditure	63.8	101	86.4	86.9	65.3	78.5	82.2	83.7	115.9	204.9
Net lending	10.4	-3.5	6.6	7.2	10.5	8.2	13.1	11.1	17.9	23.3
<i>% of GDP</i>										
1. Total revenues and grants	22.4	23.1	21.5	21.5	19.4	21.8	20.3	22.0	20.3	22.4
Total revenues	18.9	18.9	18.3	19.4	18.6	19.9	19.8	20.4	19.8	21.6
Tax revenues	17.8	18.3	17.2	18.8	17.1	19.3	17.6	19.8	17.8	19.3
Non-tax and capital revenues	1.2	0.7	1.1	0.7	1.6	0.6	2.2	0.5	2.0	2.3
Grants	3.5	4.1	3.2	2.1	0.7	1.9	0.5	1.7	0.5	0.8
2. Deficit financing (net)	0.9	2.5	1.3	2.6	1.6	2.2	1.8	2	1.3	1.5
3. Total available resources (1+2)	23.3	25.5	22.8	24.1	21	24	22.1	24.1	21.6	23.9
4. Total expenditure and net lending	23.3	25.5	22.8	24.1	21	24	22.1	24.1	21.6	23.9
Current expenditure	17.9	18.9	17.1	18.3	17	19.1	17.9	19.1	16.6	16.7
Capital expenditure	4.7	6.8	5.3	5.4	3.4	4.5	3.6	4.4	4.4	6.5
Net lending	0.8	-0.2	0.4	0.4	0.6	0.5	0.6	0.5	0.7	0.7

Source: RA NSS, RA ministry of Labor and Social Issues, Ministry of Finance, PRSP projections

806. **The growth of budget resources** in 2003-2007 would have been bigger had tax revenue to GDP ratio been maintained at the level projected in the PRSP. In reality, however, the tax revenues to GDP ratio has not registered any sustainable growth compared to 2002, while within the PRSP framework for 2003-2007 about 0.5 percent annual increase was projected (see Table 13.1). In terms of the impact this last factor had on budget resources, it should be stated that in the above period the budget revenues fell short of the projected levels by AMD 170.0 bln. One of the main causes of this development was the insufficient level of tax and customs administration; measures to improve it will gain even more priority in the coming years.

807. 2003-2006 **consolidated budget expenditure** (in relation to GDP) was also below PRSP projections (see Table 13.1). Public spending to GDP ratio was below the projected levels by 3 percent in 2003-2004, 2 percent in 2005 and 2.8 percent in 2006.

808. Lower than projected **capital expenditure** was mostly due to the non-disbursement of grants and loans from external sources. Thus, for example, the capital grants anticipated within 2004-2005 PRSP framework were not received resulting in decrease, down to 16.3%, of the capital expenditure share in the total budget spending in 2005, against 18.7% in 2002.

809. At the same time, it should be mentioned that the general **budget expenditure dynamics** for 2003-2007 was mostly in line with PRSP priorities (see Table 13.). The share of expenditure in the **socio-cultural field** in the consolidated budget spending grew from 36.4% in 2002 to 42.4% in 2007. This trend is fully in line with PRSP provision whereby the bulk of increased budget resources earmarked for increasing the access of the population to social services and improving the quality of these services should be targeted towards the socio-cultural field¹⁹⁴. The share of the resources earmarked for education grew faster than projected, mostly due to the significant increase of resources allocated to general education.

810. The share of financial resources directed towards **economic sectors** in the total budget expenditure in 2003-2006 decreased and registered, in 2006, 1% shortfall against PRSP projections. This is mostly due to the non-disbursement of some funds from external sources. Non-disbursement or partial disbursement of resources of Lincy Foundation, the World Bank and other sources resulted in considerable decrease in the volume of capital expenditure, especially in housing and utilities and road construction sectors.

811. The share of appropriations for **general public services** in consolidated budget expenditure in 2003-2007 was mostly in line with PRSP projected indicators. However, the reforms, especially in the public administration domain, unfolded slower than planned. The salaries of the public administration sector employees grew slower and with about one year's delay.

¹⁹⁴ Poverty Reduction Strategy, Yerevan, 2003, pp. 155-156

812. The nominal growth of budget resources in 2003-2007 exceeded (by approx. AMD200 bln) PRSP projections, mostly due to higher than planned economic growth rate. Notwithstanding, budget revenues and expenditure ratio to GDP remained considerably below PRSP projected levels.

Table 13.2. 2003-2007 Consolidated Budget Expenditure by aggregated budget components (functional classification) (% of GDP)

Indicators	2002	2003		2004		2005		2006		2007
	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>Actual</i>
Total expenditure	25	26.2	22.8	24.1	21	24	22.1	24.1	21.6	23.9
Social sector, culture, science	9.1	10	9	10.2	9	11	9.5	11.5	9.64	10.1
Education	2.3	2.3	2.2	2.7	2.5	3	2.7	3.1	2.7	3.1
Healthcare	1.2	1.4	1.2	1.5	1.3	1.8	1.4	1.9	1.5	1.5
Social security and social insurance	4.5	5	4.5	5.2	4.5	5.5	4.6	5.7	4.7	4.8
Culture, information, sports, religion	0.8	1.1	1.0	0.6	0.5	0.6	0.6	0.7	0.6	0.6
Science	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Defense	3.7	4.2	3.8	4.1	3.8	4.2	4.2	4.0	4.3	4.5
Economic sectors	5.2	7.4	5.8	5.4	3.6	4.4	3.4	4.2	3.6	5.0
Housing and utilities	1.7	2.5	2.6	1.5	1	1.4	1.4	1.4	1.2	1.1
Fuel and energy	0.6	0.8	0.4	0.8	0.5	0.5	0.1	0.4	0.2	0.9
Agriculture, forestry and fisheries	1.1	1.3	1.2	1.1	0.9	0.8	0.6	0.7	0.7	0.9
Transport, roads and communication	1.8	2.5	1.9	1.6	1.0	1.5	1.0	1.4	1.2	1.7
Other sectors	0.1	0.3	-0.3	0.4	0.2	0.3	0.3	0.3	0.3	0.4
General public service	1.7	1.9	1.9	2.2	2.1	2.4	2.1	2.3	2.15	2.2
Public debt liabilities	0.9	0.9	0.7	0.8	0.5	0.7	0.4	0.7	0.3	0.3
Other sectors	4.5	1.7	1	1.4	2.0	1.4	2.5	1.4	1.6	1.7

Source: RA NSS, RA Ministry of Labor and Social Issues, RA Ministry of Finance, PRSP projections

2008 - 2021 Budget Framework Projections

813. Growth of tax revenues (mostly due to improved tax administration), gradual decrease of state budget deficit and debt stability are the key benchmarks for projections on consolidated budget indicators. Budget **tax revenues** (to GDP) are projected to grow by about 0.4% annually, while the share of non-tax revenues and grants in the structure of consolidated budget revenues will gradually decrease. Some changes will take place in the structure of tax revenues: the share of direct tax revenues will gradually increase, while the indirect tax revenues will decrease thus reflecting increase in incomes of the population and economic entities conditioned by economic development.

814. Based on some fiscal signals and indicators, the tax and budgetary policy and the envisaged scenario of consolidated budget are estimated to be neutral in mid-term

period¹⁹⁵. In upcoming years, taking into account the increase in prices, they will demonstrate a rather moderate behavior. It should be mentioned that the same budget scenario is assumed in the 2009-2011 Mid-Term Expenditure Framework.

815. In the light of abovementioned estimates the taxes/GDP ratio in 2021 will comprise about 25.6% instead of actual 19.3% in 2007, while the expenses/GDP ratio will demonstrate a lower growth rate comprising 29.2% in 2021 instead of actual 23.9% in 2007¹⁹⁶. In this context the budget deficit (to GDP) will fluctuate within 1.5-2.5% without affecting the stability indicators of public debt¹⁹⁷.

Table 13.3 2008-2021 Projections on Consolidated Budget Key Indicators

Indicators	2006	2007	2008	2009	2010	2011	2015	2018	2021
	<i>Actual</i>	<i>Prelom.</i>	<i>Forecast</i>						
	<i>% of GDP</i>								
Total Revenues and Grants	20.2	22.4	21.6	22.1	22.1	22.4	24.2	25.7	26.7
Of which tax revenues	17.7	19.3	20.1	20.8	21.2	21.6	23.5	24.6	25.6
Grants	0.6	0.8	1.0	0.9	0.5	0.3	0.1	0.1	0.1
Total expenditure	21.6	23.9	24.1	24.2	24.4	24.7	26.8	28.2	29.2
Current expenditure	16.7	16.7	17.9	18.1	18.6	19.0	21.5	23.0	24.2
Capital expenditure and net lending	4.9	7.2	6.2	6.1	5.8	5.7	5.3	5.2	5.0
Balance (accrued)	-1.4	-1.5	-2.4	-1.9	-2.3	-2.3	-2.4	-2.5	-2.5
Memorandum article									
Balance according to GFS (Government Financial Statistics) based on 2001 methodology	-0.7	-1.1	-1.7	-1.1	-1.5	-1.5	-1.7	-1.9	-2.0

816. There is also a projected change in the **expenditure structure**, whereby the emphasis falls on increased public spending in the social sector, predominantly education, healthcare and social security. While the size of public capital investment compared to GDP in the projected period will decrease, it will continue to remain quite considerable annually comprising 4.6% of GDP beginning from 2014 and till the end of the projected period. At the same time in the context of public expenditure efficiency increase, issues related to enhancement of capacities in public investment assessment and planning will be highlighted. In case of relevant capacities the Government intends

¹⁹⁵ The tax and budgetary indicator (which represents the aggregate of signals indicating expenses and revenues) shows the first-grade influence on the total demand of tax and budgetary policy (extensive, neutral or moderating). Taking into account that it is impossible to assess the economic cycle in long-term perspective due to extremely short nature of numerical series for the economy of Armenia, the anti-cyclic scenario of tax and budgetary policy can hardly be developed (a tax and budgetary policy that plays a moderating role, in the period of economic upturn and an extending role in the period of economic recession).

¹⁹⁶ Additional expenses related to reforms in the pension system are also included.

¹⁹⁷ It should be mentioned that during the entire forecast period the public sector indicators (deficit/GDP and external debt/GDP) as well as increase in process will be within the Maastricht indicators framework.

to consider the expedience of making additional capital expenditures (GDP/0.5% per year) at the expense of additional loans.

817. The table below shows the projected intersectoral distribution of consolidated budget resources, by aggregative groups of budget expenditures functional classification.

Table 13.4 Distribution of consolidated budget expenditures, by aggregative groups of functional classification

	Groups of functional classification	2009	2012	2015	2018	2021
		% to GDP				
	Total expenditure	24.1%	25.2%	26.9%	28.2%	29.2%
A	Public services of general purpose (including public debt transactions)	3.6%	3.5%	3.6%	3.3%	3.2%
B	Defence, public order, security and judicial activity	4.9%	5.0%	5.0%	5.0%	5.0%
C	Economic services	2.6%	1.8%	2.0%	2.2%	2.6%
	Agriculture, forestry, fishing and hunting, environmental protection	0.6%	0.6%	0.6%	0.7%	0.7%
	Transport, road network and communication	1.2%	1.0%	1.1%	1.2%	1.5%
	Other economic services	0.8%	0.1%	0.3%	0.3%	0.4%
D	Housing and public services	0.9%	0.6%	0.4%	0.4%	0.6%
E	Social services (including science)	11.6%	13.8%	14.9%	16.0%	16.1%
	Social security	6.1%	7.5%	7.8%	8.4%	7.6%
	Healthcare	1.6%	2.2%	2.5%	2.9%	3.5%
	Education	3.2%	3.6%	4.0%	4.1%	4.5%
	Other economic services	0.7%	0.6%	0.6%	0.6%	0.6%
F	Unclassified expenditures	0.5%	0.2%	0.2%	0.2%	0.2%
G	Undistributed expenditures	0.1%	0.3%	0.7%	1.1%	1.4%

* Expenditures include crediting operations

**The expenditure level is not diminished due to the alienation of non-financial assets

*** The expenditures on accumulated pension sector are also included

818. Consolidated budget deficit adjusted indicators are somewhat higher than the initial PRSP indicators. This is conditioned by the fact that the SDP macroeconomic framework, as mentioned above, included also the scenario of introduction of the new pension system, according to which the budget expenditure will include 5% of merit pensions. It is envisaged that in the forecast period these disbursements will comprise 0.2-0.4% of GDP and will be financed through issuing of public securities. This is due to the fact that GDP actual growth rate, which considerably exceeded the PRSP projections, significantly improved public debt indicators. This, in its turn, enables some increase in the public spending without any considerable impact on the public debt load. This is confirmed by stable indicators of public debt repayment in the projected period (0.2-0.3% of GDP).

Table 13.5 2008-2021 Consolidated Budget Deficit and Funding Projections (% of GDP)

Indicator	2005	2006	2007	2008	2009	2010	2011	2015	2018	2021
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	<i>Actual</i>		<i>Projection</i>							
Deficit	-1.9	-1.4	-1.5	-2.4	-1.9	-2.3	-2.3	-2.4	-2.5	-2.5
Funding	1.9	1.4	1.5	2.4	1.9	2.3	2.3	2.4	2.5	2.5
Internal sources	1.3	0.4	-0.3	1.3	0.7	0.8	0.9	0.8	1.0	1.1
External sources	0.6	1.0	1.8	1.1	1.2	1.5	1.4	1.6	1.5	1.4

* According to IMF GFS based on 1986 methodology

RA Public Debt

819. The public debt policy was developed based on the following principles:

- The overall public debt will remain within the manageable limits – given the current stability indicator of the debt (Solvency condition)¹⁹⁸:
- The public debt/GDP ratio indicator is estimated in the light of a somewhat conservative scenario, taking into account the international experience, when economic reforms usually require additional spendings, which oblige the state to issue additional debt to accomplish reforms. As a rule, in many countries this process results in destabilization of the debt level¹⁹⁹. In case the public debt comprises 1-2% of GDP such destabilization wouldn't take place in Armenia.
- The share of domestic debt in the structure of public debt will increase, and this will make the monetary risk more manageable.
- Taking into account that henceforward Armenia will be regarded as a country with a medium income and as such the country will be able to get additional external debt at the common rate, thus additional debt will be taken only in case of availability of relevant guarantees ensuring stability of its mid-term debt.

820. In 2003-2007 Armenia's public debt in US dollar denomination grew from USD1,174 mln in 2003 to USD1,672.5 mln in 2007. In national currency denomination, however, the public debt showed downward trend and amounted AMD 485.1 bln in 2007 against AMD664.4 bln in 2003, mostly due to appreciation of the Dram. Higher than projected GDP growth rate resulted in significant improvement of the public debt indicators (see Table13.6). As of end-2007, the public debt to GDP ratio decreased more than 2.5 times compared to the respective period of 2002. The domestic debt share of the public debt somewhat increased, mostly due to appreciation of the Dram.

Table 13.6. Public Debt in 2002-2007 (% of GDP)

Indicators	2002	2003		2004		2005		2006		2007
	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>	<i>Actual</i>
Public Debt	46.0	42.7	41.8	43.0	35.7	40.7	24.7	38.5	21.9	17.8

¹⁹⁸ The Solvency condition indicator is estimated by Blanchard on the basis of primary gap indicator principle (Blanchard 1990 - primary gap indicator), in which case the stability condition is represented by such a level of primary gap, which is required to stabilize the debt/GDP indicator.

¹⁹⁹ Pension reforms in the countries of Latin America may serve as a perfect example for the abovementioned, where the estimated budget spendings comprising 1-2% of GDP were lower than actual expenses. (See "Pension Reform and Macroeconomic Stability in Latin America", IMF working Paper).

Domestic debt	2.7	2.7	2.7	2.6	2.7	2.6	2.3	2.6	3.0	2.0
External debt	43.3	40.0	39.1	40.4	33.1	38.1	22.4	35.9	18.9	15.8

Source: RA NSS, Ministry of Finance, PRSP Projections

821. **Domestic debt.** In order to extend the repayment periods and reduce the interest rates the government started, since September 2004, issuing coupon bonds with medium and long-term maturity. 2003-2006 registered increased efficiency in domestic debt management, expressed in gradual reduction of debt servicing costs and increased opportunities for financing budget deficit from internal sources (see Table 13.7).

Table 13.7. Domestic Debt Transactions, 2002-2006, AMD million

Year	Placed State Securities	Security Yield	Redemption	Domestic debt financing	Deficit Financing
2002	41,883.8	38,202.8	34,255.5	5,955.3	3,947.3
2003	43,300.0	40,267.0	37,963.7	5,587.3	2,303.3
2004	43,900.0	44,018.2	38,435.5	5,408.2	5,582.7
2005	46,800.0	45,701.6	39,333.4	5,066.4	6,368.1
2006	32,253.6	32,474.9	25,392.1	5,251.1	7,082.8

Source: MF RA, Annual Report on Public Debt of RA, 2005, Yerevan, 2006

822. One of the indicators characterizing improved domestic debt management is that in 2004 - 2006 there has been a considerable increase in the share of bonds with medium and long term maturity in government's portfolio. In the coming years, it is planned to increase the funding of consolidated budget deficit from internal sources, which will naturally reflect on the level of indicators characterizing the internal public debt. Thus, government internal debt to GDP ratio will grow from 2.4% in 2007 to 4.2% in 2011, 4.4% in 2015 and 4.5% in 2021. (see Table 13.8).

823. The tendency indicators characterizing improved domestic debt management was maintained also in 2003-2006 (see Figure 13.1). As it had been already mentioned the decrease of GDP/external public debt ratio is not only the result of progressive GDP growth and external public debt decrease, but it is also due to AMD appreciation against USD. The RA external debt had increased since 1999 at the expense of concessionary loans. This tendency was maintained also during 2003-2006. In 2006 the specific weight of the concessionary loan in the structure of general external debt was around 98.2 %.

Table 13.8. RA External debt indicator projections

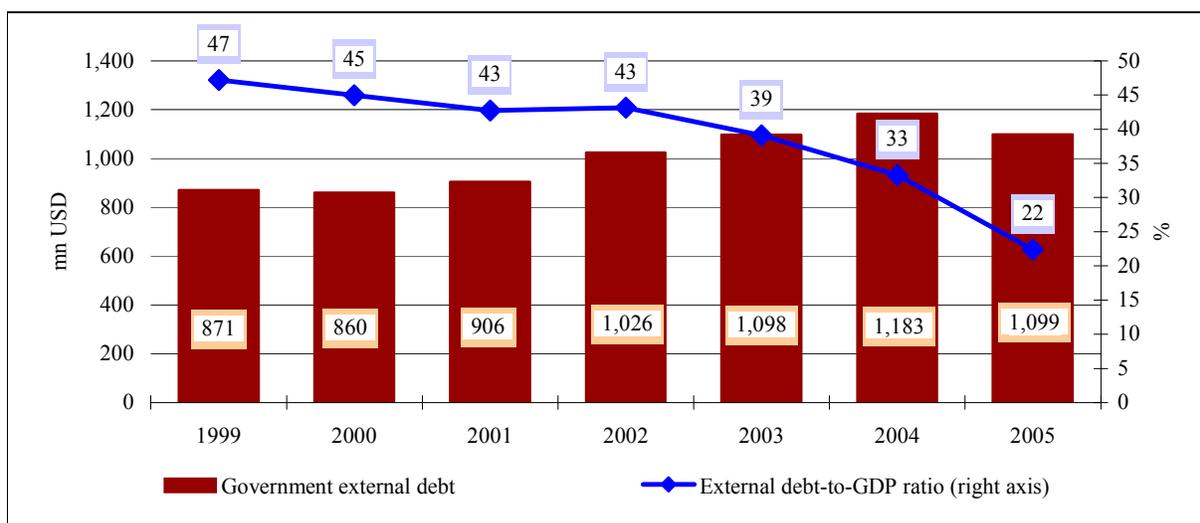
Indicators	2005	2006	2007	2008	2009	2010	2011	2015	2018	2021
	<i>Actual</i>	<i>Actual</i>	<i>Prelim.</i>	<i>projection</i>						
Public Debt, % of GDP	24.7	21.9	17.8	16.0	15.9	16.4	17.0	19.8	21.9	23.9
External public debt, % to GDP	22.4	18.9	15.8	13.5	13.2	13.2	13.3	14.5	15.3	15.9
Domestic public debt, % to GDP	2.3	3.0	2.0	2.4	2.7	3.2	3.7	5.3	6.6	8.0
External debt servicing/import of goods and services, %	2.4	1.6	1.56	1.38	1.66	1.57	1.42	1.17	1.01	0.781

Public debt percentage/tax revenues, %	2.5	2.1	1.8	1.51	1.82	1.99	2.11	2.32	2.4	2.9
Public debt percentage consolidated budget expences, %	2.0	1.7	1.5	1.26	1.56	1.73	1.84	2.03	2.24	2.5

824. The currency structure of the foreign debt is important in terms of risk assessment and management of foreign debt servicing. Since 2001, Armenia's foreign debt was mostly made up by loans denominated in US dollar, Special Drawing Rights (SDR), Euro and Japanese Yen. It should be stated that some appreciation of the US dollar vis-a-vis the SDR in 2005 was quite favourable in terms of foreign debt servicing.

825. Projections for foreign debt indicators in the coming years and in the long term are presented in In the programming period, external debt to GDP ratio will continue to decrease due to relative increase in domestic sources of financing the budget deficit, while in the long term perspective it will gradually increase (see Table 13.8). The external debt present value to GDP ratio will probably decrease in the coming two years and will then grow gradually due to the increase of non-concessionary loans in the foreign debt structure. However, it wouldn't exceed 13% of GDP by the end of projected period²⁰⁰.

Figure 13.1. Armenia's External Debt Indicators, 1999-2005



Source: MFE RA, Annual Report on Public Debt of RA, 2005, Yerevan, 2006

826. In general, as shown in Table 13.8 public debt will tend to increase. Thus, the ratio of public debt percentage to tax revenues and the share in public expenditure structure will

²⁰⁰ This projection is based on IMF and CB assessments on public debt sustainability. (see Republic of Armenia. Joint IMF/World Bank Debt Sustainability Analysis. Nov. 2007.):

increase and in 2021 will make 2.94 – 2.54%, respectively. At the same time, the specific weight of public debt servicing expenses in export of goods and services required for external debt servicing will tend to decrease, thus indicating, in particular, progressive growth rate of foreign currency income to existing demands.

827. In 2005, specific weight of public debt in GDP was already less than 25%. Starting from 2008, the public debt-to-GDP ratio will tend to increase making 23.9% in 2021. Such indicator confirms that during the projected period Armenia will continue to rank among countries having light debt burden²⁰¹.

828. Risks to the realization of abovementioned debt scenario are conditioned by the following major circumstances:

- unprecedented depreciation of AMD-to-foreign currency (especially US dollar) exchange rate;
- significant price rise of credit resources in global market;
- significant increase in consolidated budget deficit due to deviation from the SDP macroeconomic and tax and budget scenario.

829. To avoid this, continuous and effective implementation of reforms in the system of public financing offered within the PRSP framework is necessary.

²⁰¹ In such countries the public debt/GDP ratio does not exceed 25%.

14. Program Monitoring, Evaluation and Review

830. For the purposes of Poverty Reduction Strategy implementation and introduction of a system to evaluate the impact of the Strategy, the Government, by its decision No. 1780-A of November 2004 endorsed a PRSP monitoring and evaluation concept framework. Subsequently, reporting formats to be submitted by public administration bodies were established along with respective guidelines and requirements. The concept framework enables realistic evaluation of the program implementation process and offers a basis for making necessary adjustments and changes in PRSP priority policies and measures.
- 831 The system of PRSP monitoring indicators comprises 177 indicators, of which 36 are target indicators and 141 are intermediate indicators grouped in the following six categories: Poverty reduction and welfare growth, Education, Healthcare, Basic public services and utilities, Alienation and disparity, Sustainable human development.
- 832 . There were some difficulties encountered in the processing of indicators contained in the reports submitted by public administration bodies for 2001-2004 period; these difficulties precluded collection of comprehensive information on PRSP monitoring indicators for 2001-2004, and establishment of target values for these indicators for subsequent years. According to PRSP implementation report, out of 177 indicators, information was missing on 40 indicators, while information on more than 30 indicators was incomplete and of substandard quality. This means that the monitoring system functioned with regard to 60 percent of the indicators, and information under some of the indicators was not sufficiently credible. At the same time, the public administration bodies did not provide for special dedicated units tasked with collection, summary and analysis of information under the monitoring indicators, which effectively precluded organized collection of information. Moreover, lack of a standard methodology for evaluation of monitoring indicators complicated analysis of comparable indicators.
833. Review of PRSP implementation reports submitted by public administration bodies demonstrated that the formats of these reports vary considerably, in spite of standard requirements. Such disparities complicated the evaluation of PRSP implementation results and hampered the consolidation of a basis for result-oriented program review.
- 834 Improvement of the PRSP monitoring and evaluation systems parallel to PRSP review process was also highly prioritized. This requires both the improvement of the appropriate institutional framework and a review of the system of indicators, which should be accompanied by focused and targeted capacity building measures.
- 835 The of improvement of program monitoring and reflection of Sustainable Development Program peculiarities evaluation system and calls for the creation and strengthening of appropriate professional capacities both in the public and private

sectors through methodological guidance and support and on-the-job training. Some donor organizations have already expressed their willingness to provide technical support to this end.

836 The improvement and introduction of PRSP monitoring and evaluation framework implies concrete measures in terms of institutional framework creation, improved system for indicator evaluation and strengthening of relevant capacities, and creation of monitoring and evaluation capacities in the NGO sector.

837 Promulgation of an institutional framework for SDP monitoring should provide for the creation of appropriate monitoring units within public administration bodies, streamlining of information flows, as well as the establishment of a mechanisms for coordination between such monitoring units. Proper management of internal and external information and reporting flows will enable the consolidation of a quality and realistic information base required for the evaluation of SDP implementation in the previous years and priority setting and review for the future

838 For the purposes of streamlining the SDP monitoring and evaluation process, the government plans to introduce more efficient monitoring indicators framework. This will require the creation of a respective institutional framework in parallel to the improvement of the evaluation indicators system. The deployment of SDP monitoring and evaluation system implies a system of indicators review supported by a methodology for collection, evaluation and analysis of these indicators. This will enable uniformity across reporting formats furnished by various public administration bodies and will help ensure consistency in the substance of these reports. At the same time, this methodology will guide the capacity development process of implementation monitoring units.

839 The establishment of a sound SDP monitoring and evaluation system requires institution of an alternative feedback mechanism that will run parallel to the monitoring and evaluation system of which the public administration bodies are a part. More specifically, qualitative assessments may be commissioned to the non-public sector, subject to available methodology and appropriate capacities. Here as well, some donor organizations have offered the government some technical assistance.

840 SDP monitoring and evaluation system should support not only the program progress and help measure its impact on economic development and improvement of the living conditions of the population, but it should also include criteria that will define access to information by stakeholders in the framework of the participatory process thus broadening the scope of application of monitoring and evaluation data both for analysis purposes and for projections and policy development in specific sectors.

841 The government, with donor support and in view of the shortcomings and gaps of the monitoring system identified in PRSP implementation report, shall be making a

transition from the PRSP monitoring indicators system towards the deployment of a workable SDP monitoring and evaluation system which will be piloted at the level of government ministries and agencies and within two years' time frame rolled out across the public administration system.

842. Consolidated SDP monitoring and evaluation framework should define and manage the following:

- (i) System of program monitoring indicators and targets and review mechanisms;
- (ii) Methodology for indicator monitoring and evaluation;
- (iii) Methodology for collection, consolidation and analysis of the indicators assuring the gender component;
- (iv) Reporting formats and submission procedures;
- (v) Key functions of the parties to program monitoring system and their capacity strengthening measures;
- (vi) Monitoring and evaluation mechanisms for SDP-related assistance programs implemented by Armenia's development partners;
- (vii) Public awareness mechanisms on civil society participation in PRSP monitoring and evaluation process and results thereof.

843. The government provides great importance to civil society participation in SDP monitoring and evaluation process in the framework of a participatory process. Such participation will ensure communication of civil society's views on program implementation process to institutes responsible for program implementation; the latter will review and include these views in the strategy implementation report.

844. The targets defined in the Sustainable Development Program, indicators and policy priorities are not static throughout the course of the strategy implementation. They are subject to change upon program review planned for every two year based on the key country developments and shifts, trends identified in program implementation progress report, as well as proposals by stakeholders and monitoring findings.