

## **Republic of Armenia: Poverty Reduction Strategy Paper Progress Report**

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REPUBLIC OF ARMENIA

POVERTY REDUCTION STRATEGY PAPER  
PROGRESS REPORT

(August 2003 – December 2004)

Yerevan, 2005

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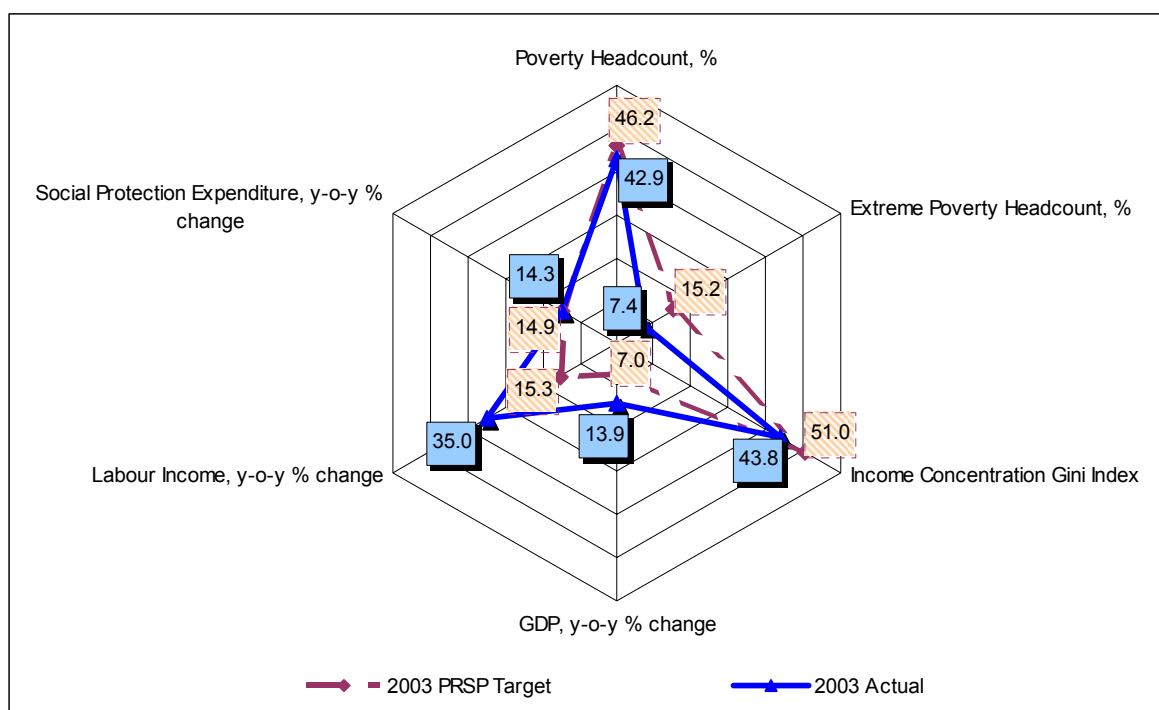
## List of Abbreviations

VAT	Value added tax
PRGF	Poverty Reduction and Growth Facility
WHO	World Health Organization
PRSP	Poverty Reduction Strategy Paper
IMF	International Monetary Fund
USA	United States of America
USAID	United States Agency for International Development
CIS	Commonwealth of Independent States
EU	European Union
MM	Mass media
Kcal	Kilocalorie
Km	Kilometer
Thous	Thousand
WB	World Bank
MDG	Millennium Development Goals
RA	Republic of Armenia
RA NA	National Assembly of the Republic of Armenia
MSI	Ministry of Labor and Social Issues of the Republic of Armenia
RA NSS	National Statistics Service of the Republic of Armenia
RA CB	Central Bank of the Republic of Armenia
RA SSIF	State Social Insurance Fund of the Republic of Armenia
GDP	Gross domestic product
AIDS	Acquired Immunodeficiency Syndrome
UNDP	United Nation Development Program
UN	United Nations Organization
IDA	International Development Association
DFID	Department for International Development
MTEF	Midterm-Term Expenditure Framework
HIV	Human immunodeficiency Virus
mn	million
bn	billion
CPI	Consumer Price Index
CJSC	Closed Joint Stock Company

## Preface

1. In August 2003, the Government of the Republic of Armenia adopted the Poverty Reduction Strategy Paper (PRSP) and undertook measures to implement it. After this adoption of the PRSP, the government also approved, in January 2004, an action plan of measures to implement the PRSP's program during 2004-2006. With the same decree, the government defined the mechanisms for quarterly reporting by governmental agencies with respect to progress towards the implementation of those measures. The PRSP was elaborated with the wide participation of all stakeholders (governmental agencies, private sector, civil society, and donor community). The government is currently making efforts to ensure a wide participation in the PRSP implementation stage too.
2. Although it would be possible to present a more comprehensive report on the results of the PRSP first two years' implementation with the final compilation of 2004 outcomes, nevertheless, the process in progress already confirms the commitment of the government toward policies in priority areas identified in the PRSP. Evidence for this is shown by certain achievements in this direction, while revealing some issues whose solutions will require even more effort.

**Figure 1. Progress in poverty reduction: 2003 actual outcomes vs. targets**



3. The developments in 2003-2004 and the current year are rather reassuring. The resulting pattern, overall, is more favorable than that which was foreseen by the PRSP development scenario. Particularly, the economy grew twice as rapidly as the projected rate, labor income increased significantly, and the government continues to implement a public expenditure policy that is focused on social sectors and infrastructure development. As a result, compared with PRSP targets, a better performance on poverty and inequality reduction has been recorded in 2003 (see Figure 1).

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4. However, parallel to these positive trends in poverty and inequality reduction, some issues have been identified and the government intends to make relevant adjustments to future programs aimed at handling these issues. In particular, these issues concern the differences in regional development and the well-being of socially vulnerable groups.
5. The current report presents the overview of actions undertaken by the government within the 2003-2004 PRSP implementation and the analysis of results.
6. In the first part of the report, a comparative analysis of poverty and inequality reduction outcomes against corresponding PRSP targets is presented, with special focus on issues in regional development and the current problems of socially vulnerable groups in this context.
7. The second part of the report refers to the macroeconomic framework and sectoral policies. It presents successes and highlights problems in those sectors. In particular, an analysis is presented of public policy measures undertaken in these sectors: education, health, social security, infrastructures, agriculture. Finally, an analysis is done of developmental trends and attained outcomes.
8. The report especially focuses on issues related to public finances. It refers, in particular, to the government's intentions over the mid-term.
9. The successful implementation of the Poverty Reduction Strategy Paper is very dependent on the involvement and active participation of civil society, the private sector, and that of the donor community associated with the process. The progress related to these issues is represented in the next two sections of the report.
10. The development and introduction of the PRSP monitoring system has a critical role in the context of the evaluation of program outcomes and the improved efficiency of future updates. Over the last year, the government took a number of steps towards this end. The results are summarized in this report.
11. Based on the first year's developments of the PRSP's implementation and possible new medium-term trends, there is a need to revise and adjust the main target indicators of the PRSP. The final part of the report presents the government's considerations and future intentions on these issues.



## PRSP objectives on poverty and inequality reduction and major developmental trends in 2001 - 2003

### General picture of poverty and inequality

12. There has been a significant reduction in the number of the poor, and an on-going reduction among the extremely poor, in 2001-2003 (see Table 1)

**Table 1. Main indicators of poverty in 1999-2003: actual outcomes vs. PRSP targets**

	1999	2001	2002	2003		
	Actual			Actual	PRSP	Actual / PRSP, %
GDP per capita, thousand drams	305.8	365.8	424.2	505.5	458.9	110.1
GDP per capita, US dollars	571.4	659.1	739.9	873.4	780.0	114.6
Population below poverty line, % of total population	55.1	50.9	49.7	42.9	46.2	92.8
<i>including: population below food poverty line, % of total population</i>	22.9	16.0	13.1	7.4	15.2	48.6
Gini coefficient of income concentration	0.593	0.535	0.451	0.438	0.51	85.1
Incomes of the poorest quantile, % of incomes of the richest quantile	3.6	5.9	6.8	7.5	6.9	108.7
<u>Memorandum item</u>						
<i>De jure population, thousands</i>	3 208.7	3 212.9	3 210.3	3 212.2	...	...

Source: National Statistical Service and PRSP projections.

13. Such a reduction of poverty and inequality in 2001-2003, as envisaged by the PRSP, was mostly conditioned by a progressive growth of the labor income of the poor, and social transfers. Furthermore, during that time, almost all targets of the main indicators projected by PRSP for 2003 were significantly bettered. This happened mainly because the economic growth rate was double that projected by the PRSP. Within the macroeconomic framework of PRSP, the GDP annual growth rate in 2003, 2004 was forecast to be 7% and 6% respectively. In fact, however, it was 13.9% in 2003 and 10.1 in 2004.
14. The indicators of poverty and inequality reduction that were achieved in 2003, more closely correspond to the long-term objectives of PRSP. Particularly :
- The actual indicator of GDP per capita in 2003 corresponds to the PRSP 2004 target. And the actual indicator of GDP per capita in 2004 is correspondent with the PRSP 2006 target indicator.
  - The 42.9% indicator for the poor was envisaged for 2005.
  - The 7.4% indicator for the extremely poor was envisaged for 2013. Thus, there was a remarkable reduction in the number of the extremely poor in 2001-2003.
  - Actual outcomes in 2003 for the Gini coefficients of current income and expenditure (consumer aggregate) concentration (0.438 and 0.271 respectively) signify a real reduction of inequality. As a result of the household survey carried out in 2003, the level of expenditure concentration as shown by the Gini coefficient echoes the similar indicator for the last years of the Soviet Union. It is also comparable to those developed European countries that are deemed to have a low inequality rate. Concerning the Gini coefficient relating to the concentration of current incomes, the PRSP envisaged reaching the 2003 level only by 2015.

**Table 2. Population income and expenditure dynamics according to household surveys and NSS macroeconomic data**

	1999	2001	2002	2003	2003 % 1999	2003 % 2001
Annual average incomes of population (household survey data), thousand drams per capita	95.1	134.6	117.4	159.9	168.1	118.8
Annual average incomes of population (NSS macroeconomic data), thousand drams per capita	195.7	234.6	265.8	362.2	185.0	154.3
<i>Annual average incomes of population (according to household surveys), % of corresponding indicator according to NSS macroeconomic data</i>	48.6	57.4	44.1	44.2		
Annual average expenditures of population (household survey data), thousand drams per capita	140.4	143.4	143.8	172.8	123.0	120.5
Annual average expenditures of population (NSS macroeconomic data), thousand drams per capita	197.2	233.1	257.9	360.7	182.9	154.7
<i>Annual average expenditures of population (according to household surveys), % to corresponding indicator according to NSS macroeconomic data</i>	71.2	61.5	55.8	47.9		
Annual incomes of the poorest quantile of the population (household survey data), thousand drams per capita	14.1	27.4	26.4	37.0	262.4	135.0
Annual incomes of the 2 <sup>nd</sup> quantile of the population (household survey data), thousand drams per capita	35.7	60.5	61.3	81.9	229.4	135.4
Annual incomes of the 3 <sup>rd</sup> quantile of the population (household survey data), thousand drams per capita	63.1	98.2	99.1	125.8	199.4	128.1
Annual incomes of the 4 <sup>th</sup> quantile of the population (household survey data), thousand drams per capita	111.6	160.2	155.5	190.2	170.4	118.7
Annual incomes of the richest quantile of the population (household survey data), thousand drams per capita	423.5	474.2	385.5	492.37	116.2	103.8
Annual expenditures of the poorest quantile of the population (household survey data), thousand drams per capita	50.1	51.8	53.6	72.5	144.7	140.0
Annual expenditures of the 2 <sup>nd</sup> quantile of the population (household survey data), thousand drams per capita	84.7	87.9	92.3	113.4	133.9	129.0
Annual expenditures of the 3 <sup>rd</sup> quantile of the population (household survey data), thousand drams per capita	116.3	121.9	125.2	153.6	132.1	126.0
Annual expenditures of the 4 <sup>th</sup> quantile of the population (household survey data), thousand drams per capita	166.4	172.4	174.6	209.1	125.7	121.3
Annual expenditures of the richest quantile of the population (household survey data), thousand drams per capita	340.0	347.3	339.3	389.4	114.5	112.1

Source: National Statistical Service.

15. Such a change in the Gini coefficients in 2002-2003 was conditioned by three factors:
  - A higher growth of the income of the poor;
  - An inadequate coverage of the income of the non-poor in recent integrated surveys of the living conditions of households. This is evident from the data in
  - 
  - Table 2;
  - A halving of the income inequality from the sale of agricultural products (see
  - Table 3).
16. As
- 17.

18. Table 2 shows, based on data of household surveys, both the incomes and expenditures of the poor have significantly increased at a more rapid pace than that of the wealthy. In 1999-2003, the incomes and expenditures of the poorest quantile of the population had the most rapid growth. On the other hand, in 2001-2003, the incomes of the richest quantile of the population had almost no increase, and the growth of spending was the lowest of all five quantiles.

**Table 3. Income concentration Gini coefficients by income type and structure of income in 1999-2003**

	1999	2001	2002	2003
Gini coefficient for current income	0.593	0.535	0.451	0.438
Gini coefficient for labor income	0.529	0.422	0.451	0.470
Gini coefficient for social transfers	0.119	0.108	0.097	0.11
Gini coefficient for incomes from sale of agricultural products	0.737	0.731	0.418	0.399
Gini coefficient for domestic and foreign transfers	0.718	0.734	0.749	0.732
Gini coefficient for other incomes (including property income)	0.476	0.578	0.547	0.547
<b>Structure of income, % of total</b>	100	100	100	100
Labor income	35.19	42.33	53.21	55.2
Social Transfers	9.33	9.61	11.53	9.91
Income from sale of agricultural products	32.11	15.64	6.4	12.69
Transfers	19.32	18.55	18.7	15.86
Other incomes (including property income)	4.05	13.87	10.16	6.34

Source: National Statistical Service.

19. Referring to the analysis of the Gini coefficient of population income concentration according to various incomes and income groups:
- The inequality of labor income in 2003, as compared with even that of 2001, had a certain growth. There was also a significant increase in the share of labor income in proportion to total income - with a corresponding decrease in the shares of all other types of income. In 2003, labor income in almost all quantile groups accounted for over half of total income, except for the poorest 20% of the population. In this case, labor income amounted to 30.6% of total income. The increase in the inequality of labor income is explained by the sharp increase of labor income in the highest income group (10<sup>th</sup> decile). In 2003, monthly labor income for the decile of the richest amounted to 28.7 thousand drams, while total income was nearly unchanged (in 2003 – 58.0 thousand drams vs. 56.5 thousand drams in 2001).
  - The inequality of income from social transfers and their share in total income have not undergone significant changes. In absolute terms, social transfers have increased in all income groups except for the poorest (1<sup>st</sup> decile) and the wealthiest (10<sup>th</sup> decile) groups.
  - The inequality of incomes from transfers and other incomes has not undergone significant changes, though their share in total income has decreased.
  - In 2002 and 2003, the main factor in the reduction of inequality was the unprecedented reduction of income from the sale of agricultural products. This was accompanied by a reduction in absolute values: in 2003, the average income from the sale of agricultural products amounted to 1691 drams per month – compared with 1754 drams in 2001.

20. The comparative analysis of the results of household surveys and information of the National Statistical Service concerning population income and expenditure (see
- 21.
22. Table 2), may lead one to assume that to summarize the analysis of the factors on the reduction of income and expenditure inequality, some further studies may be required.

**Table 4. Structure of population incomes according to household surveys**

	1999	2001	2002	2003	2003 % 1999
Average monthly per capita income, dram	7929	11217	9781	13324	168,0
<i>Including: labor income</i>	2790	4748	5204	7355	263,6
<i>social transfers</i>	740	1078	1128	1321	178,5
Average monthly per capita income for poorest quantile, dram	1178	2286	2197	3086	262,0
<i>Including: labor income</i>	240	736	701	943	392,9
<i>social transfers</i>	717	1075	1038	1161	161,9
Average monthly per capita income for the 2 <sup>nd</sup> quantile, dram	2974	5040	5108	6825	229,5
<i>Including: labor income</i>	1085	2503	2512	3674	338,6
<i>social transfers</i>	1129	1312	1478	1622	143,7
Average monthly per capita income for the 3 <sup>rd</sup> quantile, dram	5256	8180	8256	10485	199,5
<i>Including: labor income</i>	2620	4859	5251	6393	244,0
<i>social transfers</i>	860	1399	1454	1555	180,8
Average monthly per capita income for the 4 <sup>th</sup> quantile, dram	9302	13343	12957	15846	170,4
<i>Including: labor income</i>	4465	8078	8553	10152	227,4
<i>social transfers</i>	905	1198	1114	1321	146,0
Average monthly per capita income for richest quantile, dram	35294	39520	32125	41022	116,2
<i>Including: labor income</i>	10364	12494	14893	21332	205,8
<i>social transfers</i>	1010	1045	1081	1133	112,2

Source: National Statistical Service.

23. The results of the 2002-2003 household surveys indicate that the main factors of poverty reduction remains the progressive growth of labor income for the poor through economic growth, and the increase in social transfers. This is conditioned by the social policies envisaged by the PRSP to help the poor.
24. In 2002-2003, the characteristics of economic growth in programs to help the poor have been preserved. The gap between labor incomes for various income groups is narrower. This is evident even if the results of household surveys are compared with the NSS statistics on income. In 1999-2003, labor income for all five quantiles of the population grew faster than the average income according to income statistics (185%). The trends of the accelerated growth of labor income are preserved in 2004. According to the preliminary results of the household surveys, in the second quarter of 2004, the monthly labor income of the population was 8682 drams – an increase of 18% as compared with corresponding indicators for 2003.
25. The reduction in the number of families registered in the family benefit system is evidence of poverty reduction, especially of the extreme segment. In 2003, the system included 28.7% of the population; in 2001, however, it was 44%. The reduction of the number of families receiving family benefit continued in 2004 and as a result, the system included 20.1% of the population.

26. Unlike the 1999-2001 period, the progressive growth of labor income and the corresponding reduction of poverty in 2002-2003 took place within stabilizing employment conditions.
27. According to the NSS data, the overall number of the employed in 2003 was 1111.6 thousand, compared with 1106.4 thousand in 2002, and 1089.4 thousand in 2001. At the same time, some shifts in the employment structure are recorded. As a result of the recent comprehensive reforms in public administration, education, and health (as envisaged by the PRSP), the increase of income in those sectors was accompanied by a reduction in employment. With the privatization of the electricity distribution network, employment in the energy sector was reduced. As opposed to these sectors, there was a significant increase in employment in construction and trade.
28. The tendency of stabilizing jobs was preserved in the first quarter of 2004 when the employed numbered 1111.9 thousand people. Compared with 2002, it increased by 0.5%. If, in 1994-2001, economic growth in the non-agricultural sectors was almost fully due to productivity growth, in 2002-2003, with accelerated growth rates, a sufficient number of jobs were created that enabled the absorption of the work force from the non-competitive sectors of economy. Other jobs were cut through reforms.
29. This also shows the increase in the number of developing clusters of the economy and the intensity of development during 2002-2004. In this regard, construction, the export of goods, and trade had the most rapid pace of development. These changes hint at the formation of possible new trends in economic growth. It will be possible to draw clearer conclusions about these trends after summarizing the 2004 annual final results.
30. The results of 2004 (10.1% y-o-y economic growth, progressive growth of population income, further stabilization of employment, and so on) state that in 2004, the PRSP target indicators of poverty and inequality reduction have been already exceeded. In this regard, the main target indicators of the program will be revised during the first update of PRSP, which is to be done by the end of 2005.

### **Poverty in urban and rural areas, and in provinces**

31. In 2001-2003, poverty was reduced in both urban and rural areas. As The gap between the incomes of the rural and urban populations increased in the second quarter of 2004. It was 51.4%. After analyzing the results of the 2004 household surveys, the PRSP update will pay special attention to issues related to measures aimed at poverty reduction in rural areas. This should moderate the income gap between urban and rural areas.
32. Table 5 indicates, the most significant reduction of poverty was recorded in Yerevan (36.6% or by 17.1 percentage points) in 2001-2003. In other towns of the country, it was reduced by 12% or 6.8 percentage points. Moreover, the gap of poverty rates<sup>1</sup> between Yerevan and other cities has significantly increased. In 2001, it was 17.6%, whereas in 2003 – it had reached 41.7%. The discrepancy in economic development, in 2001-2003, between Yerevan and other cities, therefore, has substantially increased. Proceeding from this, the government will envisage relevant measures of regional policy during the PRSP update in 2005.
33. With regard to rural poverty, despite some reduction trends in 2001-2003 (poverty was reduced 2.5%

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<sup>1</sup> Percentage difference between poverty levels in Yerevan and other cities.

or 1.2 percentage points), in 2003, for the first time in household surveys in Armenia, rural poverty exceeded urban poverty. Hence, from the point of view of poverty reduction, there are no significant shifts in rural areas. On the one hand, this is attributed to the fact that the incomes of the rural population in 2003 had a slight increase compared with 1999. Consistent with this fluctuating behavior, this is due to the fact that measures aimed at rural poverty reduction envisaged by PRSP (rural roads, irrigation, support to sale of agricultural production, introduction of insurance system in agriculture and other long-term projects) could not have a full impact on rural poverty in just one year of PRSP activity.

34. The gap between the incomes of the rural and urban populations increased in the second quarter of 2004. It was 51.4%<sup>2</sup>. After analyzing the results of the 2004 household surveys, the PRSP update will pay special attention to issues related to measures aimed at poverty reduction in rural areas. This should moderate the income gap between urban and rural areas.

**Table 5. Urban and rural poverty in 1999-2003\***

	1999	2001	2002	2003	2003/ 1999, %	2003/ 2001, %
Population below the poverty line, %	55.1	50.9	49.7	42.9	77.9	84.3
incl.: urban	58.3	51.9	52.6	39.7	68.1	76.5
<i>of which: Yerevan</i>	55.2	46.7	43.8	29.6	53.6	63.4
<i>other cities</i>	61.7	56.7	61.9	49.9	80.9	88.0
Rural	50.8	48.7	45.3	47.5	93.5	97.5
incl.: population below the food poverty line, %	22.9	16.0	13.1	7.4	32.3	46.3
<i>of which: urban</i>	23.2	18.3	15.0	7.9	34.1	43.2
<i>Rural</i>	22.6	11.3	10.2	6.8	30.1	60.2
Average monthly incomes of the rural population, drams	8636	11843	7027	9960	115.3	84.1
Average monthly incomes of the urban population, drams	7397	10913	11656	15647	211.5	143.4
Average income of the rural population, % of average income of urban population	116.8	108.5	60.3	63.7		
Poverty line, dram/month	11735	12019	12261	12629	107.6	105.0
Food poverty line, dram/month	7194	7368	7516	7742	107.6	105.0
Depth of poverty, %	19.0	15.1	13.5	8.9	46.8	58.9
Severity of poverty, %	9.0	6.1	5.2	2.8	31.1	45.9

\* Calculations are made on a per capita basis.

Source: 1998/99, 2001, 2002 and 2003 household surveys.

35. In 2001-2003, there was poverty reduction with regard to the provinces (see Table 6), except for Shirak province, where the poverty level increased by 24.9%, Kotayk province - 3.9% and Syunik province - 5.8%. The biggest reduction of poverty was in Tavush province – (almost half), in Yerevan - 36.9%, and Lori province - 33.5%. The lowest rate of poverty reduction was recorded in Gegharkunik, Ararat, and Aragatsotn provinces. The latter has a predominance of rural population, and agricultural production is very importance. Thus, the regional differences of the poverty rate in Armenia continue to be preconditioned by economic growth and in agricultural provinces, by the extent of favorable conditions for agriculture. In this regards, in 2003, as in previous years, the population was poorest in those provinces where the rural population prevails and conditions for agriculture are quite unfavorable. Shirak province – especially Gyumri with its unprecedented growth of poverty in 2003 – is a separate topic for discussion.

<sup>2</sup> According to preliminary results of the 2004 household surveys, the urban population's per capita income in the second quarter of 2004 was 22.7 thousand drams. The rural population's income for the same period, however, was 11.7 thousand drams.

36. Although the PRSP has no targeted indicators of poverty in regional terms, after summarizing the results of the household surveys for 2004, and within the review process of the PRSP, the government will undertake relevant regional policy measures to accelerate economic development, especially in the poorest regions, to effect a substantial reduction of poverty.

**Table 6. Poverty by province in 2001-2003\***

Province	2001	2002	2003	2003/ 2001, %
<b>Shirak:</b> share of population below poverty line, %	57.8	73.6	72.2	124.9
<i>Rank by poverty level</i>	4	1	1	
<b>Gegharkunik:</b> share of population below poverty line, %	62.2	47.2	59.9	96.3
<i>Rank by poverty level</i>	1	6	2	
<b>Aragatsotn:</b> share of population below poverty line, %	60.3	72.1	57.0	94.5
<i>Rank by poverty level</i>	2	2	3	
<b>Kotayk:</b> share of population below poverty line, %	50.5	55.9	52.5	104.0
<i>Rank by poverty level</i>	8	3	4	
<b>Armavir:</b> share of population below poverty line, %	53.7	51.6	48.3	89.9
<i>Rank by poverty level</i>	6	5	5	
<b>Vayots Dzor:</b> share of population below poverty line, %	51.1	53.2	42.9	83.9
<i>Rank by poverty level</i>	7	4	6	
<b>Ararat:</b> share of population below poverty line, %	44.7	45.4	42.8	95.7
<i>Rank by poverty level</i>	10	7	7	
<b>Syunik:</b> share of population below poverty line, %	-	32.7	34.6	105.8
<i>Rank by poverty level</i>		11	8	
<b>Lori:</b> share of population below poverty line, %	54.2	44.6	34.0	62.7
<i>Rank by poverty level</i>	5	8	9	
<b>Tavush:</b> share of population below poverty line, %	59.7	42.2	30.7	51.4
<i>Rank by poverty level</i>	3	10	10	
<b>Yerevan:</b> share of population below poverty line, %	46.7	43.8	29.6	63.4
<i>Rank by poverty level</i>	9	9	11	

\* Provinces are ranked by descending order of poverty level.

Source: 2001, 2002, and 2003 household surveys.

### Characteristics of poverty for socially vulnerable groups in 1999-2003

37. Despite a significant reduction of poverty and inequality in 1999-2003, poverty in Armenia remains to be high: more than 40% of the country's population is still poor. The poverty phenomenon is characteristic of socially vulnerable groups (see
38. Table 7).
39. As
40. Table 7 indicates, in 1999-2003, a reduction in poverty was recorded for all the socially vulnerable groups that were studied, except for households with three or more children. The biggest reduction was in the group of single pensioners - whose poverty rate was reduced by about 2.5 times, while the consumption expenditures increased by 42%. As a result, the poverty of single pensioners in 2003 was

about 2.3 times less than the countrywide average. In contrast, in 1999, the difference was 118%, and in 2001, it was 165%. This reduction of poverty among single pensioners is attributed mainly to the growth policy of pensions envisaged by the PRSP. In 2003, the average monthly pension amounted to 7452 drams. This is close to the 2004 target indicator, and – as compared with 2001 – represents an increase of 62.9%. In 2004 the average monthly pension as estimated to be 8200 dram, which in comparison with 2003 has increased for 28%.

**Table 7. Consumption expenditures and poverty of the socially vulnerable population in 1999-2003\***

	1999	2001	2002	2003	2003/ 1999, %	2003/ 2001, %
<b>Households headed by an unemployed person</b>						
Monthly consumption expenditure, dram	9791	9321	10826	13035	133.1	139.8
Poverty level, %	66.5	60.1	57.8	48.9	73.5	81.4
<b>Households with six or more members</b>						
Monthly consumption expenditure, dram	9241	9572	9401	11298	122.2	118.0
Poverty level, %	66.4	64.7	61.6	57.0	85.8	88.1
<b>Households with pensioners</b>						
Monthly consumption expenditure, dram	10846	10785	11126	12969	119.6	120.3
Poverty level, %	61.1	56.8	51.6	46.8	76.6	82.4
<b>Single pensioners</b>						
Monthly consumption expenditure, dram	13573	14182	14818	19275	142.0	135.9
Poverty level, %	46.6	30.8	29.2	18.7	40.1	60.7
<b>Households with three or more children (0-14 years old)</b>						
Monthly consumption expenditure, dram	10367	9383	10829	10724	103.4	114.3
Poverty level, %	62.2	65.3	67.4	66.1	106.3	101.2
<b>Households headed by a woman</b>						
Monthly consumption expenditure, dram	11109	11278	11970	14416	129.8	127.8
Poverty level, %	58.9	55.1	51.4	43.3	73.5	78.5
<b>Households with children aged five or under</b>						
Monthly consumption expenditure, dram	9962	10595	10266	12966	130.2	122.4
Poverty level, %	60.0	58.5	58.1	53.9	89.8	92.1
<b>Country average</b>						
Monthly consumption expenditure, dram	11705	11949	11983	14404	123.1	120.5
Poverty level, %	55.1	50.9	49.7	42.9	77.9	84.3

\* Calculations are made on a per capita basis.

Source: 1998/99, 2001, 2002 and 2003 household surveys.

- 41.
42. Table 7 indicates that except for single pensioners, whose poverty rate is significantly lower than the average for the country, and households with three or more children, whose poverty rate in 2003 increased and now comprises 154% of the country average poverty level, all the remaining socially vulnerable groups can be divided into two: those whose poverty rate has decreased as compared with the average, and those whose rate has increased.
43. The first group covers the following categories of the socially vulnerable population:
  - Households headed by an unemployed person, whose poverty level in 2003 was 14.0% higher than the average – as opposed to 20.7% in 1999, and 18% in 2001;
  - Households headed by a woman whose poverty level in 2003 was 0.9% above the average – as opposed to 6.9% in 1999, and 8.3% in 2001;
  - Households with pensioners whose poverty level in 2003 was 9% greater than the average – as



opposed to 10.9% in 1999, and 11.6% in 2001.

44. Thus, the vulnerability to (or the absolute, or relative, risk of) poverty of these three groups in 2001-2003 was reduced. In the case of households headed by a woman, it was made comparable to the country average.
45. As to the second group, it covers the following categories of households:
  - Households with six or more members, whose poverty rate in 2003 was 32.9% above the average – as opposed to 20.5% in 1999, and 27.1% in 2001;
  - Households with children aged five or under, whose poverty rate in 2003 was 25.6% above the average – as opposed to 8.9% in 1999, and 14.9% in 2001;
46. Thus, despite the fact that the absolute risk of poverty was reduced by 18% in households with six or more members in 2001-2003, and households with children aged five or under by 22.3%, their relative risk of poverty, on the contrary, increased.
47. A certain increase of poverty in households with three or more children, as well as the increase of poverty relative risk in households with six or more members, and households with children aged five or under, show the fact that in 2003, as well as in 1999 and 2001, children continue to be the most vulnerable group in the population.
48. To improve this situation, further reforms in family benefit provisions are necessary. They will be implemented in the following directions :
  - Taking into account the trends of the reduction of extreme poverty, which is most likely to continue in the coming years<sup>3</sup>, the major direction of the family allowance system must incrementally shift to families with children and big households, i.e. to poor families, in the broad sense ;
  - Based on the household survey results for 2004, it is necessary in this regard to once again lower the need threshold<sup>4</sup> of the family poverty benefit, and increase the amount of additional payments per child in eligible families;

## **Macroeconomic and sectoral policies and reforms**

### **The Macroeconomic Framework**

#### Main macroeconomic developments in 2004

49. The unprecedented high economic growth rate of 2002-2003 (13.2% and 13.9% y-o-y) was preserved in 2004, as compared with the previous year, a GDP growth rate of 10.1% was recorded. This indicator surpassed the economic growth indicator projected by the PRSP scenario of just 6%. Furthermore, almost all the sectors of the economy had a positive contribution to the planned economic growth. Other conditions being equal, this would have a positive impact on income distribution equality, especially as regards to labor income. From this point of view, it is remarkable that, as the analysis of the main poverty indicators of 2003 shows, the major factor for exceeding the planned indicators of

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<sup>3</sup> The present 7.4% level of the extremely poor makes it possible to integrate more poor families in the family benefits system. Assuming that 100% of such families receive a family benefit, in 2003, more than half of the benefit-receiving families will comprise poor families: those whose income is above the food poverty line.

<sup>4</sup> At present, the threshold for families to be classified eligible for family benefits is 35 points, as compared with 36 points in 2003.

poverty and inequality reduction was the increase of income from hired labor and self-employment in the total income structure of the population. In 2003, 46.9% of the household's per capita average monthly income generated from hired labor and self-employment, against 40.7% in 2002.

50. In recent years, Armenia has had a steady pace of development. Moreover, starting from 2000, accelerating tendencies characterized economic growth. In 2001-2004, two-digit indicators of economic growth were recorded (around 12% as an annual average). In 2001-2003, the major factor of such developments was the increase of foreign investments, mainly in construction sector, and the growth of exported goods and services. In 2004, the economic growth has generated mainly from agricultural and services sectors, as well as locally funded construction activities.
51. In 2004, compared with 2003, the value added in construction increased by 13.4% representing around 2.1% of the 10.1% GDP growth recorded in 2004. Investment in both public and private sectors, contributed to the growth in the construction sector. The developmental trends for 2002-2004 show that the impact of the sector had a dual nature – firstly, as a direct contribution to the domestic demand growth, and secondly (with a certain lag) as a positive impact on developments in other branches of the economy.
52. In 2004, the contribution of industry to the growth of GDP was insignificant. This sector contributed by 0.4 percentage points to the GDP's annual 10.1% growth. In 2004 as compared with 2003, value added in industry increased only by 2.1%. The decline of diamond processing industry was the main cause of such a low growth rate in this sector. In 2004, the increase of production volumes in industrial sector, excluding diamond processing, was 7% y-o-y. The increase of production volumes in chemical industry was recorded as 54.9%, in mining 8.7%, in electricity, gas, and water production and distribution sectors 9.9%.

**Table 8. Main macroeconomic indicators: actual outcomes vs. targets**

	2003	2004	
	<i>Actual</i>	<i>PRSP</i>	<i>Actual</i>
<b><u>National Income and Prices</u></b>			
Real GDP, year-on-year % change	13.9	6.0	10.1
Gross domestic product, billion drams	1,623	1,609	1,893
Gross domestic product, million US dollars	2,805	2,731	3,549
GDP per capita, US dollars	873	850	1104
Consumer price index (period average), year-on-year % change	4.7	3.0	7.0
Nominal exchange rate (period average), dram/US dollar	578.8	589.3	533.5
<b><u>Value Added by Main Sector</u></b>			
	<i>year-on-year % change</i>		
Industry	15.4	8.0	2.1
Agriculture	4.3	2.8	14.5
Construction	44.4	0.4	13.4
Transport and communications	8.2	6.0	17.0
Trade	14.5	11.4	10.5
Other sectors	7.6	6.8	12.2
<b><u>Consumption and Investment</u></b>			
	<i>in % of GDP</i>		
Final consumption	94.3	94.6	97.7 <sup>1</sup>
<i>of which: private</i>	84.1	82.9	86.1 <sup>2</sup>
Gross capital formation	24.7	20.6	23.7 <sup>2</sup>

<sup>1</sup> January-September 2004

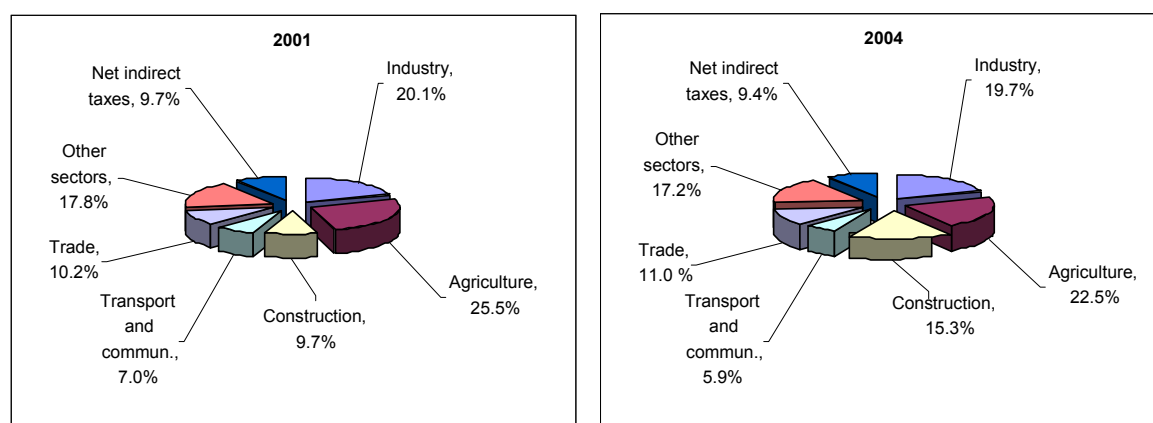
<sup>2</sup> Indicators from 2004 consolidated budget are included yet.

<b>Fiscal Sector</b>			
Consolidated Budget (on a commitment basis)	in % of GDP		
Total revenues and grants	21.5	21.5	- "
<i>of which: tax revenues</i>	17.2	18.8	-
<i>Grants</i>	3.2	2.1	-
Total expenditure and net lending	22.4	24.1	-
<i>of which: current expenditure</i>	16.7	18.3	-
<i>capital expenditure</i>	5.2	5.4	-
Overall balance	-0.9	-2.6	-
<b>External Sector</b>			
	in % of GDP, unless otherwise indicated		
Exports of goods and services	32.2	30.7	30.2"
Imports of goods and services	50.1	46	47.2"
Current account balance	-6.8	-5.8	-6.0"
Public external debt	39.1	40.4	33.3
Gross foreign reserves (end of period), in months of imports	4.3	4.6	5.3"

Source: National Statistical Service, Central Bank of Armenia, Ministry of Finance and Economy and PRSP projections.

53. In 2004, value added in agriculture increased by 14.5% y-o-y. As compared with 2003, the growth in agricultural sector was attributed by the gross production growth in agricultural farming (except vegetables) (+20.1%) and cattle breeding (+8.0%). Although the influence of climate conditions on the sector is high, the underdevelopment of the physical and financial infrastructures, however, is the main factor impeding progress in this sector. This significantly limits productivity growth, as well as complicates marketing issues.
54. The impact of the service sector on GDP growth was significant and contributed by 4.3 percentage points to the GDP's annual 10.1% growth. Particularly, in 2004, the transport and communication sector recorded a 17.0% y-o-y increase of value added, against 8.2% in 2003. Moreover, over the last three years, the trade and catering sector grew at rather high rates (+15% annually on average).
55. These developments in the major sectors of the economy resulted in some shifts in the structure of the GDP. In 2004, as compared with 2002, the share of construction increased by 2.7 percentage points to 15.3%. The share of agriculture, however, decreased by 0.9 percentage points (22.5% in 2004). The comparable indicator for industry increased by 0.8 percentage points (19.7% in 2004). As compared with 2002, the share of service sector to GDP decreased by 1.3 percentage points, and in 2004, this sector consisted 34.1% of GDP.

**Figure 2. GDP structure by main sector (percentage of total)**



Source: National Statistical Service of the Republic of Armenia.

56. Referring to GDP components according to their use, and while comparing the period from January to September 2004<sup>5</sup> with same period of 2003, both final consumption expenditures and gross capital formation increased 11% y-o-y and 9% y-o-y, respectively. Because of developments during last years, remarkable changes were recorded in the GDP structure's components as well. Particularly, although final consumption expenditures were characterized by growth, the share of final consumption expenditures in the GDP, however, (as was foreseen) was constantly reduced. Moreover, if the share of public final consumption expenditures was nearly unchanged (around 10-11%), the share of private final consumption expenditures constantly declined: it was 84% in 2003 as opposed to 94% in 2001. During this time, the share of gross capital formation increased by five percentage points, and in 2003 amounted to 25% of GDP.
57. In 2004, per capita GDP in nominal terms amounted to 1104 US dollars, compared with 873 US dollars in 2003<sup>6</sup>. In the macroeconomic framework of the PRSP, the relevant planned indicator (re-estimated based on the forecast of the *de jure* population) was about 850 US dollars<sup>7</sup>. The difference between actual and projected indicators is attributed mainly to the higher actual growth rate of the GDP, and partially, to the lower depreciation of the dram against the US dollar, as compared with the pertinent projections.
58. Regarding prices, wages and exchange rates, in 2004 prices did not exceed the projected level in PRSP. In December 2004, compared with the same period of 2003, consumer prices increased by 2.0% (the average annual change of CPI was 7.0%). Meanwhile, in this context, considering the behavior of indicators related to population incomes, it must be stated that their changes in real terms was positive, despite the rather sharp increase in prices. Particularly, the average salary in 2004 amounted to 42.0 thousand drams and, in real terms (deflated by the average CPI), increased by 15.06% y-o-y. A similar trend is also typical for income indicators based on the results of the 2003 household survey. Incomes from hired labor (per capita) compared with 2002, grew by 36.0%, while incomes from social transfers - by about 17%. In 2004, the nominal exchange rate of the Armenian dram was appreciated against the US dollar, mainly because of the increase of foreign currency and remittances inflow. In addition, it is important to take into consideration that on international level, the US dollar has been depreciated against other currencies. Accordingly, in 2004 the Armenian dram appreciated against the US dollar by 7.8%, as opposed to the envisaged 1.8% depreciation.
59. In the area of public finances, in 2004, the execution of the budget was in line with the approved annual budget plan. State budget revenues and expenditures in 2004 increased by 3.1% and 10.2% accordingly in nominal terms and amounted to 301.1 and 344.7 bn drams<sup>8</sup>, respectively. The lion's share of revenues was raised through taxes. On the expenditure side, however, priority was given particularly to expenditures in the social sectors. The nominal growth rates of budget revenues and expenditures, however, were lower than the growth rate of the nominal GDP. As a result, some differences were recorded in actual and projected indicators relative to the GDP. In 2004, the actual

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<sup>5</sup> Annual indicators for 2004 are not available yet.

<sup>6</sup> Calculations are based on the *de jure* population.

<sup>7</sup> PRSP projections of GDP per capita are based on indicators of the *de facto* population, actual data for which are not available. In the next PRSP update, the GDP per capita targets will be adjusted based on the *de jure* population.

<sup>8</sup> The indicators from the state budget are initial and calculated based on the actual implementation of the state budget (excluding PIU financial resources) and the planned amounts of PIU financial resources.

total revenues-to-GDP and total expenditures-to-GDP ratios, as compared with the corresponding indicators for 2003, declined by 2.1 and 1.1 percentage points respectively and consisted 15.9% and 18.2% , respectively. The high GDP growth was not directly and fully reflected in the behavior of tax revenues since the higher rate of GDP growth (as compared with the projections) was largely generated in the tax-exempted sectors, especially in agriculture sectors. At the same time, the Government of Armenia considers that one of the most significant sources of tax revenue increase is the improvement of tax administration. It continues to take measures in this regard. The role of external support in the budget structure was decreased. In 2004, it amounted to 3.1% net of GDP, compared with 5.9% for 2003. As a result of better budget management and control, the overall budget deficit (compared with 2001), improved significantly: the deficit-to-GDP ratio decreased from 4.3% in 2001 to about 2.3% in 2004.

60. Indicators on both exports and imports of goods and services in 2004 (in US dollars) significantly went beyond the level of the relevant projected indicators for the external sector. Compared with the first 9 months of 2003, actual growth rates of exports and imports in the same period of 2004 amounted to 5.6% and 6.5%, respectively. The annual planned indicators were 9.4% and 7.4%, respectively. In the case of both exports and imports, such differences were due to the deviation of actual outcomes from projected indicators for precious and semiprecious metals and stones, as well as the result of Armenian drams appreciation against the US dollar. Besides, in the case of exports, the impacts of non-precious metals and the production of raw ores (partially due to favorable price conditions) were high. On the import side, imported fuel (attributed to a high investment activity in the economy), had an important contribution to the overall growth of imports. Workers' remittances and private transfers continue to play an ever increasing and significant role in the population's income structure. Compensation of employees (including border, seasonal and other workers) (in net terms) compared with the first 9 months of 2003, increased by 27.9%, while private transfers grew by 84.5%. In 2003, they amounted to 110.2 and 203.4 mn US dollars respectively. In the first 9 months of 2004, the current account deficit of the balance of payments amounted to 137.3 mn US dollars (or 6.0% of GDP): an improving of 2.4 percentage point compared with the previous year. The current account deficit was mostly financed by capital transfers, foreign direct investments, and official external support. At the same time, gross foreign reserves decreased (at the actual exchange rate) by 18 mn US dollars as compared to December, 2003. By the end of the ninth months of 2004, they amounted to 484 mn US dollars (equivalent to 5.3 months of imports of goods and services). In 2004, improvements were recorded concerning the public external debt. This was primarily due to the debt-equity swap with the Russian Federation, as well as positive macroeconomic and fiscal developments. In 2004, the external debt accounted for 33.3% of GDP, while the current value of the debt-to-GDP ratio accounted for 20%,<sup>9</sup> as compared with the corresponding indicators of the previous year, which were 39.1% and 26.1%, respectively.

## **Poverty reduction sectoral policies**

### Education

61. In the sphere of education, the PRSP's major goals are to insure the availability of education and to

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<sup>9</sup> According to the initial estimations.

increase the quality of general education. To meet these objectives, there is an assumed increase of government spending directed towards education.

62. The actual expenditures of the 2003 consolidated budget on education increased by 19% compared with 2002. It amounts to 35.1 bn drams. The allocations in the 2004 budget exceed the actual indicator of 2003 by 40%. The overwhelming part of this increase lies in expenditures on general education: 36 percentage points (of the planned 40% of growth in 2004) are directed towards general education<sup>10</sup>. The allocations increasing has continuous trend, thus in the 2005 budget it exceeds the budget indicator of 2004 by 26%.
63. Table 9 indicates that the government realized the 2004 budget plan based on priorities defined in the framework of the PRSP. Consequently, in order to ensure progress, there are planned predictions for the budget means allocations. Moreover, in June 2004, while making changes in the annual budget adopted in December 2003, there were an additional seven bn drams allotted to education. The overwhelming part was directed towards capital expenditures to improve building conditions of schools in the general education network. This circumstance conditioned the difference between the nominal indicators planned in the PRSP's framework for government spending in the sphere of education, and the actual indicators of the 2004 budget. Such a redistribution of means resulted in a certain inter- and inner-shift of budget structure as compared with that planned in the PRSP. On the one hand, the section of consolidated budget expenditures targeted for education was enlarged. On the other hand, in the general expenditures of the education sphere, the allocation for general education increased. Consequently, in the case of a higher than planned GDP growth for the whole year, it can be anticipated that as a result of such a change, the optimally close value of the target indicator for the expenditures-GDP correlation in the sphere of education defined by PRSP will be ensured.

**Table 9. Consolidated budget expenditures in the education sector in 2003 - 2004**

	2003	2004	2003	2004
	PRSP		Actual	Preliminary
<b>Total, billion drams</b>	<b>35.2</b>	<b>42.8</b>	<b>35.4</b>	<b>51.9</b>
<i>in % of GDP</i>	2.4	2.7	2.2	2.7
<i>in % of consolidated budget total expenditure</i>	9.4	11.0	9.7	12.7
<i>year-on-year % change</i>	18.3	21.6	19.1	46.6
<b>Primary, basic and secondary education, billion drams</b>	<b>23.0</b>	<b>30.2</b>	<b>23.2</b>	<b>34.7</b>
<i>in % of GDP</i>	1.6	1.9	1.4	1.8
<i>in % of consolidated budget total expenditures on education</i>	65.4	70.5	65.5	66.9
<i>year-on-year % change</i>	23.2	31.0	23.4	49.6

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

64. The government assumes that an important prerequisite to raise the quality of education is the increase of teacher and administrative personnel salaries in the general education sphere. This became one of the more salient factors of government spending growth in the education sphere. In 2004, the average monthly salary for a full-time teacher was set in the budget at 30.6 thousand drams – exceeding the previous year's figure by about 70%. The salary rate is still low: a teacher's average salary and the planned GDP per capita correlation is 0.7. The government continues the salary increase policy. Particularly, in the 2005 budget it is planned that the average monthly salary of a

<sup>10</sup> Government spending growth resulted in an increase in the quality of education. This had its effect as reflected in the reduction of private tutoring. According to the results of household surveys, in 2003, private tutoring was 9.3% as opposed to 11.6% in 2001

teacher is to be 50.5 thousand drams, which conforms to the provisions of the PRSP. Thus, in 2005, a teacher's average salary is planned to be equal the GDP per capita rate.

65. Another priority of government expenditures in the sphere of general education is to solve the problems relating to building facilities and heating. This ought to ensure an uninterrupted educational process and raise attendance. Through the state budget, 25 school buildings were constructed and 187 schools were fundamentally renovated in 2004. With the financial collaboration of the Armenian Social Investment Fund, 16 school buildings were constructed and 148 schools were totally renovated. Since 2003, the quantity of fuel provided for heating purposes and the duration of the heating season have been increased differentially according to the topological and climatic conditions of the school. The government intends to extend the heating system network of local schools with appropriate expenditures from the state budget. In this regard, the deposits provided by international organizations in the form of credits and grants are important.
66. With respect to a better and uniform quality of education, special attention is paid to teacher training and the improvement of a school's pedagogical and material capacities. In 2004, 28000 teachers were incorporated in training sessions. To modernize the General Education National Curriculum and assessment system, "General Education State Standards" have been designed and the Assessment and Testing Center has been created. In the work done in this regard, the role of program assistance from external sources is essential. In particular, within the framework of a credit program called "Education Quality and Relevance" that is being financed by the World Bank in 2004, it is envisaged to modernize the content of general education, input a contemporary system of assessing the educational process and the learner's knowledge, expand the introduction of Information Communication Technologies, and encourage teacher training and professional development.
67. The government has taken steps to ensure equal education and its universal availability. The policy of providing free books to pupils of elementary classes is preserved. New regulations are set and adopted concerning the relocation (for professional reasons) of teachers to remote, frontier, and mountainous areas. During the 2004 year, 149 teachers were relocated.
68. Concurrently, with government spending increases, there are issues being dealt with that relate to the management and efficiency of the educational system. In 2003, according to the decentralization of management and the increasing of the institutions' autonomy, every school was redefined as a state non-commercial legal entity. According to the ratified schedule, by 2005, it is planned to complete, in all schools, the activities related to their financing on a per pupil basis<sup>11</sup>. The measures taken to raise the productivity of the system's activities aimed to establish the number of teachers, increase teacher workloads, and optimize the school network. As a result, there were positive changes in significant indicators defining productivity. These comply with the PRSP considerations. In 2004, the pupil/teacher ratio in general schools was 13.1, as opposed to 11 in 2003. The average class size was 22.2 pupils, instead of 21 in 2003. Ministry of Education and Science of RA with the Center for Education Projects in cooperation with the RA Ministry of Labor and Social Affairs a support program for the teachers made redundancy has been elaborated and implemented and 50 million drams has been allocated to this end from the World Bank credit funds.

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<sup>11</sup>Except for those schools that are included in the list approved by the government

69. In the framework of activities targeting increase of quality and availability of preschool education a „Program on Elaboration and Piloting of the Pre-school Educational program“ is adopted. The program elaboration has already started. In the result of the first stage of pilot period 180 children have been involved in additional services provided by the pre-schools. The results of the pilot program implemented in Gegharkunik marz with the support of UNCEF have been summed up, and it has been decided to expand the program. During 2004 training of 65 head masters of pre-schools and 320 teachers have been organized. Copy-books and methodological manuals for children at the age of 6 have been published
70. For increase of the quality of vocational education and professional training programs, training for 50 teachers working in the vocational educational institutions has been realized during 2004. Educational standards for 6 health care sector specializations in the vocational education sphere has been elaborated. The RA Law on „Higher and Post-graduate Education“ has been adopted.

### Health Care

71. The main objective of the PRSP in health care is to improve the availability and quality of health services. This is done by focusing on the primary unit and the mitigation of regional imbalances. In order to achieve the established objectives, public expenditures in health care will be increased, and actions will be taken to improve the system’s management and efficiency.
72. In 2003, public expenditures in health care were characterized by positive developments. Actual expenditures in 2003 are consistent with the adjusted budget program. They exceeded the parallel indicator of 2002 by 23% and amounted to 19.6 billion drams. Both in drafting the 2004-2006 mid-term expenditures framework, and the 2004 Annual Budget, the government was guided by the PRSP’s priorities and the target indicators of public expenditure in health care (see Table 10). The 2004 State Budget has provided for an increase in the allocations to health care of up to 25 billion drams (which is a nominal 28% increase, as compared with the 2003 actual indicator)<sup>12</sup>. The nominal value of the 2003 public expenditures in health care corresponds to the PRSP target. There were certain deviations of the expenditure-to-GDP ratio, however, that reflected the fact that the actual economic growth rate was higher than planned. This behavior has been observed in 2004 as well. Nevertheless, in the medium term, the government intends to follow the scenario identified in the PRSP. It has expressed this attitude in the MTEF 2005-2007.

**Table 10. State budget expenditures in the health sector in 2003-2004**

	2003	2004	2003	2004
	PRSP		Actual	Preliminary
<b>Total, billion drams</b>	<b>21.0</b>	<b>24.9</b>	<b>19.6</b>	<b>24.7</b>
<i>in % of GDP</i>	1.4	1.5	1.2	1.3
<i>in % of state budget total expenditures</i>	6.5	7.6	6.3	6.0
<i>year-on-year % change</i>	31.2	18.6	22.8	26.0

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

<sup>12</sup> According to the household survey data, the frequency of patient visits to health institutions has increased by 8 percentage points, as compared with the 2002 indicator and to 40% in 2003. At the same time, the average medical care expenditure per family member has decreased from 119 drams in 2002 to 85 drams in 2003. Such data may allow one to infer a reduction of unofficial expenditures in health care.



73. When drafting the 2004 budget, the government has been led by the inter-sectoral and intra-sectoral priorities identified in the PRSP. Specifically, the progressive increase in health care expenditures as a proportion of total expenditures will result in an increased share of health care expenditures within the total budget. In its turn, within the structure of health care expenditures, the share of public spending in the primary unit will increase to around 35% (which is 1.7 percentage points higher than the corresponding 2003 indicator). Such an inter-sectoral redistribution of the health care budget complies with the relevant PRSP provisions. These foresee an increasing share of spending on the primary unit within health care expenditures to 40% in 2006. The corresponding indicator determined for 2006 by the MTEF 2005-2007 is around 42 percent.
74. Large scale renovation and reequipment activities have been realized in 80% of the medical centers/hospitals. Characteristic is the establishment of new departments supplied with the contemporary equipment. During 2004 the latest medical equipment at the total price of 1 billion dram has been purchased and at the expense of health care sector budget.
75. In order to emphasize primary medical care, the government has adopted the “2003-2008 Strategy for Primary Health Care of the Population of the Republic of Armenia”, which aims to improve the availability of primary medical care, particularly through the introduction of a family medicine system. In this context, the government has undertaken to manage system activities and introduce appropriate financing. Special emphasis has also been put on staff training and retraining through the involvement of ambulatory-polyclinic institutions in pilot projects, in Yerevan and beyond. In 2004 8.7 billion dram has been allocated to this sector from the state budget capacities, exceeding the 2003 level for 2.2 billion drams. The price of outpatient medical centers’ visits has increased reaching 823 dram (in comparison with the 450 dram registered in 2003). Increase of financing of health care sector will continue in 2005 as well and it is envisaged that the 2004 indicators will be exceeded for 28%.
76. The activities to eliminate local imbalances aim to improve the material and technical basis of medical institutions in the regions, especially in rural areas, and to equip them with up-to-date facilities. The 2004 budget has made provisions for that purpose and is implementing them. Moreover, an objective of the program is to improve the availability of diagnostic equipment in the regions. Appropriate contracts have been concluded with the regional polyclinics to provide especially costly diagnostic services. In order to ensure the availability of emergency aid services in rural areas and to assign this function to the primary unit doctors, the Ministry of Health has allowed about 82 rural ambulance stations. They have been provided with ambulances through the World Bank-financed credit program. They service emergency aid calls by state mandate.
77. Maternal and child health care, which is a PRSP priority, aims to achieve the relevant objectives of the Millennium Declaration<sup>13</sup>. While stressing these issues, the government has approved a number of key documents to implement the relevant program provisions in the PRSP. In 2003, the government approved the “2003-2015 Strategy for Maternal and Children’s Health Care”, which, among other goals, defines the objectives of reducing maternal and child mortality, and the number of under-weight neonates, ensuring a 95% (or higher) vaccination rate, and improving the indicators of exclusive

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<sup>13</sup> An encouraging trend in the maternal and children’s mortality indicators has been observed over the last years. Provided that such trends persist in the future, the objectives of the Millennium Declaration are likely to be achieved. Nevertheless, there are certain statistical problems in the registration of births and child mortality. These will be dealt with through the joint efforts of the Ministry of Health, the Ministry of Justice, and the National Statistical Service.

- breastfeeding.
78. In this context, special emphasis is put on improving the quality of obstetric and gynecologic care and strengthening the material and technical basis of maternity institutions. This has been appropriately reflected in public expenditures. The 2004 budget expenditures in obstetric and gynecologic care exceed the same indicator of the previous year by 20 percent. Individual delivery expenses are planned to be 44.0 thousand drams, as compared with 36.0 thousand drams in the previous year. Besides state funds, donor organizations and governments have been providing a sizable input to these projects, especially in terms of dealing with regional issues<sup>14</sup>.
79. The government consistently implements programs to fight and prevent transmitted diseases such as tuberculosis, malaria, and AIDS/HIV. In 2003, the government approved the “National Program to Fight Tuberculosis”. It aims at the systematic prevention, detection, and treatment of this disease. It also provides for anti-tuberculosis drugs to hamper any further development of morbidity and disability among the population. Although the cases of malaria are decreasing every year and the programs implemented show positive effects, additional efforts will be needed for the complete elimination of this disease. The “Program for AIDS/HIV Prevention” is implemented through activities to improve the population’s knowledge of medical and hygienic factors. Preventive work among AIDS risk groups, as well as running an information center for AIDS/HIV diseases are some of the approaches used with family members, nurses, and medical staff. Voluntary units for AIDS consultation and examination are also included.
80. Improving the system management and efficiency are among the key objectives of health care reforms. Work in this area involves institutions in both primary and hospital units. The system’s optimization aims to transfer the load of health care services from the relatively expensive hospital unit to the relatively inexpensive primary unit. Concurrently, the government pursues the goal of concentrating its scarce resources on a minimum number of hospitals. Thus, the 2004 state mandate has been placed in a selected number of multi-profile hospitals, pursuant to the criteria developed by the Ministry of Health. In terms of enhancing the efficiency of health institutions, the focus is on their enlargement through mergers – especially in Yerevan. In 2003, under the optimization program of the health care system in Yerevan, nine consolidated units were created through the merger of 34 health care institutions. The merging process was based on criteria regarding locale and medical services. Implementing this process results in a more efficient combination and utilization of available capacities and staff potential.
81. In the result of target policy implementation in the health care sector the number of appliance of patients has increased. For example since 2002 the number of patients registered in the hospitals has increased (at the rate of 100 people in 2001 it was registered to be 4.9, in 2002 -6.1, in 2003-6.9, in 2004 –6.9 (according to the preliminary data)). The number of visits to the outpatient medical centers (at the average at a rate of one resident in 2001 it was registered to be 1.8, in 2002-1.9, 2003-2.0 and in 2004 2.1 (according to the preliminary data)) has also increased. Despite the above-mentioned, still there exist problems related to early diagnosis and reveal of illnesses, as well as prevention of spread of illnesses. Thus, the forthcoming activities are to be directed towards these problems.

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<sup>14</sup> Through the contribution of the UN Population Fund, maternity institutions in Armavir and Spitak were provided with mobile reanimation units for emergency obstetric assistance. In the future, these services will be made available primarily in remote areas.

Social Protection System

82. Social policy plays an important role in terms of reducing inequality and material poverty within the framework of the PRSP. Improved targeting in the family benefit system is considered a social assistance priority and a key instrument to reduce poverty among the most vulnerable segments of the population. Moreover, the program emphasizes the provision of targeted and high-quality social services to those groups of the population needing special protection (the disabled, orphans, refugees, and the homeless). It aims to meet the demand for such services. In the area of social insurance, the policy aims to improve the system's efficiency, to raise pensions (while differentiating them based on length of service), to introduce the system of individual registration, and to ensure the transition to a pension system based on the amount of insurance payments made in the past.

**Table 11. Consolidated budget expenditures on social security and social insurance in 2003-2004**

	2003	2004	2003	2004
	PRSP		Actual	Preliminary
<b>Total, billion drams<sup>1</sup></b>	<b>71.4</b>	<b>82.6</b>	<b>73.0</b>	<b>101.0</b>
<i>in % of GDP</i>	4.8	5.1	4.5	5.3
<i>in % of consolidated budget total expenditures</i>	19.0	21.3	20.1	24.7
<i>year-on-year % change</i>	18.4	15.8	19.7	38.4
<i>of which:</i>				
<b>State Budget, billion drams</b>	<b>30.5</b>	<b>36.1</b>	<b>29.3</b>	<b>35.7</b>
<i>in % of GDP</i>	2.1	2.2	1.8	1.9
<i>in % of total expenditures in the sector</i>	42.8	43.7	40.2	35.3
<i>year-on-year % change</i>	29.6	18.2	23.0	21.8
<b>State Social Insurance Fund, billion drams</b>	<b>40.8</b>	<b>46.5</b>	<b>43.2</b>	<b>64.7</b>
<i>in % of GDP</i>	2.8	2.9	2.7	3.4
<i>in % of total expenditures in the sector</i>	57.2	56.3	59.2	64.1
<i>year-on-year % change</i>	11.1	13.9	17.6	49.8

<sup>1</sup>Expenditures of the State Social Insurance Fund on system maintenance and development are excluded.

Actual outcomes for 2003 include 409 million drams spent on social security and social insurance from local budgets. It is assumed that the corresponding indicator for 2004 will be consistent with its 2003 level.

Source: National Statistical Service, State Social Insurance Fund, Ministry of Finance and Economy, and PRSP projections.

83. Public expenditures for social security and social insurance – under both the MTEF 2004-2006, and the 2004 Annual Budget – have been planned according to the PRSP priorities and the targets of public expenditures in this sector (see Table 11). Allocations to this sector from the 2004 consolidated budget are 88.3 billion drams. This figure exceeds the same indicator for the previous year by 21% (in 2003, expenditures in the sector were also characterized by an almost identical dynamics of increase).
84. The nominal value of the 2004 budget provisions for the sector is almost 6 billion drams above the PRSP indicator. This reflects the higher level of planned expenditures in the pensions financed from the State Social Insurance Fund (3.7 billion drams more than the PRSP projection), and in separate programs for social insurance (1.3 billion drams more than the PRSP projection). Even in the presence of this redistribution in public spending, however, the ratio of PRSP targets for social security and social insurance expenditures to GDP will most probably not be achieved, because economic growth has been higher than expected. Nevertheless, as in the other priority areas, in the medium-term, the government intends to make appropriate adjustments to the allocation quotas for social protection, as guided by the PRSP priorities and targets.

85. In 2003, expenditures in family benefits totaled 12.4 billion drams (0.8% of GDP), or 17% of public spending in the sector. As guided by the PRSP priorities and policies, the 2004 budgeted allocations for this sector have significantly increased (see Table 12).

**Table 12. Public expenditures on family benefits in 2003 - 2004**

	2003	2004	2003	2004
	PRSP		Actual	Preliminary
<b>Family benefits, billion drams</b>	<b>12.7</b>	<b>16.1</b>	<b>12.4</b>	<b>16.1</b>
<i>in % of GDP</i>	0.9	1.0	0.8	0.9
<i>in % of consolidated budget total expenditures</i>	3.4	4.1	3.4	4.1
<i>in % of consolidated budget expenditures on social security and social insurance</i>	17.9	19.5	16.9	16.4
<i>year-on-year % change</i>	5.5	26.3	2.2	33.9

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

86. The system of family benefits has proven its viability as a rather efficient instrument for poverty reduction. These benefits still play a vital role in the income structure of the population belonging to the lowest quantile. In view of these two facts, the government, while increasing family benefit expenditures, is improving the system's efficiency and introducing mechanisms for the differentiation of benefits provided to families with many children and with a higher exposure to poverty.
87. Since January 2004, the base amount of the family benefit is set at 4500 drams, an increase of 500 drams over the previous year's figure. Concurrently, the allowance provided to minors who are members of families with a vulnerability unit<sup>15</sup> between 35.01 and 38.00 is 2500 drams. The allowance provided to those with a family vulnerability unit of 38.01 or more is 3000 drams. This contrasts to the allowance paid in the previous year, which was 2000 drams - with no differentiation based on the level of vulnerability. Moreover, resources provided for the payment of one-off pecuniary aid have been reduced from 5 to 3% of the total state budget allocations set aside for this purpose. Such changes, provided the number of beneficiary families remains the same, will result in an almost 30% increase in benefits, as compared with the 2003 indicator.
88. The government's children-oriented policy is expressed through the revised amount of the one-off benefit for childbirth: since October 2003, it is 35 000 drams rather than the previous 5900 drams.
89. The activities on improvement of the family benefit system will continue in 2005. It is envisaged to change the family benefit scoring system, reducing the minimum 35 score for 34, and to make the base family benefit size 6000 dram, instead of 4500 offered in 2004. The allowances offered to children up to the age of 18 range from 3000-4500 dram, differentiated on the basis of poverty of the given family as well as depend on the factor of living in bordering or highland regions. The one-time benefit for covering the expenses related to childbirth provided to the families involved in the family benefit is set to be 70.000 dram.
90. The authorities act consistently to improve the efficiency and financial viability of the pension system. In 2003, expenditures for pensions<sup>16</sup> increased by around 25 percent, as compared with the previous year, and amounted to 42.6 billion drams (or 2.6% of GDP) (see Table 13). The 2004 budget also

<sup>15</sup> The marginal vulnerability unit for a family benefit is set at 35.00 since January 2004, which is one unit less than the previous year's indicator. This has helped to maintain the 2003 number of beneficiary families.

<sup>16</sup> Expenditures in the pension security of military personnel and their families, as financed from the state budget, are not included into these figures.

provides an increase in public expenditures in this sector (20% more as compared with the actual 2003 indicator).

**Table 13. Consolidated budget expenditures on pensions in 2003 - 2004**

	2003	2004	2003	2004
	PRSP		Actual	Budget
<b>Total, billion drams<sup>1</sup></b>	<b>40.6</b>	<b>47.0</b>	<b>42.6</b>	<b>50.9</b>
<i>in % of GDP</i>	2.8	2.9	2.6	3.0
<i>in % of consolidated budget total expenditures</i>	10.8	12.1	11.7	12.9
<i>in % of consolidated budget expenditures on social security and social insurance</i>	56.9	56.8	58.4	57.6
<i>year-on-year % change</i>	18.8	15.6	24.7	19.6
<i>of which:</i>				
<b>Labor pensions (based on payment of contributions), billion drams</b>	<b>38.6</b>	<b>44.2</b>	<b>40.6</b>	<b>47.9</b>
<i>in % of GDP</i>	2.6	2.7	2.5	2.8
<b>Social pensions</b>	<b>2.0</b>	<b>2.7</b>	<b>2.0</b>	<b>3.0</b>
<i>in % of GDP</i>	0.1	0.2	0.1	0.2

<sup>1</sup> Excluding state budget expenditures on pensions of military service pensioners and their family members.

Source: State Social Insurance Fund, Ministry of Finance and Economy, and PRSP projections.

91. The increase in pension expenditures has been driven mainly by two factors – the increased revenues of the State Social Insurance Fund from mandatory social insurance payments, and the differentiation between social pensions/non-insurance payments and insurance pensions, with a subsequent separation of their financing. Since 2003, social pensions are financed from the state budget, and since 2004, budgetary financing is also provided for the supplementary payments against employment periods and other activities included in the insured length of service, for which the state is legally bound to make social payments.
92. Improvement of the overall resource package has permitted a consistent increase in the annual value of the insured length of service. This contributes to the further differentiation of the pension size depending on the length of service. Particularly, over the first three quarters of 2003, it was 100 drams, as compared with 80 drams for the third quarter of 2002. For the fourth quarter of 2003, it was raised to 120 drams. Since October 2004, the annual value of the insurance length of service has been further increased to 160 drams. These changes have an impact on the average size of pensions. The average monthly insurance pension in 2003 was 7452 drams, which exceeded the same indicator of the previous year by about 34 percent. In 2003, the average monthly insurance pension was almost equal to the extreme poverty line. This contrasts with the situation in 2002, when it was only 75% of that level. The increase of the pension size continued in 2004 as well and currently the average pension size is set to be 8672 drams (the increase of the pension size (in comparison with the average pension registered during the previous year) constituted 28% ).
93. When considering the potential impact of the implementation of this policy on the reduction of poverty, and based on the initial results of the 2003 household survey, one can conclude that the policy has had a greater impact on improving social conditions of single pensioners. Their poverty level in 2003 was 18.7 percent, which was 12 percentage points lower than the 2001 level. Certain positive trends were also observed in the indicators describing the poverty level of households having pensioners (2.2 percentage points below the 2001 level).
94. Within the framework of pension insurance system reforms, preparations are in progress to introduce

the individual (personalized) registration system. The effectiveness of this system and the availability of personalized reports are expected to enable the generation of reliable data on a person's wages, the deposits made in favor of social payments, and on his/her insured length of service. This will allow the linking of wages, accumulated insurance payments, and the future pension amount.

95. The government also supports those groups of the population needing special protection. Along with the expanding resource potential of the state, it has increased – as much as possible – the allocations for social protection programs and has met the demand for such services. Since 2003, the government has established new rules to define clearly the procedure to provide the disabled with prosthetic-orthopedic devices, to enhance its controllability and transparency, as well as to enlarge the range of free devices. Measures have been taken to better address and target the availability of social assistance to veterans, disabled veterans, and the families of those killed in action. These measures provide pecuniary aid rather than privileges. Moreover, actions have been taken to utilize scarce resources more efficiently. Specifically, the privilege of providing a free voucher for sanatorium treatments for the disabled has been canceled. The resources thus saved have been channeled to provide for regular and timely increases in pensions.
96. The government especially emphasizes children's social assistance programs. In the course of 2003 and 2004, a number of legislative acts dealing with the problems in this area were adopted. In particular, the procedure to provide a home to children deprived of parental care has been approved. Since 2003, the program to provide public assistance to graduates of children's tutoring institutions has been implemented. It aims to insure the social protection of the 1991-2003 graduates of children's homes and their integration in society<sup>17</sup>. Furthermore, programs are implemented to protect the rights and legal interests of children who, being deprived of parental care, are wards of the state. These programs ensure their upbringing and education in a family (or a family-like) environment, and decrease the pressure on children's homes and orphanages by arranging for child placements outside such institutions.

### Infrastructures

97. Within the poverty reduction strategy, the main objective of the government's policy in water management is to provide accessible, available, and high-quality services to the population. This requires paying attention to the priority issues in this sector, such as improving the accessibility, availability, and quality of services, enhancing the targeting of subsidies, promoting a better management and efficacy of companies working in the system, and increasing the accountability of the system.
98. The 2004 state budget's provision for water management is around 21.9 billion drams, which is slightly higher than the PRSP's provision for the same year (amounting to 21.6 billion drams). The structure of budgetary expenditures in the sector, as compared with that of the PRSP, is also slightly different. Thus, the PRSP's provision for subsidizing the system's companies is 4.4 billion drams, whereas the state budget's allocation is 5.8 billion drams. In addition, the investment programs as per the PRSP and the state budget are 17.2 and 15.4 billion drams, respectively. In this regard, the government's policy, as also defined by the PRSP, will aim for the gradual reduction of the subsidies, until their complete

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<sup>17</sup> The 2004 budget provision for this program is 335 million drams, as compared with 200 million drams for the previous year.

termination based on the improved financial viability of the system's companies. Consequently, the resources thus released will be channeled to the implementation of social programs that have a better focus.

99. As shown by the results of the household survey conducted in 2003, significant progress has been recorded in the availability of potable water. In 2003, the availability of water mains for potable water improved by 1.9 percentage points. This indicator mainly reflects the improved water supply in rural areas, by about 3.6 percentage points (see Table 14).

**Table 14. Access to drinking water**

	2001 <sup>18</sup>	2002	2003
Access to a centralized water supply, %	85.0	89.1	91.0
<i>Urban population, %</i>	94.2	97.0	97.8
<i>Rural Population, %</i>	64.7	77.0	80.6
Share of households using transported water, %	6.1	5.2	5.9

Source: 2001, 2002, and 2003 household surveys.

100. The improved availability of the centralized water supply in rural areas may be largely driven by a number of investment programs in the sector. Owing to the programs implemented by the German Bank of Development Credits (KfW), the International Fund for Agricultural Development (IFAD), the US Department of Agriculture, and the Armenian Social Investment Fund in more than forty rural localities, water supply systems have been restored or constructed. Nevertheless, it may be possible to attribute the value of this better indicator to statistical error, since it was calculated based on survey results, and could subsume certain deviations.
101. As shown in Table 14, around 6% of households still use transported water, which involves additional expenses. In this respect, in places where constructing a water main would be economically inefficient, the government's policy will aim to compensate any additional expenses.
102. In the framework of the World Bank "Irrigation System Development" project the two stages of a gravity irrigation system construction covering 4.5 acres of land in Vayots Dzor has started and the total expenditures for each stage of construction is estimated to make 7.6 and 3.8 million US dollars respectively. It is envisaged to finish the two stages of the above-presented activities in 2006. In the framework of the above-mentioned program the reconstruction of the Armavir main water channel has been continued during 2004, the total expenditures of this enterprise making 2.4 million US dollars, as well as the reconstruction of the most damaged parts of the Armavir, Arzni-Shamiram, Talin Shirak nad Vorotan (the reconstruction of the Vorotan construction is already completed) was undertaken. It is also envisaged to reconstruct the internal network, which will be provided to the water consumers' companies, with the condition of 30% participation of water consumers.
103. One of the important directions of the investment policy in water management, as identified in the PRSP, is to change the energy-consuming structures that serve the system. For this purpose, under the World Bank-financed Irrigation System Development Project, work on the construction of three gravity-flow systems has started. The construction of the Ayrum and Aygedzor gravity flow system has

<sup>18</sup> The difference between the PRSP data on the access to centralized water supply and the corresponding data presented in the table reflects the fact that the PRSP data has been calculated on basis of the number of water taps in residential units.

already been completed, and the construction of the system in Vayots Dzor was started in July. With the operation of these three gravity-flow systems, annual savings of electricity will be around 48 million kilowatt/hours. This represents about 20% of the electricity consumed in the system.

104. Over the reporting period, activities for saving electricity have been undertaken also in the potable water consumption sector. Namely, due to the amendments introduced in the “Yerevan Water and Sewer Company” CJSC water provision and distribution schemes it became possible to save significant amount of electricity. In the result of these activities, the amount of electricity consumed during the fourth quarter of 2004 had reduced for 25% in comparison with the first quarter consumption data.
105. The water management accountability system has also been significantly improved and modernized. This is another important component of the investment policy in the sector. In order to accomplish these changes, important work has been carried out in the service areas of the “Yerevan Water and Sewer Company, CJSC”, the “Armenian Water and Sewer Company, CJSC”, and the “Nor Akunq, CJSC”. As of the end of December 2004, consumers in the service area of the “Yerevan Water and Sewer Company, CJSC” have installed about 273 thousand individual water meters (about 86.6% of consumers). Those in the service area of the “Armenian Water and Sewer Company, CJSC” have installed about 112 thousand individual water meters, and in the area served by the “Nor Akunq, CJSC”, about 11.8 thousand individual water meters.
106. According to the PRSP, the tariff policy in water management and general public services should aim to bring tariffs in line with operating expenses. Over the reporting period, certain steps have been taken in this direction. Since April 1, 2004, new tariffs have been established in this system. The new tariff for potable water supply for the “Yerevan Water and Sewer Company, CJSC” is 90.2 drams per cubic meter. The rate for the “Armenian Water and Sewer Company, CJSC” is 100.4 drams/cubic meter, while that of the four branches of the “Irrigation-Water Catchment, CJSC” is subdivided based on the relevant drainage basin, with as many as eight tariffs. Even with these higher rates, however, tariffs are still below the breakeven point. Future policies will seek to better harmonize tariffs with operational and maintenance expenses.
107. Based on the PRSP, the 2004 state budget allocations for road construction have considerably increased. In 2003, the actual budgetary expenditure on road construction (excluding loan and grant programs) was 2.3 billion drams. In the 2004 state budget, however, 6.5 billion drams are allocated for this same purpose – some 2.8 times more than the 2003 level.
108. Besides this, the 2004 state budget also provides for allocations to another PRSP priority – the fundamental repair or operational maintenance of roads important to a given community. Some 540 million drams, or about 8% of the total budgetary expenditures on road construction, were assigned in this fashion.
109. In 2004, under the road construction component of the World Bank-financed Transportation Project, the fundamental repair of about 88 kilometers of inter-state roads and roads of national significance has been accomplished to the tune of about 4.8 billion drams.
110. One of the important components of the investment policy in the energy sector, as identified in the



PRSP, is the restoration and development of the electricity transmission and regulation grid. Over the reporting period, the government has taken relevant actions to that effect.

111. Specifically, in order to modernize and develop the electricity transmission grid, the government has started a project for the reconstruction of the “Alaverdi-2” substation, to be financed by funds saved during the reconstruction of the “Vanadzor-2” and “Kamo” substations, and from the proceeds of the loan provided by the German Bank of Development Credits (KfW) under the Caucasian Initiative. An international tender has been being announced to select the contractor and the activities on summing up of the results of the tender are currently in process.
112. Equipment has been replaced in the following 220 V substations: Shinuhayr, Yeghegnadzor, Ararat-2, Shahumyan-2, Zovuni, Marash, Ashnak, and Lichk of the “High Voltage Networks. CJSC”. These were also partially reconstructed with credits provided by the World Bank.
113. Pursuant to the agreements concluded between the governments of Armenia and the Islamic Republic of Iran, the assembly work for the second 220 V overhead transmission line from Agarak to Shinuhayr has so far been completed. The operation of this line will provide better opportunities to implement optimal modes of electricity generation.
114. Work on the country’s gas distribution network has continued over the reporting period. The number of customers is now almost 187 thousand (38%). For 2004, it was planned to provide with gas 117.2 thousand consumers and in the result 121 thousand consumers have been supplied with gas, i.e. the project had been exceeded by 3 percent. Due to the latter by the end of 2004 it became possible to increase the number of gas consumers making it 257, which, however, is still rather low as compared with the total number of customers in the past. In this regard, the policy will aim to consistently increase the number of customers to the levels of the past.

### Agriculture

115. The gross agricultural product in 2003, as compared with the 2002 level, increased by around 4.3 percent. The same growth dynamics were observed during 2004. The increase over the same period of the previous year amounted to 14.5 percent.
116. As shown by the results of the household survey conducted in 2003, rural poverty increased by 2.2 percentage points as compared with 2002, although revenues of the rural population grew by about 41.7% over the same period.

**Table 15. Dynamics of gross agricultural output in 2001 – 2004**

	2001	2002	2003	2004
Gross agricultural output, billion drams	351.0	377.6	410.1	504.1
Gross agricultural output, year-on-year % change	11.6	4.4	4.3	14.5
<i>of which: crop production, year-on-year % change</i>	19.0	4.6	4.4	20.1
<i>livestock production, year-on-year % change</i>	2.3	4.2	4.2	7.9

Source: National Statistical Service.

117. The level of rural poverty is still higher than that of urban poverty. In 2003, these indicators were 47.5 and 39.9 percent, respectively. This may reflect the fact that per capita revenues in rural areas are about 36.3% lower than those in urban areas.

118. Revenues from hired work in rural areas remain at a low level. In 2003, their share of total monetary revenues was only 18.8%, whereas in urban areas the same indicator was 51%. This means that in rural areas, the problem of developing non-agricultural work is still unsolved. Thus, the government's policy will aim to introduce efficient mechanisms to stimulate non-agricultural employment in rural areas.
119. In 2003, the agricultural product price index was 109.9%, and the consumer price index was 104.7%, as compared with the 2002 level. The overtaking increase in the prices of agricultural products could possibly explain why the monetary revenues in rural areas have shown a faster growth rate (41.7%), than those in urban areas (34.2%). The above-presented tendency has been observed also in 2004, thus, in 2004 the agricultural products price index in comparison with the 2003 data has constituted 109.6%, whereas the consumption price index was set to be 107.0%
120. In 2003, labor productivity in agriculture increased by 2.5%. This growth could be possibly conditioned by the improved crop capacity of a number of plants in 2003. Production volumes in 2003 (as compared with 2002 levels), substantially increased – by 28.8% for potatoes, 5.8% for vegetables, 22.1% for orchards, and 21.2% for fruits and berries.
121. With regard to the poverty reduction strategy, the establishment of an operational system of agricultural insurance is important to sustain agricultural development. The government, therefore, is implementing a program to assess agricultural insurance risks. If successfully completed, this will create the prerequisites for the introduction of an agricultural insurance system starting in 2005.
122. "Agriculture Sustainable Development Strategy of RA" adopted by Government Decree No. 682-N on April 14, 2004 will highly contribute to reduction of food insecurity, which is the most important component of income poverty.

### **Fiscal framework and public expenditure policy**

#### **Fiscal developments in 2003-2004 and budget program for 2004-2005**

123. The 2004 state budget was the first budget drawn up deriving from the priorities underlying the PRSP. The process of the state budget and PRSP harmonization had commenced since the 2003 state budget drawing up, though the 2003 annual budget was adopted before the approval of the Poverty Reduction Strategic Program. Nevertheless, budget priorities were defined while considering the interim PRSP provisions, and the conclusions and recommendations of the standing work-group for public expenditure in the poverty reduction strategy. Work-group activities were implemented in parallel with the development of the final PRSP document and the MTEF 2003-2005.
124. In 2003-2004, the Armenian authorities, within the scope of a realistic expansion of the budgetary resource package, sought to increase public expenditures in priority areas (particularly, in the social sector and infrastructures). This was done mainly by improving tax administration and involving additional resources in the form of external grants. In parallel, the government sought to maintain the budgetary balance within acceptable limits, while allocating funds to repay accumulated debts.
125. In spite of certain concerns at the beginning of the year (mainly reflecting political developments in the

country<sup>19</sup>), the implementation of the 2003 state budget was generally consistent with the annual program. Consolidated budget revenues increased by 14.2, from 306 billion drams in 2002 to 349 billion drams in 2003. This tendency was observed also in 2004 during which the consolidated budget revenues increased in comparison with the 2003 by 5.2 percent, thus constituting 367.1 billion dram. Internal revenues, particularly tax revenues (including duties), comprised a major share in the total growth; their nominal increase in 2003 and 2004 was registered to be 15.3% and 16.8% respectively. This was due to an improved tax administration and the macroeconomic environment, which was more favorable than had been forecast. The increase in grants registered in 2003 reflected the receipt of additional capital grants (+30.9% as compared with the previous year), in contrast to the reduced receipts from the general budget assistance current grants (-31.9%).

**Table 16. Consolidated budget framework in 2002 - 2005 (on a commitment basis)**

	2002		2003		2004		2005	
	Actual	PRSP	Actual	PRSP	Preliminary <sup>20</sup>	PRSP	Budget	
<i>in billions of drams</i>								
<b>1. Total revenues and grants</b>	<b>305.6</b>	<b>339.9</b>	<b>348.9</b>	<b>346.2</b>	<b>367.1</b>	<b>383.0</b>	<b>425.6</b>	
Total revenues	258.1	279.0	297.4	312.9	354.2	349.6	413.5	
Tax revenues	242.3	269.4	279.3	302.2	326.2	338.8	383.4	
Non-tax and capital revenues	15.7	9.6	18.0	10.7	28.0	10.9	30.1	
Grants	47.5	61.0	51.5	33.3	12.9	33.4	12.1	
Current	17.1	14.1	11.6	9.7	9.7	9.0	12.1	
Capital	30.5	46.9	39.9	23.7	3.2	24.4	0.0	
<b>2. Deficit financing (net)</b>	<b>12.1</b>	<b>36.5</b>	<b>14.4</b>	<b>41.9</b>	<b>41.9</b>	<b>39.2</b>	<b>49.3</b>	
Domestic sources	-24.7	46.4	-24.4	2.7	-3.5	3.6	14.6	
External sources	36.7	-9.9	38.8	39.2	45.4	35.6	34.7	
<b>3. Total resource available (1+2)</b>	<b>317.7</b>	<b>376.5</b>	<b>363.3</b>	<b>388.1</b>	<b>409.0</b>	<b>422.2</b>	<b>474.9</b>	
<b>4. Total expenditures and net lending</b>	<b>317.7</b>	<b>376.5</b>	<b>363.3</b>	<b>388.1</b>	<b>409.0</b>	<b>422.2</b>	<b>474.9</b>	
Current expenditures	243.5	279.0	271.5	294.0	319.4	335.6	371.0	
Capital expenditures	63.8	101.0	85.2	86.9	78.5	78.5	93.8	
<i>of which: capital grant financed</i>	30.5	46.9	39.9	23.7	3.2	24.4	0.0	
Net lending	10.4	-3.5	6.6	7.2	11.1	8.2	10.1	
<i>in % of GDP</i>								
<b>1. Total revenues and grants</b>	<b>22.4</b>	<b>23.1</b>	<b>21.5</b>	<b>21.5</b>	<b>19.4</b>	<b>21.8</b>	<b>20.2</b>	
Total revenues	18.9	18.9	18.3	19.4	18.7	19.9	19.6	
Tax revenues	17.8	18.3	17.2	18.8	17.2	19.3	18.2	
Non-tax and capital revenues	1.2	0.7	1.1	0.7	1.5	0.6	1.4	
Grants	3.5	4.1	3.2	2.1	0.7	1.9	0.6	
Current	1.3	1.0	0.7	0.6	0.5	0.5	0.6	
Capital	2.2	3.2	2.5	1.5	0.2	1.4	0.0	
<b>2. Deficit financing (net)</b>	<b>0.9</b>	<b>2.5</b>	<b>0.9</b>	<b>2.6</b>	<b>2.2</b>	<b>2.2</b>	<b>2.3</b>	
Domestic sources	-1.8	3.2	-1.5	0.2	-0.2	0.2	0.7	
External sources	2.7	-0.7	2.4	2.4	2.4	2.0	1.6	
<b>3. Total resources available (1+2)</b>	<b>23.3</b>	<b>25.5</b>	<b>22.4</b>	<b>24.1</b>	<b>21.6</b>	<b>24.0</b>	<b>22.6</b>	
<b>4. Total expenditures and net lending</b>	<b>23.3</b>	<b>25.5</b>	<b>22.4</b>	<b>24.1</b>	<b>21.6</b>	<b>24.0</b>	<b>22.6</b>	
Current expenditures	17.9	18.9	16.7	18.3	16.9	19.1	17.6	
Capital expenditures	4.7	6.8	5.2	5.4	4.1	4.5	4.5	
<i>of which: capital grant financed</i>	2.2	3.2	2.5	1.5	0.2	1.4	0.0	
Net lending	0.8	-0.2	0.4	0.4	0.6	0.5	0.5	

Source: National Statistical Service, State Social Insurance Fund, Ministry of Finance and Economy, and PRSP projections.

126. Consolidated budget expenditures increased by 14.4%: from 318 billion drams in 2002 to 363 billion drams in 2003. The tendency of increase continued in 2004 as well, in course of which the consolidated budget expenditures increased by 12.6% constituting 409 billion drams. Both current and

<sup>19</sup> In the first quarter of 2003, Presidential elections were held, together with those for the National Assembly.

<sup>20</sup> Calculations based on PIU expenditures program data.

capital expenditures increase (by 11.5% and 33.5%, respectively; with an 8.8 and 6.7 percentage point participation in the total increase in expenditures, respectively<sup>21</sup>) has been registered in 2003. Unlike the current expenditures actual indicator, which was close to the planned one, however, the actual capital expenditure was around 15 billion drams below target, thus causing the basic deviation of the actual indicator from the planned one. In particular, the under-execution of capital expenditures was conditioned by the actual level of externally financed expenditures. These were lower than planned, whereas the program for internally financed capital expenditures was almost fully executed (see Table 17).

**Table 17. State budget capital expenditures in 2003 (million drams)**

	2003	
	Budget	Actual
Domestic Sources	16,884.3	17,971.0
<i>including: co-financing of externally funded projects</i>	2,823.5	1,581.1
External Sources	82,137.7	64,549.7
<i>Loans/Credits</i>	35,489.6	24,740.7
<i>Grants</i>	46,648.1	39,809.0
<b>Total<sup>1</sup></b>	<b>99,022.0</b>	<b>82,520.8</b>

<sup>1</sup> Excluding expenditures on repayment of expenditure arrears accumulated in previous years.

Source: Ministry of Finance and Economy.

127. Although the 2003-2004 budget revenues and expenses both increased in nominal value, the increase was not sufficient to achieve the PRSP targets in terms of ratios relative to GDP. Particularly, the 2003 revenues and expenses (as a share of GDP) were 21.5% and 22.4% respectively (which is around 1 percentage point lower than the 2002 level), A deviation from the PRSP targets by -1.6 and -3.2 percentage points. And in 2004 the revenues and expenditures (as a share of GDP) constituted 19.4 and 21.6 % respectively, deviating from the PRSP target indicators by -2.1 and - 2.5 percent. At the same time, the 2003-2004 budget was executed with a deficit of 0.9% and 2.2% of GDP respectively, instead of the planned 2.5% deficit. Nevertheless, in the short term, and especially in yearly terms, the dynamics of the ratios relative to GDP should be considered more accurately, since in this case these developments were mainly caused by deviations between the target and actual GDP indicators. Thus, in 2003, the nominal increase of GDP was 19%, instead of the planned 10%<sup>22</sup> and in 2004 the nominal increase in GDP increased by 17.7% instead of the 10.2% targeted by the program.
128. Concerning another PSRP priority, which is the social sector<sup>23</sup>, the government, abiding by the implemented policy, has met its expenditure commitments. In 2003, expenditures in this sector had a greater growth compared with the increase in total expenditures. It amounted to 128 billion drams (+20% as compared with the previous year), which continued in 2004 as well reaching 177.6 billion dram (+ 38.9% in comparison with the previous year) and resulted in certain shifts in the structure of budgetary spending in favor of social expenditures. Thus, the share of social expenditures within the consolidated budgetary spending envisaged in increased by 1.6 percentage points in 2003 as compared with the 2003, and in 2004 it increased by 8.2% and constituted 43.4 percent. It was mainly due to the GDP growth rate being higher than the one planned in 2003, that the increase was insufficient to achieve the PRSP targets of GDP ratios. The social expenditures-to-GDP ratio in 2003

<sup>21</sup> The input of net borrowing was negative.

<sup>22</sup> Such a development scenario was already anticipated in the last phase of the PRSP's elaboration, and it was appropriately reflected in the PRSP document.

<sup>23</sup> It comprises education, health care, social security, and social protection.

was 7.9%, instead of the 8.7 forecast, however the results registered in 2004 allowed to restore the loss and achieve the PRSP target indicators, namely the 2004 social expenditures (as a share to GDP) constituted 9.4% percent instead of the planned 9.3%.

129. The 2005 state budget has been elaborated based on the PRSP ideology and developed under the guidance of PRSP priorities. In view of the macroeconomic developments of the second quarter of 2004, however, and the newly available data (concerning, in particular, the expected external assistance), the resource package of the annual budget has undergone certain changes, as compared with the PRSP budget framework targets (see Table 16). Firstly, the 2005 budget forecasts involved a higher GDP growth than the rate recorded in 2003 and 2004 exceeding the ones anticipated by the PRSP ( 13.9%, instead of the PRSP's 7% for 2003, and for 2004 9% instead of the PRSPs 6%). This circumstance, as well as the expectations from the improved tax administration, was reflected in the upward revision, as compared with the PRSP budget framework target, of the budget revenues by 63.9 billion drams. This enabled maintaining the 2005 forecast revenues to GDP ratio (19.9%) approximately within the limits of the PRSP target. Secondly, since the terms of the anticipated assistance in the form of special-purpose capital grants were not finally negotiated and clarified, the resource package dealing with this issue was negatively revised by 24.4 billion drams, while accordingly changing the allocations to the expenditure functions linked to those resources (road construction, housing construction, construction of cultural establishments).
130. The nominal value of total expenditures, as approved by the 2005 state budget, exceeds (by around 53 billion drams) the relevant indicator in the PRSP budget framework, moreover the current expenditures exceed by 35 billion drams and the capital expenditures by 15 billion dram. This addition has been mainly due to increase of financing in the sectors that are considered to be a PRSP priority such as public governance, social security and social insurance. Allocations to certain other functions, however, conformed to the PRSP forecasts, such as transportation, and housing and communal services. This was widely conditioned by the non-receipt of externally financed special-purpose capital grants. Nonetheless, the problems in the infrastructure sector appear to be among the basic factors slowing down the country's economic development and hinder further improvement of the nation's welfare. The government will still attend them, and the utmost efforts will be expended for their solution.
131. A comparative analysis of the basic fiscal indicators (as ratios relative to GDP) as for the 2005 state budget and the PRSP shows that the differences between them are mainly driven by the non-receipt of externally financed special-purpose capital grants. The planned annual budget revenues-to-GDP ratio is 20.2 percent, against the PRSP forecast of 21.8 percent. For expenditures, this difference is smaller: 22.6% of GDP against the PRSP forecast of 21%. This reflects the redistribution of funds amounting to around 0.4% of GDP from the available budget balance at the beginning of the year. The planned annual budget's deficit-to-GDP ratio is 2.3%. In general, this is consistent with PRSP forecasts (particularly when considering that the fraction of the deficit equal to 0.4% of GDP will be financed from the available budget balance).
132. For the third successive year, significant deviations are observed between the economic growth forecasts and actual results. In view of this, the government emphasizes the improvement of short-

term forecasting capacities. This would contribute to enhancing the formulation of policies and their implementation over the short run, and to improving the quality and efficiency of medium- and long-term planning.

### **Poverty reduction strategy and the medium-term public expenditures framework**

133. Inclusion of the PRSP priorities in public expenditures and financial backing of the benchmarked policies and actions appear to be key prerequisites for the successful implementation of the Poverty Reduction Strategy. In this context, a mid-term public expenditures framework is considered by the government as a key operational mechanism for poverty reduction
134. The first attempt to develop a medium-term public expenditures framework was initiated in 2000 with the development of the MTEF 2003-2005. Capacities to develop a medium-term public expenditures framework have been gradually expanded both in the Ministry of Finance and Economy and in sectoral ministries<sup>24</sup>. Activities to create relevant institutional capacities have been especially beneficial for that process. In particular, while emphasizing the role and significance of developing MTEFs, the standing higher council of a medium-term public expenditures framework and the standing work-group coordinating the development of a medium-term public expenditures' framework were established in 2002 by governmental decree. In parallel, actions were taken to build the MTEF process on a legislative basis. In 2003, appropriate amendments were enacted in the law "On the Budgetary System of the Republic of Armenia". Pursuant to those amendments, the procedure for planning public expenditures was recognized as a separate component of the budgetary process. It determined that prior to submitting next year's draft budget, the government should present (to the National Assembly), a document summarizing the strategy of public expenditures for the next three years. This puts greater emphasis on the MTEF as a key political document. On the other hand, a medium-term public expenditure framework is considered by the government to be a consultative document to assist negotiations on the involvement of international assistance.
135. In chronological terms, the MTEF 2004-2006 was developed as the last phase of the final development of the PRSP document. This proved to be beneficial in terms of an efficient reconciliation of these two documents of strategic importance for the country's further progress. The PRSP activities to be taken from 2004 to 2006 were included – to the extent possible – in the MTEF 2004-2006. Specifically, the PRSP and the MTEF 2004-2006 were reconciled as follows:
  136. Priorities and objectives: The MTEF 2004-2006 complies with the PRSP priorities, and the public expenditures policy will contribute to the realization of the PRSP objectives.
  137. Macroeconomic framework for 2004-2006: Both documents are based on the same scenario of macroeconomic development.
  138. Fiscal framework for 2004-2006: The fiscal frameworks were reconciled in both documents. For those sectors of key importance for the poverty reduction strategy (such as social security and social insurance, health care, and education), the PRSP objectives, and policies guided the MTEF forecasts.

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<sup>24</sup> Only four sectoral agencies (Ministries of Health Care, Education, Social Security, as well as the State Committee of Water Management) were involved in the development of the MTEF 2003-2005. All units of the public administration, however, participated in the MTEF 2004-2006 development.

Expenditure allocations under these two frameworks were almost the same, both in nominal expression and as ratios to GDP.

**Table 18. State budget framework for 2004 – 2007: PRSP and 2005 - 2007 MTEF projections**

	2004	2005	2006	2007	2004	2005	2006	2007
	PRSP				Budget <sup>1</sup>	2005 - 2007 MTEF		
<i>in billions of drams</i>								
<b>1. Total revenues and grants</b>	<b>288.5</b>	<b>318.6</b>	<b>350.8</b>	<b>389.9</b>	<b>274.1</b>	<b>311.8</b>	<b>347.1</b>	<b>386.6</b>
Total revenues	255.2	285.1	318.7	359.0	263.2	302.9	338.9	379.0
Tax revenues	247.6	277.4	310.8	347.5	257.1	297.4	333.3	373.2
Non-tax and capital revenues	7.6	7.8	7.9	11.6	6.1	5.4	5.5	5.7
Grants	33.3	33.4	32.2	30.8	10.9	8.9	8.2	7.6
Current	9.7	9.0	8.5	10.2	10.9	8.9	8.2	7.6
Capital	23.7	24.4	23.7	20.6	0.0	0.0	0.0	0.0
<b>2. Deficit financing (net)</b>	<b>41.9</b>	<b>39.2</b>	<b>38.6</b>	<b>41.3</b>	<b>54.9</b>	<b>43.7</b>	<b>43.0</b>	<b>46.7</b>
Domestic sources	2.7	3.6	4.3	1.2	17.2	5.9	7.0	8.0
External sources	39.2	35.6	34.3	40.1	37.6	37.7	36.0	38.7
<b>3. Total resources available (1+2)</b>	<b>330.4</b>	<b>357.8</b>	<b>389.5</b>	<b>431.2</b>	<b>329.0</b>	<b>355.4</b>	<b>390.1</b>	<b>433.3</b>
<b>4. Total expenditures and net lending</b>	<b>330.4</b>	<b>357.8</b>	<b>389.5</b>	<b>431.2</b>	<b>329.0</b>	<b>355.4</b>	<b>390.1</b>	<b>433.3</b>
Current expenditures	238.0	273.0	296.7	330.2	246.0	293.1	312.7	345.6
Capital expenditures	85.2	76.5	81.7	88.0	71.7	52.7	64.0	72.6
<i>of which: capital grant financed</i>	23.7	24.4	23.7	20.6	0.0	0.0	0.0	0.0
Net lending	7.2	8.2	11.1	13.0	11.3	9.7	13.3	15.1
<i>in % of GDP</i>								
<b>1. Total revenues and grants</b>	<b>17.9</b>	<b>18.1</b>	<b>18.3</b>	<b>18.6</b>	<b>15.3</b>	<b>16.0</b>	<b>16.3</b>	<b>16.6</b>
Total revenues	15.9	16.2	16.6	17.1	14.7	15.5	15.9	16.3
Tax revenues	15.4	15.8	16.2	16.6	14.4	15.2	15.6	16.0
Non-tax and capital revenues	0.5	0.4	0.4	0.6	0.3	0.3	0.3	0.2
Grants	2.1	1.9	1.7	1.5	0.6	0.5	0.4	0.3
Current	0.6	0.5	0.4	0.5	0.6	0.5	0.4	0.3
Capital	1.5	1.4	1.2	1.0	0.0	0.0	0.0	0.0
<b>2. Deficit financing (net)</b>	<b>2.6</b>	<b>2.2</b>	<b>2.0</b>	<b>2.0</b>	<b>3.1</b>	<b>2.2</b>	<b>2.0</b>	<b>2.0</b>
Domestic sources	0.2	0.2	0.2	0.1	1.0	0.3	0.3	0.3
External sources	2.4	2.0	1.8	1.9	2.1	1.9	1.7	1.7
<b>3. Total resources available (1+2)</b>	<b>20.5</b>	<b>20.4</b>	<b>20.3</b>	<b>20.6</b>	<b>18.4</b>	<b>18.2</b>	<b>18.3</b>	<b>18.6</b>
<b>4. Total expenditures and net lending</b>	<b>20.5</b>	<b>20.4</b>	<b>20.3</b>	<b>20.6</b>	<b>18.4</b>	<b>18.2</b>	<b>18.3</b>	<b>18.6</b>
Current expenditures	14.8	15.5	15.5	15.8	13.7	15.0	14.7	14.8
Capital expenditures	5.3	4.4	4.3	4.2	4.0	2.7	3.0	3.1
<i>of which: capital grant financed</i>	1.5	1.4	1.2	1.0	0.0	0.0	0.0	0.0
Net lending	0.4	0.5	0.6	0.6	0.6	0.5	0.6	0.6

<sup>1</sup> According to the Law on the 2004 State Budget of the Republic of Armenia (including amendments made by the National Assembly in June 2004). The 2004 indicators expressed in terms of GDP are calculated based on 2004 GDP revised forecasts. Source: PRSP and 2005 - 2007 MTEF projections.

139. The Poverty Reduction Strategic Program was one of the key guiding documents for the development of the 2005-2007 mid-term expenditures framework. Major changes in the resource package of the budget framework<sup>25</sup> were required, owing to a more favorable macroeconomic scenario in contrast to the PRSP forecasts (particularly, by the higher GDP growth rate in 2003) and by the revisions of the anticipated receipts in the form of external assistance (especially of grants) (see Table 18). Owing to the first factor, the 2005-2007 forecasts (in nominal value) for tax revenues were revised upward. The vagueness surrounding the receipt of capital grants led to their exclusion from the resource package for the next three years, while making relevant negative changes in the capital expenditures programs linked to them. Under the MTEF 2005-2007, public expenditures were planned based on PRSP

<sup>25</sup> Although the PRSP budget framework includes the operations of the consolidated budget, in this section of the report, the relative analysis of the relevant indicators of these two documents will be carried out mainly with regard to the state budget, since the MTEF 2005-2007 forecasts for public finance developments refer to the state budget's framework.

priorities, particularly in the social sector (health care, education, social security, and social insurance), infrastructures, and modernization of the public administration system. In nominal terms, there are no deviations between the PRSP and the MTEF 2005-2007 budget frameworks. Significant differences, however, are observed between the relevant ratios with respect to GDP. This is particularly true for tax revenues and capital expenditures (mainly in infrastructures).

140. At the same time, based on present demand and prospects for development, the government still believes that in the next few years, consolidated budget operations should be around 24-25% of GDP. It will require appropriate actions to generate these resources, particularly through tax revenues. On the other hand, given the scarcity of resources, the government will implement inter-sectoral redistributions of public expenditures in favor of PRSP priorities, to achieve PRSP targets for public expenditure,-to-GDP ratios in these sectors. In particular, this approach can be observed in the MTEF 2005-2007 provision for social expenditures.

**Table 19. State budget social expenditures: PRSP and 2005 – 2007 MTEF projections**

	2004	2005	2006	2007	2004	2005	2006	2007	
	PRSP				Budget <sup>1</sup>	2005 – 2007 MTEF			
<i>in billions of drams</i>									
<b>Total social expenditures</b>	<b>100.4</b>	<b>120.0</b>	<b>137.9</b>	<b>155.0</b>	<b>107.2</b>	<b>132.3</b>	<b>150.0</b>	<b>176.1</b>	
Education	39.4	47.9	54.8	62.8	45.7	54.9	59.8	68.1	
Health	24.9	30.8	35.5	40.9	25.0	31.7	36.8	50.1	
Social security and social insurance	36.1	41.4	47.6	51.3	36.5	45.7	53.5	57.9	
<i>of which: family benefits</i>	16.1	20.2	24.9	27.2	16.1	20.2	24.9	26.8	
<i>year-on-year % change</i>									
<b>Total social expenditures</b>		<b>19.6</b>	<b>14.9</b>	<b>12.3</b>		<b>23.5</b>	<b>13.4</b>	<b>17.4</b>	
Education		21.6	14.5	14.6		20.2	8.8	14.0	
Health		23.5	15.4	15.1		26.8	16.0	36.2	
Social security and social insurance		14.7	15.1	7.7		25.4	17.0	8.2	
<i>of which: family benefits</i>		25.6	23.4	9.2		25.6	23.4	7.6	
<i>in % of GDP</i>									
<b>Total social expenditures</b>	<b>6.2</b>	<b>6.8</b>	<b>7.2</b>	<b>7.4</b>	<b>6.0</b>	<b>6.8</b>	<b>7.0</b>	<b>7.6</b>	
Education	2.4	2.7	2.9	3.0	2.6	2.8	2.8	2.9	
Health	1.5	1.8	1.9	2.0	1.4	1.6	1.7	2.2	
Social security and social insurance	2.2	2.4	2.5	2.4	2.0	2.3	2.5	2.5	
<i>of which: family benefits</i>	1.0	1.2	1.3	1.3	0.9	1.0	1.2	1.2	
<i>in % of state budget total expenditure</i>									
<b>Total social expenditures</b>	<b>30.4</b>	<b>33.6</b>	<b>35.4</b>	<b>35.9</b>	<b>32.6</b>	<b>37.2</b>	<b>38.5</b>	<b>40.6</b>	
Education	12.0	13.4	14.1	14.6	13.9	15.4	15.3	15.7	
Health	7.6	8.6	9.2	9.5	7.6	8.9	9.4	11.6	
Social security and social insurance	10.9	11.6	12.2	11.9	11.1	12.9	13.7	13.4	
<i>of which: family benefits</i>	4.9	5.6	6.4	6.3	4.9	5.7	6.4	6.2	

<sup>1</sup> Indicators expressed in terms of GDP are calculated based on the 2004 GDP revised forecasts

Source: PRSP and 2005 - 2007 MTEF projections.

141. The priority of social expenditures (health care, education, social security, and social insurance) is high. Furthermore, the actual GDP growth rate was higher in 2003. Because of these two factors, and while wishing to achieve the PRSP targets for public spending in these sectors, the MTEF 2005-2007 provides for a significant redistribution of budgetary spending to these sectors. The MTEF 2005-2007 provides for a bigger increase in social expenditures as compared with that of the total budgetary spending. Thus, in 2007, the share of social expenditures within the state budget will increase by around 8 percentage points, from 32.6% of the adopted budget in 2004 to around 40.6% (see Table 19).



## Budget reforms

142. Since 2001, the government has initiated preliminary work to create the prerequisites for the gradual transition from receipt-based budgeting (based on the resources used to provide services) to result-based budgeting. The anticipated targets for the budgetary expenditures programs in social sectors (health care, education, social security and social insurance), therefore, were included in the draft state budgets for 2002, 2003, and 2004. In 2003, these targets were included in the Law on the State Budget for that year, whereas in 2002 and 2004 they were included in the government's budget messages for those years.
143. In 2003, the government agreed with the World Bank on an action plan for structural budgeting reforms. This was later supported by the Prime Minister's decree on starting the 2005 budgeting process. This action plan considers that the efficient structure of an expenditures program provides the basis for successful structural budgeting and for operative links between policies and budgets. Now, the Armenian budget structure appears to be a mixture of services, receipts, other (sometimes, strict) measures, and expenditures functions.
144. According to the action plan, all public bodies should transform their programs to achieve a beneficial consolidation of services. This aims to provide the government with more effective information on the services, or the direct results with respect to the funding received from the government. Through the transformation of these programs and through their financial assessment according to services, the government will be better informed about the value of the services provided. This will help the government to have a clearer idea about the possible outcomes of decisions on expenditures related to the provision of services, and to channel the available resources to the sectors and functions that better permit attaining the government's objectives. Thus, such information is of vital importance to strengthen the links between policies and budgets. This issue gains more significance than in the past, since the PRSP process has commenced, and the political requirements have widened in terms of the evidence for links joining the government's actions, achievements, and accountability. The fact that these requirements are set forth by the National Assembly and by the government itself, emphasizes the need for reforms.
145. Over 2003-2004, this approach has been applied in the Ministry of Labor and Social Issues (MLSI). In accordance with the action plan, and starting in 2004, it is applied to three other ministries: the Ministry of Health, the Ministry of Education and Science, and the Ministry of Culture and Youth Affairs. Pursuant to the action plan, the new structure of the MLSI programs has been publicized in the MTEF 2005-2007 and should be included in the 2005 draft state budget. As for the other three ministries, the new structure of expenditures will be included in the MTEF 2006-2008 and the 2006 draft state budget. Based on the program transformation experience accumulated in these ministries, such activities will be implemented, in 2005, in all public bodies so as to enable them to prepare the 2007-2009 mid-term claims and the 2007 budgetary claims in the new structure of the expenditures programs.
146. To arrange effectively for these activities, the government collaborates with experts invited, since 2002, with the assistance of the United Kingdom's Department of International Development. Courses are run at the Training Center of the Ministry of Finance and Economy for the employees of public administration bodies with the goal of disseminating knowledge on applying the new budgeting

methods. Over the next few years, courses on this topic will be included in the curricula of the Training Center.

147. Presently, parallel to the above-mentioned activities, discussions are held on the Treasury's execution and accountability of the result-based budgetary spending programs.

### **Actions taken to ensure participation in the implementation of poverty reduction strategies**

148. After PRSP adoption, the Analysis and Information Center of Economic Reforms of the government, in assistance with of the Armenian office of the UN Development Program, and on the initiative of the government and the PRSP workgroup, arranged to have presentation meetings in ten regions and Yerevan. This was done in November and December of 2003. At that time, the "Poverty Reduction Strategic Program" booklet was presented. Program objectives and implementation issues were also discussed. In general, the eleven meetings/discussions were attended by 1200 participants and an equal number of booklets were distributed to the participants.
149. These meetings were attended by officials of Provincial Administrations and the municipality of Yerevan. The PRSP workgroup members were present as were community leaders, heads of regional structures, NGO representatives, businesspersons, employees of the social, health care, and educational systems, members of the mass media, representatives of various social groups, and other stakeholders in the PRSP implementation process, representing the civil society of their regions. The meetings were dealt with in the regional and national mass media and reported on the "HH1", "Prometheus", "Hrazdan", and "Tzayg" television channels. Advertisements were placed in the "Hayastani Hanrapetutyun", "Hayotz Ashkharh", and "Irvunq" newspapers. The film-program "What does the PRSP imply?" (26 minutes) was broadcast on regional television channels and presented by the "Dzragir" series of Armenian Public Television on December 8, 2003.
150. Through the assistance of the German Technical Support Cooperation Program, the simplified version of the PRSP was developed and published with a 10 000 print run. In this version, the main PRSP objectives and tasks were presented in the form of questions and answers. The publication was disseminated in all regions of the country. Between April and August 2003, discussions devoted to its presentation were arranged during visits to the regions. The PRSP workgroup members, representatives of regional NGO-s, participated in the arrangement of these meetings. During the meetings, the present achievements in PRSP implementation were also presented.
151. A website has been created ([www.prsp.am](http://www.prsp.am)) containing the PRSP both in Armenian and English, as well as the latest news on the PRSP implementation process. The web page contains all the information about the PRSP implementation, its monitoring system and participation process. Its pillars are about the Publications about the program, activities and surveys done in different spheres related to PRSP (PSIA Poverty social impact assessment), links to other PRSPs of the world, donor participation in the program etc. It is simultaneously being updated with new information and is meant to be an important source for public awareness.
152. After PRSP adoption, RA government initiated Action plan development for year 2004-2006 for the program implementation and its priorities and policies creation. During the PRSP working group

- sessions, the Action Plan was discussed and after the document's approval, it was submitted to the government. In January 2004, the government adopted the Action Plan with its 298 activities.
153. Pursuant to a government decree, at the end of each quarter, public administration bodies have to submit information to the Minister of Finance and Economy on the implementation of these activities. They also have to do this to those stakeholders (non-governmental sector) that expressed a commitment to participate in the implementation of the activities of the Action Plan. At the same time, representatives of civil society have been asked to express their interest in participating in the process. So far, public administration bodies have already submitted reports on the PRSP actions for the first, second and third quarters of year 2004, as well as the yearly report of PRSP action plan implementation.
  154. After the PRSP adoption, while emphasizing the need for efficient control over the program's implementation, and for public trust creation in its outcomes, the government has taken steps to establish a participatory monitoring system for PRSP implementation.
  155. On November 26, 2003, the government and the PRSP working group initiated a conference, which announced the beginning of the pre-negotiation phase for a public partnership agreement development in the PRSP implementation. During the conference, the first stakeholders' groups expressed a commitment to act as parties in the negotiations of the PRSP implementation public partnership agreement development.
  156. Over the last few months, the government and the PRSP working group have implemented activities to select stakeholders and its representatives for the PRSP implementation public partnership agreement creation. Thus, through the assistance of the government and the PRSP working group, the negotiating parties and their representatives were identified. The participants of these discussions represented interests of the following parties: National Assembly, RA government, Armenian Apostolic Church, Trade Unions, local self-governance bodies, employers and entrepreneurs, and NGOs.
  157. On March 31 and April 2, 2004, meetings of the PRSP implementation stakeholder NGOs were held, and so the NGO representatives were selected. During the meetings, five sectoral working groups of NGOs were formed: (i) Special needs group (NGOs working on the vulnerable groups, disabled people, refugees etc); (ii) Human rights protection (including health care, education, social security and social insurance); (iii) Environment protection group; (iv) Small and medium entrepreneurship group; and (v) Rural issues group. A representative to each group was selected.
  158. On July 30, 2004, stakeholder representatives signed a Memorandum to begin negotiations on PRSP implementation partnership agreement. The negotiation group members discussed the three main priorities of PRSP for partnership agreement. It anticipated the development activities of PRSP by September 2004.
  159. In October 30, 2004, the Partnership Agreement was signed on PRSP implementation between the Negotiation table's parties. It reflected three main priorities on PRSP implementation for the next 3 years. The priorities are; 1. Improvement of business environment with small and medium enterprises promotion targeted at employment stipulation, particularly for the vulnerable groups, 2. Strengthening of Social protection system, social security insurance, human development and its direction to poverty

- reduction, 3. Life support infrastructure development of in rural areas, meantime taking into consideration environmental issues.
160. After signing the Partnership Agreement, RA government and the participation parties created three new bodies; The PRSP Steering committee, Working Group and Open Forum. PRSP Steering Committee consists of 15 members and is formed from representatives of RA government, Armenian Apostolic Church, NGOs, members of Negotiation Group etc. RA Prime Minister chairs PRSP Steering Council. PRSP Working group undertakes PRSP ongoing activities, preparation of PRSP implementation process decision and their enforcement. PRSP Working group undertakes PRSP ongoing activities, preparation of PRSP implementation process decision and their enforcement. PRSP Open forum is formed to assure participatory process on PRSP implementation stage. Main objective of the forum is to insure Public awareness on PRSP implementation process and its results, assurance of feedback and establishment of reporting environment.
  161. The first PRSP Steering Committee meeting chaired by the RA Prime Minister A. Margaryan took place on February 23, 2005. The RA Minister of Finance and Economy V. Khachatryan, representatives of donor organizations, NGO representatives, parliamentarians and a delegate from the Armenian Apostolic Church took part at the meeting.
  162. Deriving from the Poverty Reduction Strategy Paper and its Partnership Agreement principles, the PRSP Workgroup was established and its staff was approved during the meeting. The RA Deputy Minister of Finance and Economy T. Khachatryan will head the PRSP workgroup. The workgroup has seven representatives from RA government, 5 members from NGO groups, 1 from trade unions and the representative of the union of communities.
  163. To ensure transparency and public participation in the PRSP implementation process the PRSP Open Forum was established and its working plan was approved. During the meeting the election of the PRSP Open Forum Responsible was held. The candidate nominated, Ludmila Haroutiunyan was elected as the person responsible for the PRSP Open Forum operation. The RA Prime Minister Andranik Margaryan, emphasizing the importance of the Open Forum performance particularly stressed, that the most essential functions of the body are the establishment of interconnection between the government and the public. Providing the organizations, unions and individuals that are not involved directly in the PRSP implementation process with an opportunity to express their opinion and introduce their proposals through the PRSP Open Forum.
  164. During the first steering committee meeting it was also discussed and approved the work plans for the PRSP coordination bodies for year 2005. It was mentioned the registered progressive developments, caused the need of the PRSP annual report drawing up and the presentation of the PRSP updated version to the Steering Committee envisaged for October 2005.
  165. On February 25, 2005, a press conference on presentation and establishment of the PRSP Open Forum took place in the Union of Journalists of Armenia. Ludmila Harutsyunyan, the person who is responsible for this new body operation, together with the deputy minister of RA Ministry of Finance and Economy presented the concept of the Open Forum to the wide public. The two members of the PRSP new Working Group, Emin Yeritsyan (Union of Communities) and Arman Vardanyan (Foundation for mental health care NGO) emphasized the importance of public participation in the

PRSP implementation.

### **Co-ordination of PRSP and donors' country assistance strategies**

166. Representatives of the donor community have actively participated in the PRSP discussions, presenting their approaches to the solution of the existing problems. This has provided an additional impetus for intensifying the government – donor community cooperation in the PRSP implementation process. The government believes that the donor community, having participated in the program development discussions, will take an active part in its implementation as well. Moreover, through the PRSP, the donor community has received a clear message from Armenian society about the country's development priorities for the next few years.
167. The fact that the main donors considered the PRSP priorities when defining their interim CAS activities can be recognized as the first step to further collaboration in the PRSP's implementation. Among the donors are the World Bank, the International Monetary Fund, the UN Development Program, the US International Development Agency, the United Kingdom Department of International Development, and the European Union.
168. Pursuant to the PRSP, the International Monetary Fund has made appropriate changes in the program objectives and priorities of its Poverty Reduction and Growth Facility (PRGF).
169. In June 2004, the World Bank approved the Country Assistance Strategy, which, besides the wide range of proposed PRSP actions, mainly focuses on three areas: promoting private sector led economic growth, orienting growth to help the poor, and reducing non-income poverty. These three areas best fit the World Bank's comparative advantage, and complement the activities of other donors. In each of these areas, the CAS starts on the premises of the country's long-term goals, and subsequently defines specific results that can be achieved over the four-year CAS program.
170. In order to support Armenia on its way to implementing the PRSP and achieving the Millennium Goals, the United Nations Organization has developed a country assistance strategy for 2005-2009. This is consistent with the PRSP objectives and priorities. According to the strategy, among the PRSP priorities, the UN will focus on reducing poverty and mitigating inequality, improving the quality and availability of basic social services, enhancing the accountability and transparency of public administration bodies, improving the efficiency of natural resource management, and encouraging the introduction of technologies that comply with environmental norms.
171. The main objectives of the European Union's TACIS program activities in Armenia in 2004-2005, include supporting the country's institutional, legal, and administrative reforms, and in overcoming the social consequences of the transition period. These objectives also appear to be among the PRSP priorities.
172. After adopting the PRSP, bilateral programs implemented by the United Kingdom Department for International Development (UK DFID) have been brought in line with the PRSP policies and priorities. This is evidenced by the fact that the PRSP has served as a guiding document for developing the Armenian part of the UK DID 2004-2007 program for regional support to countries in Central Asia, the South Caucasus, and Moldova.

173. In 2003, the US International Development Agency's 2004-2008 strategy in support of Armenia was developed in close collaboration with the government. It defines five strategic targets, namely: expanding employment in the competitive private sector, ensuring safe and sustainable availability of energy and water resources, enhancing democratic governance, ensuring the availability of high-quality primary medical care services, and improving social security. These targets are fully consistent with PRSP priorities.
174. The fact that the Board of Directors of the Millennium Challenges Fund has identified Armenia as a country eligible for applying for the Fund's assistance can also be considered as an opportunity to collaborate in the PRSP's implementation.
175. In its earlier declarations, the government asserted that the assistance to be provided by the US government to face the Millennium Challenges would be channeled to the PRSP priorities and programs. During the discussions, it has been agreed that the proposal to be presented by the government to the Millennium Challenges Fund will involve the programs that are presented as PRSP priorities, but have not been allocated budgetary or donor financing yet.

### **Actions taken in relation to recommendations and comments presented in the IDA and IMF Joint Staff Assessment of Armenia's Poverty Reduction Strategy Paper**

176. In 2003, the Joint Staff Assessment of the International Development Agency and the International Monetary Fund positively assessed the Poverty Reduction Strategic Program of Armenia. They established the fact that these organizations consider the PRSP to be a reliable framework for providing concessional assistance to Armenia over the next few years. Since the JSA recommendations on certain sections, provisions, and approaches of the PRSP are referred to in various parts of this report, we will briefly present below the actions taken for their implementation, and our further considerations.
177. In 2003, the actual pace of poverty reduction in the country exceeded the planned one. At the same time, certain positive trends were observed in the dynamics of the indicators characterizing the poverty of vulnerable groups. Nevertheless, despite the positive trends in this area, certain disquieting developments have also been noted. The government, sharing the IMF's and the IDA's opinions that were presented in the Joint Staff Assessment document, believes that the efficiency of poverty reduction activities could be essentially improved by taking beneficiary-targeted and clearly defined actions. In particular, the trends of poverty indicators of families with many children persist to be an issue of concern<sup>26</sup>. In this regard, the government has taken certain measures (an increased allowance provided to minors who are members of families included in the family benefit system - while differentiating it by level of vulnerability<sup>27</sup>), and intends to address this issue at the next revision of the PRSP.
178. The document also emphasizes addressing rural poverty in the PRSP and the actions to be taken

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<sup>26</sup> Although the poverty level of this group has certainly decreased as compared with the 2002 level, it persists to be significantly higher than the average indicators.

<sup>27</sup> Despite the PRSP stipulation to switch to new methods for assessing the vulnerability of families, the present approaches will be applied over the next few years, while focusing on better ways to target the issues in the system.

towards that end. The government has been prioritizing these issues through their inclusion in sectoral development programs (especially externally financed programs). Special emphasis has been put on the formation and development of both physical and financial infrastructures. The authorities have been expending efforts to improve rural water supplies and roads. Measures have been taken to help the marketing of agricultural products. The results of the last household survey, however, show once again that when dealing with regional, and especially rural, development issues, there needs to be further clarification of approaches and considerable investment of effort and money.

179. Macroeconomic developments over the last years have been more favorable than expected, with a positive impact on both the population's welfare and on the budgetary potential of the state. Such a development scenario has also been supported by the public policy for institutional and structural reforms. The government is strongly committed to its intentions and believes that the implementation of focused activities to improve the institutional environment will considerably enhance the country's economic development perspectives. This will take place while assuring the increased trust, by both the private sector and the civil society, in the government's policies and future undertakings. In this context, the government shares the approaches presented in the document and puts a special emphasis on fighting corruption. It expresses its commitment to the anti-corruption strategy document adopted at the end of 2003.
180. Reforms in the judicial system and actions aimed to improve tax and customs administration will make an important contribution to the enhancement of the business environment. While avoiding any radical changes in tax rates and taxation principles in the next few years, the government considers that improving the tax and customs administration is a basic way to increase people's trust in these structures, and strengthen the state's financial background.
181. Turning to the PRSP priorities and their proper inclusion in public expenditures (in the medium term) as driven by future developments, and clarifying the scope of external assistance, the possible changes in the budgetary resource package and the relevant amendments and rectifications in the expenditure programs will be effected within the planning of public expenditures. In 2003, it was legislatively recognized as an integral and indispensable component of the budgeting process. The introduction of result-based budgeting practices (particularly, in social sectors), and the improvement of relevant capacities in sectoral ministries, and the increased involvement in all phases of the budgeting process (drafting, execution, reporting) are expected to contribute to the coordination of the PRSP's implementation and the MTEF processes.
182. Measures are taken to reform the budget administration and enhance its accountability and transparency. In particular, activities will help in switching to a budgetary classification consistent with the IMF Manual for Public Finance Statistics released in 2001. There will be a process to regulate the accountability of state non-commercial organizations. This will be done by adopting the relevant normative acts in 2003 and assigning the function of methodological management and monitoring of financial and economic activities of those organizations to the respective division of the Ministry of Finance and Economy.
183. The successful implementation of the PRSP and the efficiency of future revisions will be highly dependent on the clarity of the proposed actions and an effective monitoring system. Following the

PRSP's adoption, the government approved the list of activities for 2004-2006 that are necessary to implement the PRSP. It recognized, yet again, the importance of the civil society's participation in the PRSP implementation process. It sought a wider involvement in certain actions. Presently, the PRSP concept paper is already adopted by the RA Government. It is expected that the next report on the PRSP's implementation and assessment will be presented within the framework of indicators and mechanisms defined in the concept paper. In this context, the government emphasizes both clarifying the functions of the relevant administrative bodies and appropriately coordinating their activities, and improving their relevant capacities.

### **Development and introduction of the PRSP monitoring and evaluation system**

184. As early as August 2003, the PRSP workgroup initiated activities for the development of the PRSP monitoring and assessment system. The World Bank, the German Technical Support Cooperation, and the UN Development Program have shown consistent support for these activities. In order to develop a strategy for the PRSP monitoring and assessment system, a monitoring strategy development task team was established within the PRSP workgroup in November 2003. Over fifteen independent experts and a consulting company (assisted by the UN Development Program) were involved in the development of a set of relevant indicators.
185. The monitoring strategy development task team of the PRSP workgroup has developed and presented a concept paper to the stakeholders on the establishment of the PRSP monitoring system. It defines the PRSP implementation participants and their functional relationships. This document also contains recommendations on strengthening the capacities of the potential participants of the PRSP monitoring system, as well as certain mechanisms for involving civil society structures in the monitoring process.
186. The PRSP monitoring indicators system, created by experts and a consulting firm has been adopted by the government decision N 1780-n, 11.11.2004. On 18-20 February 2005 a workshop has been held in Tsakhkadzor, during which the PRSP monitoring indicators system has been introduced to the governmental bodies.
187. The PRSP monitoring indicators system includes 177 indicators, 36 of which are considered as objective indicators, and 141 perceiving indicators, classified into the following six groups: (i) poverty reduction and improved welfare; (ii) education; (iii) health care; (iv) basic social services and housing conditions; (v) social and civil dissociation and inequality; and (vi) sustainable environmental development.
188. The system of monitoring indicators is – to the extent possible – harmonized with the framework of the Millennium Development Indicators. At the same time, along with the introduction of the system, activities will be taken to reconcile the PRSP monitoring and the MTEF indicators.
189. The government will take steps to make the PRSP implementation assessment reports available to all stakeholders. This will be done through public presentations and discussions of the outcomes of the PRSP actions, and through the publication of assessment results.



**Table 20. Summary statistics on indicators to be included in 2004 PRSP Evaluation Report**

		Target indicators	Factor indicators	Total
	<b>Total</b>	<b>36</b>	<b>141</b>	<b>177</b>
A	Poverty reduction and improved welfare	3	41	34
B	Education	6	23	29
C	Health	9	32	41
D	Basic public services and housing conditions	10	12	22
E	Social and civil exclusion and inequality	5	27	32
F	Sustainable environmental development	3	6	9

190. The government emphasizes the efficient operation of the PRSP multi-measure monitoring system with regard not only to assessing the successful realization of the identified targets, but also to enabling more productive and targeted PRSP revisions. This implies the stability and availability of high-quality information. In this context, the government, through the involvement of all stakeholders will plan for activities to ensure a regular flow of information as it pertains to the PRSP monitoring indicators, and to enable more accurate and sustainable definitions. In particular, one of the government's immediate steps to be taken in this direction is to agree with the National Statistical Service and to approve the list of indicators that are generated through household surveys. These are to be included in the household survey summary reports on a regular basis. Activities will then be planned to mitigate, or at least disclose, the factors underlying, the (sometimes, quite large) deviations between household survey summary data and macroeconomic statistical aggregates. Otherwise, any factor analysis of poverty (in particular, the "economic growth – poverty" relation), and the resulting assessments, may prove to be essentially controversial.

### **Possible revisions and adjustments of PRSP indicators**

191. The economic situation resulting from the developments in 2003 has been more favorable than that anticipated by the PRSP scenario. In 2004, once again, the economy has developed at a faster pace and the current year will very likely end with better economic growth indicators than initially forecasted.
192. Such developments require a revision of the forecasts in terms of the main structural indicators. The revisions are first necessitated by the availability of the base year (2003) actual data and, in many cases, by their deviation from the 2003 forecasts. Moreover, for some indicators, the basic suggestions having served as means to forecast the medium-term and long-term behavior of those indicators, the underlying structural development may need to be revised.
193. Gross domestic product is one of the basic indicators to be revised. Over the last two years, the annual GDP growth rate has been around 13 percent. The analysis of the present development trends, and their drivers, prove that the PRSP mid-term (2004-2007) forecasts should be revised, to reflect both the changes in the base year (2003) indicator and the deviations from the suggestions underlying the PRSP mid-term scenario. According to the forecasts, during that period, the growth rate of the economy will be 1-2 percentage points higher than the PRSP macroeconomic framework target. The additional growth will issue from the sectors of industry, construction, and services. Furthermore, despite the positive trends in the agricultural product in 2004, so far there are insufficient reasons to propose new forecasts and revise the PRSP's medium-term scenario for that sector's development.
194. The accelerated economic growth will also affect the behavior of the population's incomes. During

2003, the incomes increased rather rapidly, and in the medium run, they are expected to accelerate further as compared with the PRSP scenario. This is particularly true for the behavior of employment incomes, whereas the incomes from the sales of agricultural products are anticipated to show a trend at least close to PRSP forecasts. Nonetheless, the forecasts of income behavior need further studies and will become more realistic after the present versions are compared with the 2004 household survey results.

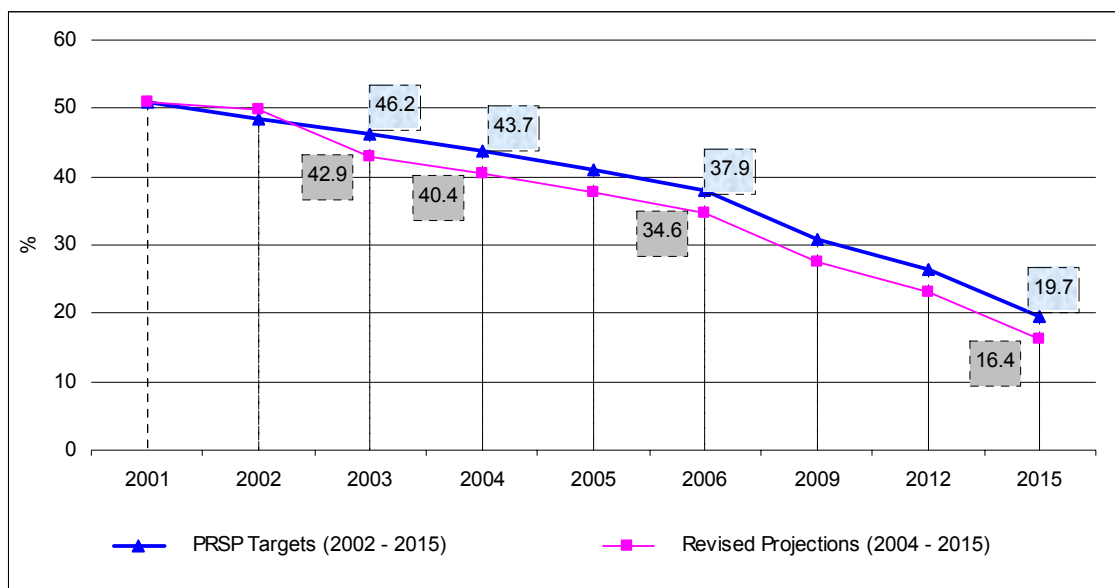
195. The next group of indicators referred to in this context involves budget revenues and expenditures. The increasing growth of GDP has resulted in the expansion of the tax base, which necessitates a positive revision of nominal tax revenues. As to the forecasts of the tax revenues-to-GDP ratio, the expectation is that within the next 2-3 years it will most probably be slightly lower than the PRSP target. This reflects the suggestion that the additional economic growth will be from the tax-exempt sectors. Hence, the tax revenues-to-GDP ratio will show similar trends, increasing by 0.3 to 0.4 percentage points annually.
196. A nominal expansion of the budgetary resource package will necessitate appropriate adjustments in expenditure programs. The government will move these changes under the guidance of the PRSP priorities. The majority of the additional resources will be consumed by the social sectors (health care, education, social security, and social insurance) and infrastructures. The government will make the respective redistributions to achieve, as much as possible, the PRSP targets set as priority expenditures-to-GDP ratios. This is primarily true for social expenditures, and the appropriate approaches have been applied accordingly in the MTEF 2005-2007.
197. Possible deviations of external assistance receipts from the planned levels may also lead to a revision of public expenditure programs. The anticipated additional receipts under the US government's Millennium Challenges Initiative, in particular, may necessitate certain revisions. If this is the case, again, when making inter-sectoral and intra-sectoral redistributions between public expenditure programs, the government will be guided by the PRSP priorities and objectives.
198. In view of the positive trends in natural growth over the last years, forecasts about population figures also need revision. Moreover, the figure for the resident population will be forecast, and the respective PRSP indicators, having been calculated based on the available population data, will be recalculated based on the number of the resident population<sup>28</sup>.
199. Concerning the possible revision of the inequality indicators, according to the initial results of the 2003 household survey, an abrupt reduction of inequality has been observed. Naturally, this will lead to revising the forecast Gini coefficients for both expenditures and revenues, based on the deviations between the actual and planned indicators. The government, however, will exercise a conservative approach in revising these indicators – especially when considering the medium-term trends of inequality reduction. The expectation is that the 2004 household survey results will allow using earlier arguments and reasoning about the medium-term behavior of inequality indicators.
200. Revising the main indicators of macroeconomic and fiscal frameworks will lead to certain changes in the behavior of poverty indicators. This is especially true, because compared to initial assessments, in

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<sup>28</sup> The PRSP framework used the indicator of available population. Actual data for this can be generated only in the census years.

2003; the pace of poverty reduction was higher than the PRSP forecast. The increasing incomes of the poor and larger social transfers were the main drivers of poverty reduction. The basic impact was from the factors identified in the PRSP. For the purposes of this report, poverty level has been revised by properly adjusting the 2003 actual indicator. The implication is that the PRSP scenario of poverty reduction trends will remain unchanged (see Figure 3). Although at this phase, a certain acceleration of the pace of poverty reduction – at least in the medium term – could be anticipated, the government will address the adjustment of poverty reduction trends during the first revision of the PRSP, based also on the 2004 household survey results.

**Figure 3. Revised targets of poverty level for 2004 - 2015**



201. The government will address the issue of revising other target indicators during the next revision of the PRSP, which is supposed to take place in 2005. At that time, the indicators quantitatively targeted by the PRSP will be revised, if necessary. Moreover, the government will also establish quantitative targets for the target and factor indicators included in the PRSP implementation monitoring system, if the PRSP does not identify targets for those indicators. Depending on the time-sensitivity of the indicators, the targets will be set through one of the following methods: either targeting on a yearly basis, or targeting for a certain time-line<sup>29</sup> (for the next 3 or 5 years). For some indicators, the targets may be defined in the form of either an interval, or an upper (or lower) limit.

<sup>29</sup> For example, ensuring an X% of growth of the indicator A within (t+5) years, as compared with the base (t) year.

Annex 1. Progress in poverty reduction: summary indicators

	2002	2003	2004	
	Actual	PRSP	PRSP	Preliminary
<b>(i) POVERTY AND INEQUALITY</b>				
Population below poverty line, % of total population	49.7	42.9	46.2	
<i>including: population below food poverty line, % of total population</i>	13.1	7.4	15.2	
Gini coefficient of income concentration	0.451	0.438	0.510	
Incomes of the poorest quantile, % of incomes of the richest quantile	6.8	7.5	6.9	
<b>(ii) HUMAN POVERTY</b>				
General secondary school completion rate, %	64 <sup>1</sup>	63	67	68
Child mortality rate, per 1 000 live births <sup>2</sup>	14.0	12.0	...	11.8
Mother mortality rate, per 100 000 live births <sup>2,3</sup>	9.3	22.4	...	26.6
Access to drinking water, % <sup>4</sup>	89.1	91.0	...	91.0
Urban population	97.0	97.8	90	97.8
Rural population	77.0	80.6	47	80.6
<b>(iii) LIVING STANDARDS AND SOCIAL EXPENDITURE</b>				
GDP per capita, thousand drams	424	506	501	589
GDP per capita, USD	740	873	850 <sup>5</sup>	1,104
Average monthly wage, drams	26,444	32,518	32,078	41,976
Minimum monthly wage, drams	5,000	5,000	12,767	13,000
Monthly extreme (food) poverty line, drams	7,516	7,742	7,632	
Monthly poverty line, drams	12,261	12,629	12,450	
Social expenditure, % of GDP	7.8	7.9	9.3	9.4
<i>of which: education, % of GDP</i>	2.2	2.2	2.7	2.7
<i>health, % of GDP</i>	1.2	1.2	1.5	1.3
<i>social protection, % of GDP</i>	4.5	4.5	5.1	5.3
<b>(iv) MACROECONOMIC INDICATORS</b>				
Nominal GDP, billion drams	1,362	1,623	1,609	1,893
Real GDP, year-on-year % change	13.2	13.9	6.0	10.1
Investments, % of GDP	21.7	24.7	20.6	23.7 <sup>30</sup>
Period average CPI, year-on-year % change	1.1	4.7	3.0	7.0
Period average exchange rate, dram/US dollar	573.4	578.8	589.3	533.5
Exports of goods and services, million US dollars	698	903	840	699 <sup>6</sup>
Imports of goods and services, million US dollars	-1,107	-1,406	-1256	-1,094 <sup>6</sup>
Current account balance, % of GDP	-6.2	-6.8	-5.8	-6.0 <sup>6</sup>
<b>(v) FISCAL SECTOR<sup>6</sup></b>				
Total revenue and grants, % of GDP	20.2	22.4	23.1	21.5
<i>of which: tax revenue, % of GDP</i>	17.8	17.8	18.3	17.2
Total expenditure and net lending, % of GDP	24.7	23.3	25.5	22.4
<i>of which: capital expenditure, % of GDP</i>	3.7	4.7	6.8	5.2
Overall balance, % of GDP	-4.5	-0.9	-2.5	-0.9
<b>Memorandum item</b>				
<i>De jure mid-year population, thousand people</i>	3,210.8	3,212.2	...	3,215.7

<sup>1</sup> Data for 2000. <sup>2</sup> Projections are based on official data of the National Statistical Service. <sup>3</sup> Three-year average. <sup>4</sup> PRSP projections are based on indicators of the availability of centralized water supply in residential units; the forecasts for these indicators will be adjusted accordingly at the next PRSP update. <sup>5</sup> PRSP corresponding target is adjusted based on estimation of de jure population. <sup>6</sup> Consolidated budget operations. <sup>7</sup> As end of the year. <sup>8</sup> The PRSP projected only de facto population: 3,013.8 thousand people.

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

<sup>30</sup> January-September of 2004

Annex 2. Breakdown of gross domestic product by main sector

	2002	2003	2004	
	Actual	PRSP	PRSP	Preliminary
<i>in billions of drams, current prices</i>				
<b>Gross domestic product</b>	<b>1,362.5</b>	<b>1,623.3</b>	<b>1,609.4</b>	<b>1,893.4</b>
Industry	256.9	322.9	337.9	373.0
Agriculture	318.8	346.1	348.9	426.0
Construction	172.2	252.2	237.9	289.7
Transport and communications	83.6	95.1	103.8	111.7
Trade	144.1	173.7	148.3	208.3
Others	255.0	285.5	270.2	325.7
Net Indirect Taxes	131.9	147.9	162.4	159.0
<i>year-on-year % change</i>				
<b>Gross domestic product</b>	<b>13.2</b>	<b>13.9</b>	<b>6.0</b>	<b>10.1</b>
Industry	13.9	15.4	8.0	2.1
Agriculture	3.8	4.3	2.8	14.5
Construction	41.5	44.4	-0.4	13.4
Transport and communications	-1.7	8.2	6.0	17.0
Trade	19.7	14.5	11.4	10.5
Others	12.0	7.6	6.8	12.2
Net Indirect Taxes	14.3	8.0	12.6	2.4
<i>in % of GDP</i>				
<b>Gross domestic product</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Industry	18.9	19.9	21.0	19.7
Agriculture	23.4	21.3	21.7	22.5
Construction	12.6	15.5	14.8	15.3
Transport and communications	6.1	5.9	6.4	5.9
Trade	10.6	10.7	9.2	11.0
Others	18.7	17.6	16.8	17.2
Net Indirect Taxes	9.7	9.1	10.1	8.4
<i>contribution to GDP growth, percentage points</i>				
<b>Gross domestic product</b>	<b>13.2</b>	<b>13.9</b>	<b>6.0</b>	<b>10.1</b>
Industry	2.7	2.9	1.7	0.4
Agriculture	0.9	1.0	0.6	3.1
Construction	4.0	5.6	-0.1	2.1
Transport and communications	-0.1	0.5	0.4	1.0
Trade	2.0	1.5	1.1	1.1
Others	2.3	1.6	1.1	2.2
Net Indirect Taxes	1.4	0.8	1.2	0.2

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

Annex 3. Use of gross domestic product

	2002	2003	2004	
	<i>Actual</i>		<i>PRSP</i>	<i>January-September</i>
	<i>in billions of drams, current prices</i>			
<b>Gross Domestic Product</b>	<b>1,362.5</b>	<b>1,623.3</b>	<b>1,609.4</b>	<b>1,243.2</b>
Final consumption	1,349.8	1,531.5	1,522.8	1,214.3
Private	1,213.8	1,364.9	1,334.9	1,070.3
Public	136.1	166.6	187.9	144.0
Gross capital formation	295.2	400.6	331.9	294.1
Net exports of goods and services	-234.8	-290.9	-245.3	-215.4
Statistical discrepancy	-47.8	-17.9	0.0	-49.8
	<i>year-on-year % change</i>			
<b>Gross Domestic Product</b>	<b>13.2</b>	<b>13.9</b>	<b>6.0</b>	<b>10.3</b>
Final consumption	8.2	9.0	7.9	11.1
Private	9.0	8.4	8.6	10.6
Public	2.2	14.0	3.2	15.2
Gross capital formation	22.5	32.9	-3.4	9.0
Net exports of goods and services	1.8	23.5	-4.2	9.3
	<i>in % of GDP</i>			
<b>Gross Domestic Product</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Final consumption	99.1	94.3	94.6	97.7
Private	89.1	84.1	82.9	86.1
Public	10.0	10.3	11.7	11.6
Gross capital formation	21.7	24.7	20.6	23.7
Net exports of goods and services	-17.3	-17.9	-15.2	-17.3
Statistical discrepancy	-3.5	-1.1	0.0	-4.0

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

Annex 4. Consolidated budget operations (on a commitment basis)

	2001	2002	2003		2004	
	Actual	PRSP	Actual	PRSP	PRSP	Preliminary
<i>in billions of drams</i>						
<b>Total revenues and grants</b>	<b>237.0</b>	<b>305.6</b>	<b>339.9</b>	<b>348.9</b>	<b>346.2</b>	<b>367.1</b>
Total revenues	227.6	258.1	279.0	297.4	312.9	354.2
Tax revenue	209.5	242.3	269.4	279.3	302.2	326.2
Non-tax revenue	16.1	13.2	7.6	14.1	9.8	15.7
Capital revenue	2.0	2.6	1.9	4.0	0.9	12.3
Grants	9.4	47.5	61.0	51.5	33.3	12.9
Current	9.4	17.1	14.1	11.6	9.7	9.7
Capital	0.0	30.5	46.9	39.9	23.7	3.2
<b>Total expenditures and net Lending</b>	<b>290.1</b>	<b>317.7</b>	<b>376.5</b>	<b>363.3</b>	<b>388.1</b>	<b>409.0</b>
Current expenditures	230.9	243.5	279.0	271.5	294.0	319.4
<i>of which: interest payments</i>	14.8	15.7	13.9	11.4	12.6	9.8
Capital expenditures	43.2	63.8	101.0	85.2	86.9	78.5
<i>of which: capital grant financed</i>	0.0	30.5	46.9	39.9	23.7	
Net lending	16.0	10.4	-3.5	6.6	7.2	11.1
<b>Overall balance</b>	<b>-53.1</b>	<b>-12.1</b>	<b>-36.5</b>	<b>-14.4</b>	<b>-41.9</b>	<b>-41.9</b>
<b>Financing</b>	<b>53.1</b>	<b>12.1</b>	<b>36.5</b>	<b>14.4</b>	<b>41.9</b>	<b>41.9</b>
Domestic sources	15.9	-24.7	46.4	-24.4	2.7	-3.5
External sources	37.2	36.7	-9.9	38.8	39.2	45.4
<i>in % GDP</i>						
<b>Total revenues and grants</b>	<b>20.2</b>	<b>22.4</b>	<b>23.1</b>	<b>21.5</b>	<b>21.5</b>	<b>19.4</b>
Total revenues	19.4	18.9	18.9	18.3	19.4	18.7
Tax revenue	17.8	17.8	18.3	17.2	18.8	17.2
Non-tax revenue	1.4	1.0	0.5	0.9	0.6	0.8
Capital revenue	0.2	0.2	0.1	0.2	0.1	0.6
Grants	0.8	3.5	4.1	3.2	2.1	0.7
Current	0.8	1.3	1.0	0.7	0.6	0.5
Capital	0.0	2.2	3.2	2.5	1.5	0.2
<b>Total expenditures and net Lending</b>	<b>24.7</b>	<b>23.3</b>	<b>25.5</b>	<b>22.4</b>	<b>24.1</b>	<b>21.6</b>
Current expenditures	19.6	17.9	18.9	16.7	18.3	16.9
<i>of which: interest payments</i>	1.3	1.2	0.9	0.7	0.8	0.5
Capital expenditures	3.7	4.7	6.8	5.2	5.4	4.1
<i>of which: capital grant financed</i>	0.0	2.2	3.2	2.5	1.5	0.0
Net lending	1.4	0.8	-0.2	0.4	0.4	0.6
<b>Overall balance</b>	<b>-4.5</b>	<b>-0.9</b>	<b>-2.5</b>	<b>-0.9</b>	<b>-2.6</b>	<b>-2.2</b>
<b>Financing</b>	<b>4.5</b>	<b>0.9</b>	<b>2.5</b>	<b>0.9</b>	<b>2.6</b>	<b>2.2</b>
Domestic sources	1.4	-1.8	3.2	-1.5	0.2	-0.2
External sources	3.2	2.7	-0.7	2.4	2.4	2.4
<b>Memorandum items</b>						
<i>Social expenditures<sup>1</sup>, % of GDP</i>	9.2	7.8	8.7	7.9	9.3	9.4
<i>Primary balance<sup>2</sup>, % of GDP</i>	-3.3	0.3	-1.5	-0.2	-1.8	21.1

<sup>1</sup>Includes expenditures on education, health care, social security and social insurance:

<sup>2</sup>Defined as overall balance, excluding interest payments.

Source: Ministry of Finance and Economy of the Republic of Armenia, State Social Insurance Fund of the Republic of Armenia, and PRSP projections.

Annex 5. Consolidated budget operations: external financing requirements

	2001	2002	2003		2004	
	Actual		PRSP	Actual	PRSP	Preliminary
<i>in billions of drams</i>						
<b>1. Total domestic revenues</b>	<b>227.6</b>	<b>258.1</b>	<b>279.0</b>	<b>297.4</b>	<b>312.9</b>	<b>354.2</b>
Tax revenue	209.5	242.3	269.4	279.3	302.2	326.2
Non-tax and capital revenue	18.1	15.7	9.6	18.0	10.7	28.0
<b>2. Domestic financing</b>	15.9	-24.7	46.4	-24.4	2.7	<b>-3.5</b>
<b>3. Total domestic resources available (1+2)</b>	<b>243.5</b>	<b>233.4</b>	<b>325.4</b>	<b>273.0</b>	<b>315.6</b>	<b>350.7</b>
<b>4. Total expenditures and net lending</b>	<b>290.1</b>	<b>317.7</b>	<b>376.5</b>	<b>363.3</b>	<b>388.1</b>	<b>409.0</b>
Current expenditures	230.9	243.5	279.0	271.5	294.0	319.4
<i>of which: interest payments</i>	14.8	15.7	13.9	11.4	12.6	9.8
Capital expenditures	43.2	63.8	101.0	85.2	86.9	78.5
Net lending	16.0	10.4	-3.5	6.6	7.2	11.1
<b>5. External financing requirements (4-2)</b>	<b>46.6</b>	<b>84.3</b>	<b>51.0</b>	<b>90.3</b>	<b>72.5</b>	<b>58.3</b>
Grants	9.4	47.5	61.0	51.5	33.3	12.9
Current	9.4	17.1	14.1	11.6	9.7	9.7
Capital	0.0	30.5	46.9	39.9	23.7	3.2
Loans/Credits	37.2	36.7	-9.9	38.8	39.2	45.4
<i>in millions of US dollars</i>						
<b>1. Total domestic revenues</b>	<b>410.0</b>	<b>450.1</b>	<b>475.8</b>	<b>513.8</b>	<b>531.0</b>	<b>663.9</b>
Tax revenue	377.5	422.7	459.4	482.7	512.8	611.4
Non-tax and capital revenue	32.6	27.5	16.3	31.2	18.2	52.5
<b>2. Domestic financing</b>	28.7	-43.0	79.2	-42.2	4.6	<b>-6.5</b>
<b>3. Total domestic resources available (1+2)</b>	<b>438.7</b>	<b>407.1</b>	<b>555.0</b>	<b>471.7</b>	<b>535.6</b>	<b>657.5</b>
<b>4. Total expenditures and net lending</b>	<b>522.6</b>	<b>554.1</b>	<b>642.0</b>	<b>627.7</b>	<b>658.6</b>	<b>766.7</b>
Current expenditures	415.9	424.8	475.8	469.1	499.0	598.8
<i>of which: interest payments</i>	26.7	27.5	23.7	19.7	21.4	18.4
Capital expenditures	77.8	111.3	172.2	147.2	147.4	147.2
Net lending	28.9	18.1	-6.0	11.4	12.2	20.8
<b>5. External financing requirements (4-2)</b>	<b>83.9</b>	<b>147.0</b>	<b>87.1</b>	<b>156.0</b>	<b>123.1</b>	<b>109.3</b>
Grants	16.9	82.9	104.0	88.9	56.5	24.2
Current	16.9	29.8	24.0	20.1	16.4	18.3
Capital	0.0	53.1	80.0	68.9	40.2	5.9
Loans/Credits	67.0	64.1	-16.9	67.1	66.5	85.1
<i>in % GDP</i>						
<b>1. Total domestic revenues</b>	<b>19.4</b>	<b>18.9</b>	<b>18.9</b>	<b>18.3</b>	<b>19.4</b>	<b>18.7</b>
Tax revenue	17.8	17.8	18.3	17.2	18.8	17.2
Non-tax and capital revenue	1.5	1.2	0.7	1.1	0.7	1.5
<b>2. Domestic financing</b>	1.4	-1.8	3.2	-1.5	0.2	<b>-0.2</b>
<b>3. Total domestic resources available (1+2)</b>	<b>20.7</b>	<b>17.1</b>	<b>22.1</b>	<b>16.8</b>	<b>19.6</b>	<b>18.5</b>
<b>4. Total expenditures and net lending</b>	<b>24.7</b>	<b>23.3</b>	<b>25.5</b>	<b>22.4</b>	<b>24.1</b>	<b>21.6</b>
Current expenditures	19.6	17.9	18.9	16.7	18.3	16.9
<i>of which: interest payments</i>	1.3	1.2	0.9	0.7	0.8	0.5
Capital expenditures	3.7	4.7	6.8	5.2	5.4	4.1
Net lending	1.4	0.8	-0.2	0.4	0.4	0.6
<b>5. External financing requirements (4-2)</b>	<b>4.0</b>	<b>6.2</b>	<b>3.5</b>	<b>5.6</b>	<b>4.5</b>	<b>3.1</b>
Grants	0.8	3.5	4.1	3.2	2.1	0.7
Current	0.8	1.3	1.0	0.7	0.6	0.5
Capital	0.0	2.2	3.2	2.5	1.5	0.2
Loans/Credits	3.2	2.7	-0.7	2.4	2.4	2.4

Source: Ministry of Finance and Economy of the Republic of Armenia, State Social Insurance Fund of the Republic of Armenia, and PRSP projections.



**PRSP PROGRESS REPORT**

**Annex 6. Consolidated budget expenditure by main functions (on a commitment basis)**

	2001	2002	2003		2004	
	Actual		PRSP	Actual	PRSP	Preliminary
<i>in billions of drams</i>						
<b>Total expenditures</b>	<b>290.1</b>	<b>317.7</b>	<b>376.5</b>	<b>363.3</b>	<b>388.1</b>	<b>409.0</b>
General public services	27.3	28.7	28.3	36.2	35.5	45.4
Defense, public order and safety	54.5	54.0	61.3	65.1	66.8	78.2
Education and science	33.0	32.4	38.2	38.3	46.1	51.9
Health	17.4	16.0	21.0	19.6	24.9	24.7
Social security and social insurance	60.6	61.8	73.1	74.1	84.4	101.0
Culture, information, sports and religion	7.3	11.1	16.5	15.8	9.4	10.4
Housing and public utilities	11.1	22.7	36.1	41.7	24.0	22.1
Fuel and energy	7.1	8.4	12.2	7.0	13.5	13.6
Agriculture, forestry and water, fishing	18.9	15.3	19.2	19.9	17.0	16.7
Manufacturing, mining, construction and environment	0.7	0.7	4.6	-6.3	6.5	5.1
Transportation, road utility and communications	7.2	24.2	36.6	30.6	25.3	18.8
Other expenditure	45.0	42.3	29.4	21.3	34.8	20.9
<i>of which: debt service</i>	<i>14.8</i>	<i>15.7</i>	<i>13.9</i>	<i>11.4</i>	<i>12.6</i>	<i>9.8</i>
<i>in % GDP</i>						
<b>Total expenditures</b>	<b>24.7</b>	<b>23.3</b>	<b>25.5</b>	<b>22.4</b>	<b>24.1</b>	<b>21.6</b>
General public services	2.3	2.1	1.9	2.2	2.2	2.4
Defense, public order and safety	4.6	4.0	4.2	4.0	4.1	4.1
Education and science	2.8	2.4	2.6	2.4	2.9	2.7
Health	1.5	1.2	1.4	1.2	1.5	1.3
Social security and social insurance	5.2	4.5	5.0	4.6	5.2	5.3
Culture, information, sports and religion	0.6	0.8	1.1	1.0	0.6	0.6
Housing and public utilities	0.9	1.7	2.5	2.6	1.5	1.2
Fuel and energy	0.6	0.6	0.8	0.4	0.8	0.7
Agriculture, forestry and water, fishing	1.6	1.1	1.3	1.2	1.1	0.9
Manufacturing, mining, construction and environment	0.1	0.1	0.3	-0.4	0.4	0.3
Transportation, road utility and communications	0.6	1.8	2.5	1.9	1.6	1.0
Other expenditure	3.8	3.1	2.0	1.3	2.2	1.1
<i>of which: debt service</i>	<i>1.3</i>	<i>1.2</i>	<i>0.9</i>	<i>0.7</i>	<i>0.8</i>	<i>0.5</i>
<i>in% of total expenditure</i>						
<b>Total expenditures</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
General public services	9.4	9.0	7.5	10.0	9.1	11.1
Defense, public order and safety	18.8	17.0	16.3	17.9	17.2	19.1
Education and science	11.4	10.2	10.1	10.5	11.9	12.7
Health	6.0	5.0	5.6	5.4	6.4	6.0
Social security and social insurance	20.9	19.5	19.4	20.4	21.7	24.7
Culture, information, sports and religion	2.5	3.5	4.4	4.4	2.4	2.5
Housing and public utilities	3.8	7.1	9.6	11.5	6.2	5.4
Fuel and energy	2.4	2.7	3.2	1.9	3.5	3.3
Agriculture, forestry and water, fishing	6.5	4.8	5.1	5.5	4.4	4.1
Manufacturing, mining, construction and environment	0.2	0.2	1.2	-1.7	1.7	1.3
Transportation, road utility and communications	2.5	7.6	9.7	8.4	6.5	4.6
Other expenditure	15.5	13.3	7.8	5.9	9.0	5.1
<i>of which: debt service</i>	<i>5.1</i>	<i>5.0</i>	<i>3.7</i>	<i>3.1</i>	<i>3.2</i>	<i>2.4</i>

Source: Ministry of Finance and Economy of the Republic of Armenia, State Social Insurance Fund of the Republic of Armenia, and PRSP projections.

Annex 7. Consolidated budget social expenditures (on a commitment basis)

	2001	2002	2003		2004	
	Actual		PRSP	Actual	PRSP	Preliminary
<i>in billions of drams</i>						
<b>Total social expenditures</b>	<b>107.9</b>	<b>106.6</b>	<b>127.6</b>	<b>127.9</b>	<b>150.3</b>	<b>177.6</b>
Education	30.7	29.7	35.2	35.4	42.8	51.9
Health	17.4	16.0	21.0	19.6	24.9	24.7
Social security and social insurance <sup>1</sup>	59.8	61.0	71.4	73.0	82.6	101.0
<i>of which: family benefits</i>	16.1	12.1	12.7	12.4	16.1	16.6
<i>year-on-year % change</i>						
<b>Total social expenditures</b>	<b>3.8</b>	<b>-1.2</b>	<b>20.3</b>	<b>20.0</b>	<b>17.8</b>	<b>38.9</b>
Education	1.2	-3.3	18.3	19.1	21.6	46.6
Health	6.6	-8.1	31.2	22.6	18.6	26.0
Social security and social insurance <sup>1</sup>	4.4	1.9	18.4	19.7	15.8	38.4
<i>of which: family benefits</i>	-8.4	-24.8	5.5	2.2	26.3	33.9
<i>in % GDP</i>						
<b>Total social expenditures</b>	<b>9.2</b>	<b>7.8</b>	<b>8.7</b>	<b>7.9</b>	<b>9.3</b>	9.4
Education	2.6	2.2	2.4	2.2	2.7	2.7
Health	1.5	1.2	1.4	1.2	1.5	1.3
Social security and social insurance <sup>1</sup>	5.1	4.5	4.8	4.5	5.1	5.3
<i>of which: family benefits</i>	1.4	0.9	0.9	0.8	1.0	0.9
<i>in % of consolidated budget total expenditure</i>						
<b>Total social expenditures</b>	<b>37.2</b>	<b>33.6</b>	<b>33.9</b>	<b>35.2</b>	<b>38.7</b>	43.4
Education	10.6	9.3	9.4	9.7	11.0	12.7
Health	6.0	5.0	5.6	5.4	6.4	6.0
Social security and social insurance <sup>1</sup>	20.6	19.2	19.0	20.1	21.3	24.7
<i>of which: family benefits</i>	5.5	3.8	3.4	3.4	4.1	4.0

<sup>1</sup> Excluding expenditures on system maintenance and development.

Source: Ministry of Finance and Economy of the Republic of Armenia, State Social Insurance Fund of the Republic of Armenia, and PRSP projections.

Annex 8. Armenia: balance of payments

	2002	2003	2004	
	Actual	PRSP	PRSP	Preliminary
	<i>in millions of US dollars, unless otherwise indicated</i>			
<b>Current account</b>	<b>-148</b>	<b>-191</b>	<b>-159</b>	<b>-137<sup>6</sup></b>
Trade balance	-369	-434	-373	-341 <sup>6</sup>
Exports (f.o.b.)	514	696	639	522 <sup>6</sup>
Imports (f.o.b.)	-883	-1130	-1012	-863 <sup>6</sup>
Services (net)	-41	-68	-43	-54 <sup>6</sup>
Credits	184	207	201	177 <sup>6</sup>
Debits	-225	-276	-244	-231 <sup>6</sup>
Income and private transfers (net)	207	252	202	220 <sup>6</sup>
Official transfers (net)	55	60	55	38 <sup>6</sup>
<b>Capital and financial account</b>	<b>152</b>	<b>192</b>	<b>202</b>	<b>105<sup>6</sup></b>
Capital transfers (net)	68	90	55	15 <sup>6</sup>
Foreign direct investments (net)	111	121	80	131 <sup>6</sup>
Portfolio investments (net)	2	0.3	0	-4 <sup>6</sup>
Public sector (net)	45	25	67	2 <sup>6</sup>
Disbursement	84	92	80	48 <sup>6</sup>
Amortization	-39	-68	-13	-46 <sup>6</sup>
Other capital (net)	-73	-43	-0	-39 <sup>6</sup>
<b>Errors and omissions (net)</b>	<b>-4</b>	<b>-2</b>	<b>0</b>	<b>7<sup>6</sup></b>
<b>Overall balance</b>	<b>-39</b>	<b>-2</b>	<b>-42</b>	<b>25<sup>6</sup></b>
<b>Financing:</b>				
Change in gross reserves ('-' increase)	-82	-46	-36	18 <sup>6</sup>
IMF (net)	7	2	-6	7 <sup>6</sup>
Financing gap	35	43	0	0 <sup>6</sup>
World Bank	35	43	0	0 <sup>6</sup>
Other	0	0	0	0 <sup>6</sup>
<b>Memorandum items</b>				
Current account (in % of GDP)	-6.2	-6.8	-5.8	-6.0 <sup>6</sup>
<i>excluding official transfers</i>	-8.5	-8.9	-7.9	-7.6 <sup>6</sup>
Gross reserves (end of period)	431	502	480	484 <sup>6</sup>
<i>in months of imports</i>	4.7	4.3	4.6	5.3 <sup>6</sup>
Nominal external debt	1,026	1,098	1,104	1,183
<i>External debt-to-GDP ratio, %</i>	43.2	39.1	40.4	33.3
Present value of external debt	673	732	623	710 <sup>7</sup>
<i>Present value of debt-to-GDP ratio, %</i>	28.4	26.1	22.8	20
<i>Present value of debt-to-G&amp;NFS exports ratio, %</i>	96	82	74.2	-

<sup>6</sup> January-September of 2004: <sup>7</sup> Preliminary estimates:

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