

Annex  
To RA Government Decree # 442 - N  
On 27<sup>th</sup> of March, 2014

# **Armenia Development Strategy for 2014-2025**

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## PREFACE

1. Taking into consideration developments and new realities induced by the global financial and economic downturn, the Government of the Republic of Armenia has revised the Sustainable Development Program (SDP) adopted in 2008.
2. The revised strategy is aimed at ensuring a coordinated post-crises strategic framework for the development of state policies. The strategy provides an opportunity to the government to unite national capacities in developing the country's long-term development vision, taking into consideration the accumulated experience, current conditions and global development challenges.
3. The period covered under the strategy is until the year 2025. It documents the country's enlarged group of socio-economic development priorities, objectives, main development obstacles and restrictions, key reforms to achieve priority objectives and policy tools, as well as main risks.
4. The overarching goal of the government long-term strategy is permanent increase of welfare of society.
5. Taking into account peculiarities of current stage of development of the country, the increase of employment through creation of quality and high productivity jobs is announced as the main objective of the strategy.
6. The activities of the RA Government will be directed at the creation of possibilities for everyone to get fair income according to the working efforts exerted. Implementation of the program will guarantee for each member of the society the strong feeling of being protected and socially secured by the own state. The activities aiming at personal development of the citizen of RA, his/her professional growth, civic education and enhanced cultural level will be always under the strong focus of the Government, fostering the willingness of each person to live in the homeland.
7. The document does not have detailed sector coverage, yet it provides sufficient milestones to develop sector programs within a standard logical frame. At the same time, the document sections and sub-sections are not proportional in terms of sector policy details and coverage, which is mainly due to specifics of some sectors. Hence the strategy should be viewed from the context of already approved sector programs, depending on their adoption timelines, coverage, and programmed time horizon, to the extent they are in line with the strategic priorities.
8. One of the key missions of the document is ensuring strategic guideline in the coming years for the development of medium-term expenditure framework (MTEF).
9. International economic integration processes are going to play an important role in the country's social and economic development during the programming period. With this regard RA membership in Customs Union, development and further deepening of economic relationships with its member states is going to have the highest priority. At the same time, taking into account common values, harmonized cooperation with European Union will continue on all mutually important directions.



10. As it was with Sustainable Development program, current program has also been developed with active involvement of civil society. The adopted approach presumes providing and deepening possibilities for social partnership and participatory monitoring also during the implementation of the program. In accordance with the Agreement signed between the Government of RA and Civil Cooperation Network (CCN) in February of 2013, the CCN will represent the interests of wider society during the implementation, monitoring and evaluation as well as revision of the program, if the later would be required. For the successful implementation of the program it is important to ensure participation of CCN in the activities carried out for the development of policies and for the evaluation, monitoring and supervision of decisions taken by public governance bodies. With this purpose the State will support the measures implemented by the civil society to develop participatory institute and the steps undertaken for its formalization. In the frames of participatory process the CCN will set up its structural units based on the principles of self regulation and will define their respective rights and obligations, whereas the public bodies responsible for the implementation of the program will take necessary actions to guarantee cooperative and transparent environment.

# I. MAIN RESULTS OF IMPLEMENTATION OF THE SUSTAINABLE DEVELOPMENT PROGRAM AND THE NEED FOR ITS REVISION

## 1. MAIN OBJECTIVES AND PRIORITIES OF SDP

11. The Sustainable Development Program (SDP) had three sets of objectives:

- Reduction of poverty in 2008-2021 to the extent that poverty will not be a problem of economic development, and extreme poverty will be totally eliminated and will no longer be a significant social phenomenon.
- Elimination of human poverty and ensuring accelerated human development, as a result of which, in a few years, the country should have moved from the group of countries with average human development to the group of countries with high level of human development<sup>1</sup>.
- Mitigation of disproportions of the territorial development and acceleration of economic growth of underdeveloped regions by developing and implementing a relevant territorial policy.

12. In order to achieve the mentioned objectives, SDP envisaged three sets of priority strategies:

- Economic policy for ensuring sustainable and accelerated economic growth;
- Active social and income policy for vulnerable groups of population (including the poor);
- Modernization of governance system, including improved effectiveness of state governance and ensuring accelerated growth of the resource envelope at the disposal of the state.

13. SDP economic policy priorities focused on ensuring accelerated, sustainable and poor-oriented economic growth and consisted of two groups: framework and direct or investment policies.

14. Framework policy is the same for all participants of the relevant sector and does not include the use of public funding for achieving policy objectives.

15. The basis for SDP economic policy was an approach, which assumed that the quality of the growth environment (business environment and investment climate in particular), freedom to enter the market, prevention of abuse by economic entities having dominant or monopoly position and promotion of competition, labor all foreign and sustainable domestic macroeconomic policy, have a decisive role in ensuring accelerated and sustainable economic growth.

16. Framework economic policy priorities included the design and introduction of the main elements and institutions of knowledge-based economy, as well as the institutional

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<sup>1</sup> According to UNDP Human Development Index which is published in the annual Human Development Reports.

modernization of the country, which also can be considered as the environment where economic growth takes place.

17. Direct or investment policy assumes the financial intervention of the state for achieving policy goals and has an interventionist nature.
18. The direct economic policy of SDP was to make only those investments from public financial resources, either fully or partially, which currently or in the near future, cannot be made by the private sector, but are necessary for ensuring economic growth and aim to eliminate the bottlenecks of the economy. Thus, the main priorities of the direct policy were public investments in infrastructure sectors.
19. Another priority of the direct policy was investments within the framework of Public-Private Partnership, which would be necessary for attracting foreign investment, as well as mitigating disparities of regional development.
20. The targeted social policy, which was the second strategic priority of the SDP, was a mix of direct and framework policies, where the direct policy assumed the accelerated growth of the public funding in the corresponding sectors, and the framework policy was directed to considerable improvement of the quality, conditions and accessibility of services provided to the population in the social sector.
21. The active social policy covered the following sectors:
  - Social assistance, where the priority is the allocation of family benefits, as the main tool for eradicating extreme poverty. The main objective of the framework policy was to continuously improve the targeting of family benefits, and the goal of the direct policy was to increase family benefits to around 70 percent of the poverty line.
  - Social insurance, where the priority of the direct policy was the sharp increase of pensions up to the value of the minimum consumer basket, and the framework policy aimed to move labor pensions to the budget, as well as establish the foundations for funded pension and its gradual introduction.
  - Social infrastructures, where the priorities of the direct policy were the accelerated increase in the volumes of public funding for basic social services (including education and healthcare), and the main priority of the framework policy was to improve the accessibility, effectiveness and quality of services by continuing the comprehensive reforms in the sector.
  - Income policy, where the direct policy aimed to ensure the accelerated growth of primary incomes in the budgetary and social infrastructure sectors. The main priority of the framework policy was the use of the set value of minimum wage as one of the main tools for significantly reducing the number of “working poor” and the later elimination of this group of population.
22. Improving the effectiveness of the state governance sector, at all levels of governance, which is the third strategic priority of the Sustainable Development Program, is also a mix of direct and framework policies, where the direct policy aims to continually increase the volumes of resources at the disposal of the state, and the framework policy describes and lists the measures, which will ensure the mentioned increase, as well as significantly increase the effectiveness of the state and the quality of and access to services provided by the state, as well as the level of accountability to citizens.

23. The framework policy for increasing the volume of resources at the disposal of the state<sup>2</sup> should have focused on significantly improving tax and customs administration and disclosure and reduction of shadow economy.
24. The framework policy for public expenditures aims to improve their distribution and technical effectiveness, in particular, through transition to results-based and program budgeting.
25. The priorities of the framework policy for enhancing the effectiveness of state governance are the drafting and introduction of a new effective anticorruption strategy, maximum possible transparency of decisions made by the state and ensuring active participation of the civil society in the process of decision-making, in particular through the introduction of electronic management and information systems at all levels (e-government, e-management, etc.).

## **2. 2008-2012 GENERAL DEVELOPMENT TRENDS AND THE NEED FOR SDP REVISION**

26. The Sustainable Development Program was approved by the Decree of the Government of Armenia No. 1207-N dated 30 October 2008, right at the outset of the global financial and economic crisis. The crisis could not have been taken into account during the drafting of the program and its spread throughout the world in 2008-2009 could not have no impact on Armenia's economy and have no influence the process of SDP implementation and achievement of its indicators. Thus, the crisis, by itself, became the main factor justifying the revision of SDP.
27. The economic growth model in Armenia formed prior to the crisis (2003-2008) was based on foreign financing (direct foreign investment, official and private transfers), the volumes of which grew year-to-year. As a result, in conditions of double-digit economic growth, imports grew rapidly, the competitiveness of local industrial products in the domestic market declined, non-agricultural employment rates did not grow, and the relative and absolute volumes of exports shrunk.
28. In conditions of declining competitiveness of the industry and the relative decrease in exports, the main engine of economic growth in the country was construction and services sectors, the combined share of which in the GDP increased from 50.1 percent in 2003 to 56.4 percent in 2007 and 59.3 percent in 2008, while the combined share of industry and agriculture in the GDP declined from 44 percent in 2003 to 29.6 percent in 2008.
29. Considering that the model of economic growth based on foreign financing and the resulting increase in domestic demand cannot be maintained in the long run, the SDP envisaged a gradual transition to an economic growth model based on the accelerated increase in the volumes of exported goods and services, as a result of which the country would gradually become less dependent on foreign financing and the share of construction in GDP would decline gradually.
30. The impact of global financial and economic crisis emerging in September 2008 reached Armenia in the fourth quarter of 2008, when the GDP produced in the quarter declined by 1.2 percent compared to the same period in 2007, and the decline continued in 2009 resulting in

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<sup>2</sup> It was assumed that the accelerated growth of the volumes of resources at the disposal of the state, at 0.3-0.4 percentage points of GDP annually, should take place without a heavier tax burden.

a 14.1 percent drop in GDP. The crisis ended in 2010, when 2.2 percent year-on-year GDP growth was recorded in Armenia, and the global economy, of which also Armenia entered the recovery phase.

31. The recovery continued in 2011-2013. Thus, during that period average growth was 5.1 percent: Main contributors to the growth were the services (including trade) – 2.2 percentage points, agriculture – 2.0 percentage points and industry – 1.4 percentage points. The construction sector continued to have negative contribution to GDP (-1 percentage point).
32. At the same time economic crisis has brought in new global challenges, which have created necessity to revise country's long-term development strategy in correspondence to the post-crisis realities, the main of which are as follows:
  - (1) As a result of the global economic crisis, the sectoral structure of economy changed significantly and the share of construction has visibly declined because of the increase in the share of all other macro-sectors. It is, on the one hand, more stable compared to the pre-crisis structure, since it is less dependent on the volumes of foreign financing, and on the other hand, unlike the previous development model, it cannot ensure very high growth rates, because of the sharp decline in construction and its contribution to economic growth.
  - (2) The sharp decline of the volumes of foreign financing (Sum of net foreign direct investments, private and official transfers) by about 31 percent in 2009-2011 has made it significantly difficult to continue the 2003-2007 economic growth model based on the increase in domestic demand in current conditions.
33. At the same time, a new challenge is created by the fact, that until now economic growth in Armenia does not lead to increased employment:
  - 1) In 1994-2003, during the recovery growth, the main factor behind the significant decline in employment and changes to its structure was the transition process, since the new economic structure had a lower level of demand for jobs, compared to the former structure which was being dismantled and transformed.
  - 2) In 2003-2008, the rapid economic growth did not result in increased employment, because the growth in the newly formed economic sectors was assured mainly as a result of higher productivity, and consequently higher incomes from employment, while employment continued to shrink in sectors inherited from the USSR, as well as in social infrastructures.
  - 3) In 2008-2009, there was a decline in employment as a result of economic crisis, due to the decline of production in new sectors, particularly in construction, and the subsequent job losses.
34. The preconditions and causes of economic growth without increased employment in Armenia after independence can be divided into two groups:
  - 1) The first one is based on objective reasons resulted from transition processes and impact of corresponding factors is gradually diminishing and in the current phase of development, where the new structure of the economy has already been formed

and the old Soviet era sectors have practically transformed or disappeared, they can no longer be considered as crucial or decisive.

2) Secondly, the absence of adequate coordinated policies aimed at increasing jobs. In the previous long-term strategic programs creation of jobs was considered one of the priorities of economic policy; however the application of relevant direct policy tools was either not in place or had fragmented nature. Particularly, the policy of creation of jobs and reduction of unemployment in those strategies was based on the assumption that the role of the state in that sector should be limited to improvement of business environment and investment climate, promotion of competitiveness, restriction of abuse of dominant or monopoly position and public investments should be directed only at infrastructure maintenance and improvement. Improvement of public administration sector was viewed as an important precondition for employment growth, including reduction of public regulations and their simplification, combating corruption, improving effectiveness and quality of public services.

35. Nonetheless, starting from 2008 these approaches have been significantly revised and institutionalized and in addition to framework policy and activities aimed at improvement of business environment and investment climate, the government has implemented activities financially supporting business and individual sectors. At the same time, clarification of the scope of the said activities in medium-and long-term perspectives, is still on the agenda.

36. Another important reason for developing a new strategic program was the change of views on both economic policy and its toolset, which was demonstrated during the global economic crises and continues until now, emphasizing the importance of increasing the state regulatory role and the direct policy.

## II. ARMENIA DEVELOPMENT STRATEGY (ADS) PRIORITIES AND MAIN OBJECTIVE

### 3. THE ADS TIME COVERAGE AND PRIORITIES

37. The ADS covers the period of 2014-2025 and is the country's main socioeconomic development strategy and the basis for medium-term, sectoral and other program documents.
38. Being the primary guide of the Government, ADS is based on the following four priorities:
- 1) Priority 1. Growth of employment;
  - 2) Priority 2. Development of human capital;
  - 3) Priority 3. Improvement of social protection system; and
  - 4) Priority 4. Institutional modernization of the public administration and governance.
39. During the first five years of ADS, employment growth will be recognized a key priority, highlighting activities aimed at creation of quality, well-paid jobs<sup>3</sup>. The activities of the RA Government will be directed at the creation of possibilities for everyone to get fair income according to the working efforts exerted.
40. Activities aimed at *development of human capital* will be geared at enhancing the scope, quality and accessibility of primary services (including healthcare, education, science, culture and primary infrastructures) with a special emphasis on nature-human relationships and harmonious development as well. The activities aiming at personal development of the citizen of RA, his/her professional growth, civic education and enhanced cultural level will be always under the strong focus of the Government, fostering the willingness of each person to live in the homeland.
41. Activities aimed at *improvement of the social protection system* will be geared at improvement of the effectiveness of current systems (including improvement of the targeting) and creation of the basis for financial stability in the long-term, ensuring provision of comprehensive social guarantees, essential reduction of social risks and reduction of poverty. At the same time, activities will be implemented in the medium term to gradually transit from delivery of primarily monetary social aid to vulnerable population groups to provision of needs-based complex packages of social assistance. Implementation of the program will guarantee for each member of the society the strong feeling of being protected and socially secured by the own state.
42. Activities aimed at *institutional modernization of the public administration system* will adhere to the adopted fundamental policies and will be geared at improving the public efficiency, growth of public resources and their targeted use, improvement of service quality and accessibility, reduction of corruption, transparency of decision-making, and increased civil society participation in these processes.

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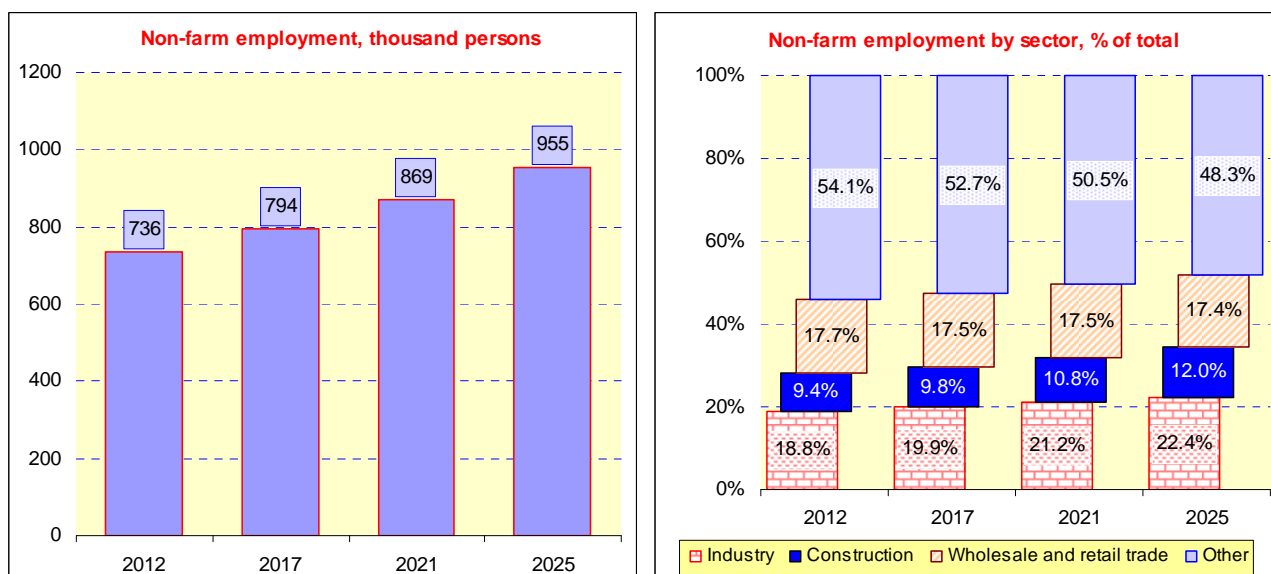
<sup>3</sup> Quality job ensures physical and psychological well-being of the employed person, as well as creates sense of job satisfaction.

#### 4. ADS MAIN OBJECTIVE, POLICY DIRECTIONS AND TARGETS

43. The main objective of the ADS is increase in employment through creation of quality and well-paid jobs.
44. Employment increase will be the measurable outcome of implementation of the sustainable economic growth policy. Policies ensuring sustainable economic growth, which creates new quality jobs, have systemic nature, i.e. they will flow from the priority of the primary objective by promoting its achievement or at least not hampering it.
45. Highlighting the importance of framework policies aimed at main program objective, they will be complimented by financial, credit and monetary tools geared at increase of jobs and reduction of unemployment.
46. In monetary policy these tool will be aimed at increasing accessibility and affordability of borrowings.
47. Along with framework policy aimed at increase of the country's international competitiveness, as well as improvement of business environment and investment climate, a special importance will be given to modern industrial and export with direct interventionist elements aimed at job creation.
48. When designing such policies sector specifics and conditions of job creation will be taken into consideration. Particularly the policy will differ based on labor-intensive and modern academic sectors. Special emphasis will be placed on regional specifics of employment which will be viewed within direct regional development intervention mechanisms.
49. Unlike the previous economic development phases, when economic growth was ensured mainly due to work productivity increase, the planned activities will result in the following picture: during 2014-2025 in non-agriculture sector of economy about 4/5 of percentage point of economic growth will be ensured through productivity and 1/5 through employment growth. In industry, which will be the one of the main sectors contributing to increase in employment, the growth proportions will be 3/4 and 1/4, correspondingly.
50. As a result of the implemented activities it is expected to achieve the following targets of employment growth in non-agriculture sector:
  - Employment growth of around 60 thousand by 2017 vs. 2012,
  - Employment growth of around 135 thousand by 2021 vs. 2012, and
  - Employment growth of around 220 thousand by 2025 vs. 2012.
51. In addition to employment growth, an increase in formality of non-agriculture employment is envisaged as well, which is planned to reach 78% in 2017, 80% in 2021, 83% in 2025, as compared to 73% recorded in 2011.
52. Apart from employment growth, the program envisages also employment structure changes (Figure 1) due to the fact that around 50% of employment growth will be assigned to industry and construction sectors. As a result it is expected that in 2025 the share of industry in non-farm employment will increase by around 3.5 percentage points as compared to 2012, and will make up 22.4% and the share of construction will increase by 2.5 percentage points reaching 12% in 2025..



**Figure 1. Non-farm employment in 2011-2025**



53. Expansion of jobs in industry will be ensured mainly by creation of quality jobs, characterized as above-medium productivity and salary job places.
54. Expansion of jobs in construction will be ensured through recovery of economic growth in the sector (in average, 6.0-6.5% annually), as well as framework policy promoting increase of employment formality and reduction of shadow activity in the sector.
55. As for employment in the services sector, here also absolute employment increase is expected, though at a slower rate, which will reduce the share of employment in services in the structure of non-farm employment. Projections of such developments are explained with the fact that along with sectors that have big potential of growth and expansion in the services sector (in particular, information technologies and tourism infrastructures) there are sectors with employment surplus as well.
56. Viewing employment growth as the main socioeconomic development objective for the coming years, **the income policy** actions and measures will be designed with the logic, that salary increase should not exceed the productivity increase, thus not allowing increase of the unit labor costs<sup>4</sup>, which is critical for the increase of the country's international competitiveness.
57. At the same time, the minimum salary acierated increase policy will be implemented, one of the main goals of which is drastic reduction of working poor. This policy will result in net minimum to average salary ratio sharp growth, reaching around 40 % in 2014 (versus 26.8% in 2012) and this level will be retained until 2025. With planned increase by 2017 net minimum salary will make up around 160% of the upper poverty line, reaching 240% in 2025 as compared to 88% in 2012.

<sup>4</sup> Unit labour costs (ULC) measure the average cost of labour per unit of output and are calculated as the ratio of total labour costs to real output.

### III. MACROECONOMIC FRAMEWORK

#### 5. 2008-2012 MAIN MACROECONOMIC DEVELOPMENTS

58. The actual developments of macroeconomic indicators, particularly the rates of economic growth, have significantly deviated from the scenario forecasted for macroeconomic indicators by the Sustainable Development Program, which is largely result of the impact of the global financial and economic crisis of 2008. In Armenia, as well as numerous other countries, development programs were replaced by anti-crisis programs because of the uncertainties of medium-term and long-term forecasts. Already in 2009, the application of the principle of following MTEF and long-term development programs, which was exercised for a continuous period not only in Armenia, but also in a number of other countries, was temporarily halted. Formerly, prominent international organizations revised their short-term economic forecasts 1-2 times per year, while in 2009 those organizations revised their forecasts repeatedly<sup>5</sup>.
59. The considerable worsening of the global economy had a negative impact especially on countries with open economies, including Armenia. The main reason behind the relatively deeper decline in Armenia were the specific structural characteristics of economic growth in Armenia - the high rates of economic growth in 2000-2008 were the result of the unprecedented growth of non-export sectors, specialty construction, which was the result of the sharp increase in capital inflow into Armenia and concentration of the capital in the construction sector. The evidence proving that fact is that 10.5 percentage points of the 14.1 percent decline recorded in 2009 was the share of the construction sector. But it is important to note that regardless of the serious decline recorded in 2009, it was possible to avoid macroeconomic destabilization in the post crisis period due to the coordinated monetary and fiscal policies, and economic growth tendencies were recorded already in 2010-2013. Characteristically, the structure of economic growth considerably improved as well with a larger share of export sectors, which will give a new quality and sustainability to the formation of future economic growths. Nonetheless, it must be noted that after the crisis and high rates of economic growth, the Armenian economy was naturally make the transition to lower rates of economic growth, which will nevertheless be of higher quality and more resistant to shocks, which is very important considering the uncertainties of current global economic developments.
60. The above mentioned characteristics of economic development are reflected in the development of different sectors of the economy, as well as directions of the enacted macroeconomic policy.

##### 5.1. THE REAL SECTOR

61. In the pre-crisis period of 2003-2008, an average annual economic growth of 12 percent with the participation of all the main sectors of economy was recorded in Armenia, but the main contribution to the GDP was made by non-export sectors of the economy<sup>6</sup> at an annual average of 8.3 percent. As a result, in 2003-2008, the share of non-export sectors of the economy significantly increased in the structure of the GDP - rising from around 47 percent of

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<sup>5</sup>For example, the team drafting the IMF published World Economic Outlook report changed economic growth/decline indicators for the European Union four times in the period of December 2008 to June 2009.

<sup>6</sup>Non-export sectors are services and construction sectors.

the GDP to 59 percent. However, during the crisis and the following years, the structure of economy was adjusted and the share of export sectors of the economy increased. In 2009, an unprecedented high rate of economic decline was recorded in Armenia at 14.1 percent, and later in 2010-2013 growth rates were recorded in the economy at an average of 4.4 percent, which was a modest, but qualitatively different growth compared to the pre-crisis era and was characterized by the relatively higher diversification of structure of economy.

62. The share of the construction sector in the GDP increased and reached 25.3 percent in 2008, with an accelerated increase of the share in GDP (on average 26 percent in 2003-2008). The unprecedented growth of construction in the pre-crisis period was mainly due to private investment, especially the increase in the volume of housing construction. The reason behind the construction boom was monetary transfers from abroad and, in parallel, the higher rates of increase in savings of the population compared to previous years<sup>7</sup>. Naturally, because of the significant decline in monetary remittances in 2009, the construction sector recorded a serious drop of 41.6 percent. After the crisis, the construction sector did not recover its former high levels and as of 2013 continued to decline. Thus, during 2010-2013 construction sector declined on average by 4.2 percent annually. As a result, the share of construction in GDP in 2013 was 10.3 percent. But characteristically, after the crisis, despite the decline in private housing construction, the share of industrial construction aimed at the real sector improved and recorded a growing trend.
63. The share of services in the GDP in 2008 amounted to 33.7 percent because of the high level of demand for services in the preceding five years, which, in its turn, was the result of the high rate of growth of incomes. In the pre-crisis period (2003-2008), the average growth rate of the sector amounted to 12.2 percent, which was mainly the result of growth in non-export subsectors – trade, transport and communication, as well as the financial mediation sector. The decline in services during the crisis was relatively modest at 3.3 percent and was mainly impacted by trade, transport and communications subsectors. In 2010-2013, services increased on average by 5.1 percent, serving as one of the engines for GDP. In 2010-2013 as well, the growth in services was based on the above-mentioned subsectors, but compared to the pre-crisis period, the role of trade declined and the contribution of services related to export in the total growth of the services sector increased to some extent.
64. The industrial sector had the smallest share in the GDP in 2008 (the average growth in 2003-2008 amounted to 3.8 percent), which was the result of a number of factors. First, during the economic upturn in 2006, the industrial sector had a 2.5 percent decline, the main cause of which was the 11 percent decline in the production volumes of electricity, gas, water and steam, as well as the decline in the production volumes of processing industry subsectors, in particular chemical production, diamond processing and tobacco production. In addition, the growth of the industrial sector throughout the mentioned period was stifled due to the unfavorable export price environment. During the crisis, the industrial sector had a 6.9 percent decline, mainly as a result of the reduced demand in the global and domestic markets and the decline in foodstuff and construction material productions. After the crisis, growth in foodstuff and beverages production, as well as mining and metallurgy, contributed to the industrial growth, which was impacted by the anti-crisis policy implemented by the government, creation of a relatively favorable price environment for exports (currency exchange rate and international prices of raw materials), and the global economic recovery. Characteristically, the

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<sup>7</sup> The high growth rates of monetary remittances in the mentioned period resulted in the manifestation of the “Dutch disease”. As a result of the continuous growth of remittances, the real effective exchange rate appreciated and reduced export competitiveness. As a result, the profitability of non-export sectors -construction and services, increased, and investments were channeled to those sectors.

share of industry in GDP in 2011 amounted to 17.1 percent, compared to the 14.2 percent planned by the Sustainable Development Program for that year, whereas in 2013 it reached 17.4 percent.

65. The share of agriculture in the GDP in 2008 was small and exceeded only the share of industry. In the preceding period, the growth of the sector (on average 7.4 percent in 2003-2008) was the result of higher intensity in the sector and natural climatic conditions. During the crisis, agriculture was the only sector recording a growth rate (6 percent). However, 2010 was a turnaround year for agriculture because of the unfavorable natural climatic conditions, as a result of which the sector recorded a decline of 16 percent, mainly because of the decline in the crops farming subsector. In 2011, the sector began to recover as a result of favorable natural climatic conditions in the number of programs implemented by the government<sup>8</sup> and made the highest contribution to the economic growth. The sector continued to grow in 2012-2013, and the value added of the sector increased on average by 8.8 percent annually with respect to the preceding year. The share of agriculture in GDP in 2011 amounted to 20.3 percent, compared to the 14.2 percent planned by the Sustainable Development Program.
66. Under the above-mentioned pre-crisis developments, the accelerated growth of the construction sector and the high initial share of the services sector in the GDP had resulted in reduced shares of the industrial and agricultural sectors in GDP. After the crisis, the structure of economy changed. The construction sector, which was the main engine of economic growth in the preceding period, shrunk and state continues to shrink as a percentage of GDP. As a result, in 2010-2013, the contribution of sectors with better perspectives and export potential to the GDP increased, and the share of construction declined by 15 percentage points compared to the level in 2008 and amounted to 10.3 percent.
67. As a result of the high rates of economic growth and large volumes of remittances received from abroad, changes had taken place in the ratio of consumption and savings in the pre-crisis period, national savings were increasing, the major part of which, basically bypassing the financial sector, became investments. In those conditions, the volumes of especially private investments were increasing, including investments in the housing construction sector. As a result, the share of investments and national savings in the GDP increased in 2008 amounting to 41 percent and 32 percent respectively. During the crisis, the share of investments in the GDP declined sharply mainly because of the decline in the volume of private monetary remittances, and national savings declined even to a larger extent. In 2010-2013, investments continued to shrink parallel to the decline in the volumes of housing construction. National savings have also declined compared to the pre-crisis period, but certain improvement is noticed since 2011.
68. As a result of the mentioned economic development trends, the per capita GDP in US dollars in 2008 amounted to 3606 US dollars, compared to 740 US dollars in 2002. But it declined sharply in 2009 and started to recover gradually in the post-crisis period – 3,447 US dollars in 2013.

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<sup>8</sup> In 2010-2011, the government initiated a number of measures – the subsidizing of interest rates on credits, ensuring the market chain for agricultural products, seed production for wheat and barley, development of organic agriculture, development of local bio-fertilizers, refurbishment of agricultural machinery.

## 5.2. PRICES

69. Consumer price increase (12 months) in 2008-2013, amounted to an average annual of 5.8 percent, compared to the planned annual 4 (+/- 1.5) percent. Price increase was mainly result of the global financial and economic crisis and the rapid changes of natural climatic conditions impacting the agricultural sector, as well as due tariff increase for energy resources. In 2008, the main reason for deviation from the forecasts of price rises was the price increases of food, including cereals and vegetable and animal fat, as well as fuel, especially in the first nine months, while in 2009, despite the price drops recorded in the first nine months, price rises were the result of higher prices of food and non-food goods in the international markets because of the more active global economy at the end of the year and the impact of the implemented expansive monetary-credit and tax-budgetary policies. And the consequences of these developments continued also in 2010.
70. Characteristically, the environment of price rises further worsened in 2010, because of the reduced demand for agricultural products and higher tariffs for certain utility services. As a result, only 7.5 percentage points of the 9.4 percent price increase (12 months) in 2010 was due to food price rises, where around five percentage points of price rise was recorded due to higher prices of domestic agricultural products and more than two percentage points of price rise was recorded due to higher prices of imported food products.
71. Nonetheless, in 2011, especially at the end of the year, the price rise environment became softer, as a result of which the price rise for the 12 months of the year was within the target value. Contributing factors were the reduced international prices of basic raw material and food products due to slower global economic growth and deepening of debt problems in the Eurozone, stricter monetary-credit conditions introduced at the beginning of the implemented year and the preventive tax-budgetary policy, as well as larger supply of agricultural products. 2012 was favorable in terms of inflationary developments as 12 months' inflation was around the midpoint of the target and its corridor's lower bound – 3.2 percent. In 2013 increase in energy tariffs brought it inflationary pressure in the first half of the year which was mitigated in the second half also due to mild contractionary macroeconomic environment and inflation was close to its target's upper bound - 5.6 percent.

## 5.3. EXTERNAL SECTOR DEVELOPMENTS

72. In 2008-2009, developments of the export sector of the economy were predominantly impacted by the decline in global demand for specialty nonfood products resulting from the financial and economic crisis, rapid worsening of Armenia's trade conditions and the reduction of foreign currency inflows into the country mainly due to lower level of remittances.
73. At the same time, the relatively lower rates of actual consumption did not result in significant reductions in the volume of imports, which together with the decline in the volume of private remittances, has resulted in a sharp increase in the current account deficit. The current account deficit in 2007 amounted to 6.7 percent of the GDP, while in 2008 it increased sharply up to 11.8 percent - constituting 1,382 million US dollars. At the same time, in 2008, the inflow of capital and funds somewhat increased amounting to a total of 1,147 million US dollars. As a result, there was a deficit of payment balance in 2008, which resulted in reduced net external assets of the Central Bank.
74. Despite certain improvement of the trade balance, because of the sharp decline of GDP, the deficit of current account as a share of GDP further worsened in 2009 amounting to 16.2

percent of the GDP. Nonetheless, due to the recovery of the global economy, formation of optimistic expectations and implementation of the package of anti-crisis measures by the government, the current account began to improve in 2010, amounting to 14.8 percent of the GDP.

75. The improvement trends of the current account continued in the following years, coming down to 9.1 percent of GDP in 2013. The share of export increased from 15.1 percent in 2008 to 25.1 percent in 2013, while if mining and non-precious metals production and precious stones exports are excluded, the share of export amounted to 18.6 percent of the GDP (compared to 9.1 percent in 2008).

#### **5.4. PUBLIC FINANCE**

76. 2008 was unprecedented with regard to a collection of tax revenues and tax administration – the revenue/GDP ratio of the consolidated budget increased by 1.7 percentage points amounting to 20.7 percent. But already 2009, as a result of further deepening of the consequences of the crisis, the drop in GDP reduced the volume of the internal resource base of the state and public expenditures were threatened.
77. In conditions of lower rates of tax collection, the government applied for external assistance in order to prevent a sharp decline in expenditures. Due to funds received from international structures and the Russian Federation, social expenditures were made to the full extent, avoiding a sharper decline in GDP and significant worsening of social conditions, as well as a considerable increase in the level of unemployment. A significant portion of the received funds were channeled to the most important sectors of the economy and development of infrastructures, partially through sub-loans. As a result, despite the reduced ratio of taxes/GDP of the consolidated budget in 2009 down to 20.5 percent, the expenditures/GDP ratio increased by seven percentage points amounting to around 30.2 percent.
78. Naturally, indicators for the deficit and external debt also rose. The level of deficit/GDP in 2009 constituted 7.5 percent, which was in unprecedented indicator in Armenia's history. Overcoming the further deepening of the consequences of the financial crisis, in conditions of the recovery of the economic growth rates in 2012-2013, the government made the transition to the exit strategy, as a result of which indicator for deficit shrunk considerably amounting to only 2.8 percent of the GDP in 2011. Due to efficient fiscal policy decline of the deficit continue also in 2012-2013 and it reached to 1.6 percent of GDP in 2013. In 2008-2011, on average, regardless of the consequences of the crisis, as a result of improved tax administration, budget revenues of the consolidated budget as a share of GDP were higher compared to the actual level in 2007 as well as the planned levels for 2008-2011. Improvement of tax administration continued also in 2012-2013 contributing to high rates of tax collection.
79. In particular, the average ratio of actual tax revenues/GDP in 2008-2011 was 1.8 percentage points higher than the same indicator for 2007. Naturally, the average expenditures/GDP ratio for the mentioned period was significantly higher than planned level at 22.1 percent and amounted to 27.3 percent. As in previous years, in 2012-2013 also the major part of budget revenues came from tax revenues. During the last two years tax revenues to GDP ratio improved by 2.9 percentage points reaching 24.0 percent in 2013, while public expenditures to GDP increased by 0.6 percentage points with respect to 2011 constituting 27.4 percent in 2013.
80. The increased share of social expenditures, which was particularly significant in 2009, can be noted as one of the main changes to the expenditure structure. In the structure of

expenditures share of expenses on commodities and services has increased. At the same time it is worth to note that share of public capital investments decreased. In particular increased volumes of external public debt were comparable to the capital investments made during these years.

81. Public debt. As already mentioned, the external public debt of Armenia significantly increased during the crisis and post-crisis years, amounting to 35.7 percent of the GDP in 2009 and 34.7 percent and 37.5 percent in 2010 and 2013 respectively, but, due to external assistance, it became possible to avoid shocks in the financial system, as well as create conditions for restoring economic growth rates.

## **6. PROJECTIONS OF 2014-2025 MACROECONOMIC FRAMEWORK**

82. For the forecasting of the macroeconomic framework of the program, the directions and objectives of reform programs of the government, including pension reforms, as well as the main priorities for enhancing the competitiveness of the country - competitiveness of the economy, capacity building for human capital and economic institutions, were taken into account. The experience of the crisis revealed that the main precondition for sustainable development of the economy is the effective structure of the economy based on the development of export-oriented sectors.
83. At the same time, program forecasts have taken into account macroeconomic developments for 2013 and other existing programs, while macroeconomic forecast indicators for 2014-2017 contained in the midterm planning documents and other target indicators have been approximated. As a result, the approaches to the forecasts presented in the program are specifically different from the forecasts made in previous long-term programs. The main difference is that the macroeconomic framework presented in the program is somewhat more optimistic, since the main macroeconomic indicators are brought closer to target indicators, thus requiring more effort from the state governance system to achieve the target indicators, which will result in more accelerated development in income generation and poverty eradication.
84. The main precondition for expanding the possibilities for poverty eradication and income redistribution will still be the long-term sustainable economic growth. Increase in the number of jobs, production of goods corresponding to modern international competition requirements and training of specialists will, on the one hand, result in higher incomes from employment, and on the other hand, will contribute to a larger basis for state budget revenues and will expand the possibilities of the policy for redistribution of incomes implemented by the state.
85. Considering the developments of the Armenian economy in the previous years, the behavior of factors impacting the development, as well as the progress of reforms for strengthening the institutional basis of the economy, Armenian economy has recovered and in 2013 has surpassed the pre-crisis period level. For the forthcoming 12 years it is forecasted that the economy will continue to develop at sustainable rates, ensuring around 5.5 - 6.5 percent of annual growth rate.
86. From 1994 up to the crisis, the Armenian economy grew continuously, on average at almost 9 percent annual growth rate. And in 2003-2008, economic growth accelerated and amounted to an annual average of 12.0 percent. Although the economy declined as a result of the crisis, but as a result of the policy for promoting exports, the enactment of which started in 2010-2011, in the long run, it will be characterized by quite high and export-oriented economic indicators. At the same time, during the program period nominal average annual GDP growth

in US dollars will be around 9 percent, as a result of which GDP per capita will triple in 2025 compared to the level in 2013 and will constitute about 9,500 US dollars.

87. During the crisis period significantly expansive tax-budgetary policies were implemented in all countries in crisis, including Armenia, the result was a substantial increase in Armenia's foreign debt, as a result of which ensuring the necessary conditions for debt stability has become especially important for sustainable development of the economy. Based on the above-mentioned, international organizations and governmental bodies in Armenia attached importance to the necessity of resolving the issue and medium-term and long-term analyses of debt sustainability were conducted. Concluding the assessments of all the analyses, it can be stated that baseline scenarios for all the models used for analysis did not identify any serious threats, although models signaled the need for enacting a policy for reducing debt in the coming years. Nonetheless, shock tests conducted under the baseline scenario reveals that situation worsens but does not result in instability, and the stability of public debt is more sensitive to national currency depreciation and lower GDP growth rates. The long term low level of GDP growth rate is the main factor having a negative impact on fiscal stability. Consequently, the first priority of macroeconomic stability is to ensure high rates of economic growth, which, in its turn, will prevent the depreciation of national currency, since GDP growth assumes larger the amount also with regard to the national currency, which can counteract the depreciation pressures. Another conclusion of the analyses is also important, according to which the level of debt stabilizes more rapidly if the growth of tax revenues is faster than the growth of GDP, considering the fact that Armenia has such a possibility, since the assessed potential level of tax revenues is far from the level of actually collected taxes. The mentioned analyses have also served as the basis for forecasts of the macroeconomic environment, as a result of which, under the forecast of macroeconomic developments at the basis of the program and the planned directions of tax-budgetary policy, risks related to repayment of debt will continue to be at a low level in the long run. Characteristically, after the stabilization of the primary deficit of the budget in the medium-term, significant adjustments for deficit reduction in the long term would not be necessary for maintaining the low level of risks related to repayment of debts. This means that in case of possible economic instability, the tax-budgetary policy will have some flexibility from the viewpoint of promoting economic growth if necessary. However, for the near future years, the tax-budgetary policy is limited with regard to the promotion of economic growth and thus the monetary-credit policy should be more flexible, maintaining, at the same time, a high level of coordination with the tax-budgetary policy.

88. The following developments are forecasted with regard to the main macroeconomic indicators:

- 1) **The real sector.** In the planned period of 2014-2025, the GDP will have a growing trend, the rate of which will exceed the average rate of the period 2012-2011 and will be in the range of 5.5-6.5 percent. These developments will take place as a result of the following planned changes to the existing sectoral structure of the GDP. The export sector in the structure of the GDP will have the leading role and will be the engine of economic growth, mainly thanks to the industrial sector, as well as the services sector, and will serve as the sector promoting economic activity. Incentives of economic growth will gradually move to sectors operating based on expanded capital and scientific potential. In other words, high productivity sectors will gradually take the lead<sup>9</sup>.

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<sup>9</sup> The experience of development of countries in the global economy reveals that countries' economies undergo a number of transformations in their development process. The first one is the development of production of import substitutes. The subsequent one is the growth of exports at the expense of labor-intensive sectors (competitively



- 2) **Consumer prices.** Considering the recent developments in the global market, some slowdown of global economy development rates, as well as the instability of the geopolitical situation, it is forecasted that the price rises environment will be formed under various economic factors which will result in a possible continuation of price rises fluctuations. At the same time, it is generally forecasted that the impact of those factors on price rises will be balanced. Developments of the domestic economy, in conditions of certain decline in consumption growth and accelerated increase in savings, will also have a balanced impact on the price rise environment. After anticipated price level increase in 2013 due to gas price growth, the forecasted price rise will be within the target value at around 4 percent in 2014-2015. The long-term effective management of price rises will be ensured by continuing to follow the principle of price rise targeting adopted by Central Bank, which has proven to be effective also in the period of financial and economic crisis, when it was necessary to implement a flexible monetary-credit policy. The Customs Union membership's initiated process will contribute to more predictable price levels, as it will become possible to avoid sharp changes in the prices of energy resources. Within the process of stabilization of global economic conditions and the transition of the Armenian economy from low value added to high value added production (more expensive goods), which will be achieved through the development of the industrial sector, it is planned to decrease the difference between the value of the GDP deflator and the CPI in the long run.
- 3) **Structure of GDP by expenditure components.** The share of investments will be stabilized in the upcoming 12 years at the level of 26-27 percent of GDP. At the same time, it is expected that in the forecast period, the trend which began after the crisis will be prevalent in the investment structure – capital non-industrial construction (especially dwellings and buildings) will decline, reflecting the GDP sectoral developments mentioned above. In the mentioned situation, investments as a share of GDP will exceed the level recorded in post-crisis years, and the level of industrial investments will be adequate for the development of other sectors of the economy. This means that investments as a share of GDP, amounting on average to 24.1 percent in 2010-2012, will increase in the long run reaching on average 26.6 percent and will contribute to more effective and industrial investments.
- 4) **Monetary sector.** Forecasts of the monetary sector indicators have been made based on the assumption that the medium-term price rise should remain within the range of the target value of 4 (+/-1.5) percent, as well as the need for meeting the demand for money that would be necessary based on the forecast of external and domestic economic environment. In these conditions, a further increase in the level of financial mediation has been planned, although in slower rates, which, however, in conditions of the accelerated growth as a share of GDP, will result in a decline in the velocity of money circulation and higher level of monetization of the economy. It is expected that the level of dollarization of the economy will decline down to its pre-crisis level. It is also planned to further expand the diversity of monetary tools and the volume of the financial market, while transition to funded pension system and measures aimed at increase of corporate governance quality will contribute to that goal. Under these trends, savings in Armenian drams will have more accelerated growth compared to savings in foreign currency. On the other hand, the

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lower wages), then it is the transition from labor-intensive sectors to capital-intensive sectors, and the last phase of the transformation of the economy is the transition from capital-intensive sectors to high-technology or so-called knowledge-based sectors. The mentioned scenario was used for macroeconomic forecasts at the basis of the ADS, i.e. transition from labor-intensive sectors to capital-intensive and then knowledge-based economy.

improved quality of banking services parallel to the reduction of the gray sector of the economy, the increase of demand for money would be mainly in other forms than cash money. As a result, the share of cash in money supply would gradually decrease in the favor of non-cash money, amounting to around 17 percent in 2025. At the same time, the level of monetization of the economy reaches to 45.5 percent in 2025.

- 5) **External sector.** The external sector developments will be impacted mainly by domestic economy development, continuation of the qualitative changes to the structure of economy, as well as the process of integration of the Armenian economy into regional cooperation formats and international economy in general. In particular, these developments will be crucially conditioned upon processes associated with Armenia's membership in the Customs Union with Russia, Belarus and Kazakhstan. Membership in this Customs Union will provide to local producers easier access to a consumers' market with more than 170 mln population. Given that quality criteria on this product and services market being more achievable for the local producers, already in short term in a number of markets Armenian products will gain its competitive and constant position. ON the other hand, membership in the Customs Union will enable cheaper import of energy resources, which will boost competitive supply from local market. In particular it is expected that integration process will be quite smooth and fast given common historical, language, cultural and behavioral background of Armenia and the countries involved in the Union. In the mid and long term perspective Armenia will have a real possibility to carry out expanded external economic activities. On the one hand possibility of enjoying "GSP+" privileged trade regime granted by European Union, and on the other hand advantages of Customs Union membership will create important preconditions for becoming a specific crossroad for EU-Customs Union economic relations and trade flows. Within this context, it is forecasted that export will grow relatively faster compared to import, in particular due to significant increase in the volumes of export-oriented industrial production. In these conditions, the increased demand for imported items will basically coincide with GDP growth rates. Under the mentioned development, in the coming years, the negative balance of goods and services as a share of GDP will gradually decrease amounting to around 4.5 percent in 2025 compared to 24.8 percent recorded in 2012, and the reflect the impact of the high rate of growth of the more productive sectors of the economy, which will also result in larger exports of competitive goods and services. It is forecasted that the ratio of current account deficit/GDP will have almost the same behavior. The current account will gradually improve up to 2025 and by the end of planning period will be around 3.8 percent of GDP. These developments will be in line with the formation of higher levels of savings compared to investments, resulting from accelerated growth of incomes at the disposal of the population, and lower levels of foreign debt as a percentage of GDP.
- 6) **Fiscal sector indicators.** Long-term forecasts for fiscal indicators were done based on the fact that fiscal policy should be anti-cyclic, i.e. when the economic growth slows down it should be growth promoting and vice versa. However, developments oblige (explanation of this obligation is presented in box 1) to implement a fiscal policy for debt stabilization in the medium term, which limits economy expanding impact of fiscal policy . Given these limitations the deficit will be decreased in the midterm and will fluctuate around and 2.0 percent of GDP, as a result of which it would become possible to smoothly decrease the indicator for public debt as a share of GDP, and tax revenues as a share of GDP will continually so that the debt can be stabilized more quickly. As for the long-term, anti-cyclical fiscal policy will be possible, under the conditions of tax revenues growth of 0.3-0.4 percentage points of GDP annually. In the programming period the level of public capital

expenditures will be from 1.5 to 2.5 percentage points higher than the levels of deficit, which will create sustainable basis for long-term economic growth.

**Table 1. ADS macroeconomic framework: projection of main indicators**

Indicators	2011	2012	2013	2014	2017	2021	2025
	<i>Actual</i>	<i>Actual</i>	<i>Prelim.</i>	<i>Projections</i>			
<i>(in percent of GDP, unless otherwise indicated)</i>							
<b>National income and prices</b>							
Real GDP, year-on-year % change	4.7	7.2	3.5	5.5	6.1	6.4	6.5
Gross Domestic Product, million US dollars	10,142	9,950	10,416	10,928	12,759	19,141	28,753
Gross Domestic Product, billion drams	3,778	3,998	4,267	4,700	6,232	9,350	14,045
Per capita GDP, US dollars	3,358	3,290	3,447	3,589	4,171	6,252	9,441
GDP deflator, year-on-year % change	4.3%	-1.2%	3.2%	4.4%	4.0%	4.0%	4.0%
<b>Investments and savings</b>							
Investments	27.9	23.8	20.8	24.5	26.7	27.2	26.9
General government	5.4	4.0	3.6	3.5	3.1	4.0	4.2
Other	22.5	19.8	17.2	21.0	23.6	23.2	22.7
National savings	16.0	12.2	10.5	16.1	21.5	21.3	23.2
General government	1.2	0.9	0.6	1.0	1.3	2.2	2.9
Other	14.8	11.3	9.9	15.1	20.2	19.1	20.3
<b>Fiscal sector</b>							
<b>Consolidated budget</b>							
Total revenues and grants	24.5	24.8	25.8%	24.9%	25.0%	26.5%	27.9%
of which: Tax revenues	21.1	22.5	24.0	23.8%	24.3%	25.9%	27.4%
Grants	1.6	0.5	0.3	0.4%	0.3%	0.2%	0.1%
Total expenditures	27.3	26.3	27.4%	27.4%	26.8%	28.2%	29.3%
Current expenditure	22.5	22.8	27.4%	27.4%	23.7%	24.2%	25.1%
Capital Expenditure	4.8	3.6	24.2%	23.9%	3.1%	4.0%	4.2%
Overall balance	-2.8	-1.5	-1.6%	-2.5%	-1.8%	-1.8%	-1.3%
<b>Public debt</b>							
Domestic debt	5.8	6.4	6.6	6.3	7.4	10.8	12.7
External debt	36.4	37.7	37.5	36.6	34.4	24.5	18.7
Total debt	42.2	44.1	44.1	42.9	41.8	35.3	31.4
<b>External sector</b>							
Exports	23.7	24.5	25.1	26.3	31.7	33.0	34.7
Imports	47.3	49.3	49.1	47.7	46.8	42.8	39.2
Current account balance	-10.9	-11.2	-9.1	-8.3	-5.2	-5.9	-3.8

89. Forecasts of the development of economic sector were made with consideration for certain sectoral changes to the economy. In 2014-2025, the increase in the share of export sectors – industry, as well as agriculture, which began after the crisis, will continue. Before the crisis, economic growth was led by construction and services sectors, where the increase in supply was mainly a reflection of that demand formed in the economy, while the increase in productivity of the nation sectors is limited in the long run<sup>10</sup>. Instead of that, export sectors of the economy are forced to work with higher productivity in order to be competitive, and consequently are more promising from the viewpoint of ensuring long-term economic growth.

<sup>10</sup>Another proof is the assessments received from regression analysis, according to which construction and services sectors are largely dependent on the volumes of remittances from abroad.

90. In 2014-2025, the mentioned trends will change to some extent, as a result of a number of structural factors. First, capital investments in industry made in previous years will begin to gradually pay back through increasing productivity, as a result of which the development of the economy and industry in particular, as well as other capital intensive sectors, will accelerate. At the same time, due to increased demand for services provided to the industry and more complicated structure of the economy as it develops, the high rates of increase in added value of services will continue. On the other hand, the growth of industrial sectors of the economy will be followed by higher wages, which will result in the return of Armenian citizens who have left for seasonal work abroad, which in its turn will impact the volume of remittances from abroad. In the light of the above mentioned the following developments are expected:
91. In 2014-2025, the average growth rate of value added created in industry will exceed the GDP growth rate being at a rate of about 8 percent per year. As a result, in the mentioned period, the share of the added value of the sector in the GDP will stabilize at an average of around 19-20 percent. These trends will be manifested in investments made in the sector, and consequently also the acceleration of growth rates of productivity.
92. Considering the specific nature of agriculture, high rates of growth of the agricultural sector are not expected in the entire forecast period, but the productivity of agricultural sector, as well as the volumes of export, will increase. The average indicator for changes to productivity will be around three times higher than changes to productivity in the pre-crisis period. In 2014-2025, the added value of the sector will increase by 3.5-4 percent annually.
93. In 2014-2025, the average annual growth rate of the value added created in the construction sector will be 6.2 percent, and the share of the sector in the GDP will be around 10 percent. Moreover, after the expected decline in 2013, for the first half of the programming period the average growth rate of the sector will be more modest at around 6.0 percent.
94. In 2014-2025, the added value the services sector will continue to grow at a high rate at around 6-6.5 percent annually, which is somewhat faster than the GDP growth rate. As a result, the share of this sector in the GDP by 2025 will grow by 1.2 percentage points compared to 2013 level reaching 42.3 percent.
95. The continuation of such high rates of economic growth, naturally, will not have an inertial nature. That will be necessarily also conditioned by the implementation of a number of structural measures for strengthening the institutional basis of the economy, such as improving the business environment, increasing the effectiveness of investment policy, activities contributing to higher productivity and export sectors and consequently increased competitiveness, as well as development of institutions for increasing educational and scientific potential. Developments planned by the macroeconomic framework of the strategy, by main sectors of economy, are presented in Table 2.

## **7. FORECASTING RISKS**

96. Since forecasting covers the entire economy, the risks also reflect the entire spectrum of economic risks correspondingly. Internal risks can be tentatively divided into two groups. The first group includes risks associated with implementation of reforms, such as problems associated with certain public policy in ensuring competitiveness, reforming business environment and other areas. The second group encompasses undesirable structural reforms

in economy (e.g. deepening revenue inequalities, worsening quality of bank credit portfolio, etc.).

**Table 2. Development of economy by sector: projections of main indicators**

Indicators	2011	2012	2013	2014	2017	2021	2025
	Actual	Actual	Prelim.	Forecast			
<b>GDP by sector, billion drams</b>							
Industry	647.8	687.5	741.6	829.0	1,160.7	1,860.7	2,979.3
Agriculture	767.9	764.0	818.8	889.2	1,116.7	1,524.7	2,046.8
Construction	491.1	489.0	438.5	485.4	645.4	957.7	1,441.3
Services	1,458.9	1,599.0	1,761.7	1,941.3	2,582.1	3,902.1	5,946.1
Net indirect taxes	412.3	458.1	506.3	555.2	727.2	1,104.7	1,631.6
Gross domestic product	3,777.9	3,997.6	4,266.8	4,700.1	6,232.2	9,349.9	14,045.1
<b>Structure of GDP by sector, percent of total</b>							
Industry	17.1	17.2	17.4	17.6	18.6	19.9	21.2
Agriculture	20.3	19.1	19.2	18.9	17.9	16.3	14.6
Construction	13.0	12.2	10.3	10.3	10.4	10.2	10.3
Services	38.6	40.0	41.3	41.3	41.4	41.7	42.3
Net indirect taxes	10.9	11.5	11.9	11.8	11.7	11.8	11.6
Gross domestic product	100	100	100	100	100	100	100
<b>Growth rates by sector, year-on-year percent change</b>							
Industry	13.6	7.0	4.9	6.9	8.2	8.1	8.2
Agriculture	14.0	9.5	8.1	4.0	4.0	3.8	3.5
Construction	-12.2	3.3	-11.2	6.0	6.0	6.5	6.5
Services	4.7	6.5	5.3	5.6	6.3	6.8	6.8
Net indirect taxes	3.8	9.9	2.9	5.0	5.5	6.0	6.0
Gross domestic product	4.7	7.2	3.5	5.5	6.1	6.4	6.5

97. As regards the mentioned risks, it is critical to identify specific risks for each sphere and/or program, as well as qualitative assessment of the likelihood of their impact and manifestation and definition of the risk management mechanism.
98. As for the internal environment, there is also a non-human factor related risk, i.e. the risk of unfavorable natural and climate conditions, which if persists, will have a negative impact on the planned agriculture growth.
99. A number of nature and technology driven risks are specific to RA territory and realization of those will disrupt the normal economic development process putting the country into a crisis.
100. The risks related to forecasts are associated with external economic factors of not less importance. It must be noted that Armenia, as a small country with an open economy, reacts rapidly to economic developments in partner countries. As a result, the main risks of forecast are largely dependent on macroeconomic changes in the global economy. At the same time, it is important to take into account that the main risks are assessed for the medium-term and long-term assessment is not available.
101. Another group of external risks is associated with the membership of Armenia in Customs Union with Russia, Belarus and Kazakhstan and Armenia's decision not to sign Association Agreement with EU and refuse participation in the Deep and Comprehensive free trade area. Decrease in investment attractiveness for European investors, possible need to revise relations with WTO other parties, as well as possible difficulties associated with the export to EU market (in particular for mining products, which have small share in country's overall GDP but have large portfolio in export structure) may cause negative expectations among the local producers in the short and mid term perspective and urge them to change strategic development plans. In particular, as a result of diminishing external financing (due to decrease in budget assistance

and investment projects by EU) internal risks may emerge with respect to finalization of already initiated and/or planned reform projects.

102. The global economy continues to develop under significant uncertainties, which, in case of possible emerging risks, forces us to assess the possible deviations from forecasts at the basis of the program and the necessary steps for neutralizing those risks. In this regard, the main influences on the Armenian economy might emerge from adverse developments in the economies of Customs Union member states or further deepening of the debt crisis in the European Union. This situation can directly or indirectly reflect on the economic growth, price rise environment, currency exchange rates and other macroeconomic indicators.
103. It should be taken into account that even in the worst-case scenario of the deepening of the European Union crisis; the global economy will not be impacted as severely as during the crisis of 2008-2009. But the possible new crisis can be manifested in a longer period of time, but to a lesser amplitude, which will allow for implementing more flexible anti-crisis measures.
104. Customs Union member and Armenia's main economic partner – Russia's economy is particularly sensitive to volatility of prices on international energy resources markets. Decrease growth rate trend of Russia's economy in 2013 may have its adverse effect on Armenia's economy as well.
105. At the same time, USA and Japan continue facing strong fiscal policy stability problems, which are expressed in form of fiscal adjustment timing uncertainty. This may lead to negative expectations among investors adversely impacting the economic growth rates in those countries. As a result, demand for goods exported from Armenia may diminish and the prices for metals may go down.

## **7.1. RISK IMPACT DIRECTIONS**

106. Though economic activity level worldwide has increased in the second half of 2013, the risks which might result in slower global economy growth still persist and can directly or indirectly impact the Armenian economy. Eurozone has begun to grow after a period of decline, but debt issues in some of European countries still persist and can cause decline in economic growth in European countries, which can be transferred to Armenia's economy in the ways considered right below.
107. Direct impacts will be the result of lower rates of export to bilateral trade partners in the Customs Union (mainly Russia) and European Union (mainly the Eurozone), as well as reduced volumes of capital investments from them. The share of the European Union in Armenia's trade turnover 2013 amounted to 27.8 percent, whereas Russia's share was around 24.3 percent. While the share of EU and Russia in total foreign investments for the same year was around 51.2 percent. Apart from that share of Russia in the net inflow of non-commercial remittances amounted to 92.3 percent in 2013. Thus, delay of common solution to structural problems in Eurozone and deepening of Russia's stagnation trends will impact the economic activity in Armenia through the mentioned channels.
108. The indirect impacts can be due to risk of economic activity decline in developed countries conditioned upon low inflation levels in those countries (mainly Eurozone) and crisis in the European Union will spread specially to countries with huge volumes of trade with the European Union, including Russia, where the share of trade turnover with the European Union in 2011 amounted to around 48 percent. On the other hand, slower rates of economic growth in Eurozone to higher extent and in Russia in lesser extent can have adverse impact on the

overall global demand. If in these conditions, the US also implements a more preventive tax-budgetary policy, then the decline in the global demand will become more substantial. These developments will also impact the demand for mainly nonfood goods in international market, and consequently their international prices will drop. These developments will result in the worsening of trade conditions for Armenia and the decline of exports in dollar terms, which will slow down the economic growth rate. Also due to mentioned factors investment prospects will decline and can cause decrease of foreign investments in Armenia.

109. As a result, developments related to global risks impacting Armenia directly or indirectly can slow down the rates of economic growth, as well as depreciate the Armenian dram.

## **7.2. RISK MANAGEMENT**

110. Formalisation of necessary preventive measures and their consistent implementation is important for the management of catastrophic events, including technology driven and natural disasters.

111. The risks described above can introduce changes to the forecasts at the basis of the macrocosmic scenario of the program, which can be reflected on the level of revenue, and the latter will have an impact on the rate of improvements related to the level of poverty. Consequently, it is important that all steps focus on maintaining economic growth, since the slowing of economic growth will firstly, threaten the objectives of the program, secondly, will disrupt fiscal stability (paragraph 87) and thirdly, declaration of economy growth will at the same time to neutralize the risk of foreign currency appreciation. Thus, ensuring the program forecasted level of economic growth is a priority for neutralizing risks, i.e. tax-budgetary and monetary-credit policies should aim to promote economic growth. In this regard:

- 1) First, the country should quickly diagnose the threats and be prepared for a non-severe but medium-term European economic crisis. With respect to this problem, the country already has some experience with regard to the application of mechanisms and tools. However, the lessons of the previous crisis revealed that capacities for quick diagnosis and response are not available.
- 2) Second, the tax-budgetary policy should have possible alternative directions for quick replenishment of possible additional financial demand, and if necessary also with a surplus, but, at the same time, maintaining the fiscal stability.
- 3) Third, the monetary-credit policies should be flexible so that it can relax monetary-credit conditions one step ahead of the emerging signs of the risks, but, at the same time, maintaining the fiscal stability.
- 4) Fourth, recent developments in transition countries may cause risk of financial flows changes and this must be permanently under the focus.

112. It is also important to note that, during the financial and economic crisis in 2008-2009, the tax-budgetary possibilities were adequate for implementing an expansive economic policy, but the possibilities of tax-budgetary tools for counteracting the upcoming crises are quite limited (see paragraph 87), and thus, in order to expand the economy, priority should be given to the use of tax-credit tools.

## **IV. ADS ECONOMIC DEVELOPMENT STRATEGY**

### **8. ECONOMIC DEVELOPMENT FRAMEWORK POLICIES**

113. The ADS economic policy geared at creation of quality jobs is a mixture of coordinated use of various framework and direct policies and their respective toolsets.
114. An important element of framework policy is the macroeconomic environment, which is described in details in Chapter 3. The framework policies used up to now, such as improvement of the quality of business environment and investment climate, promotion of investments and competitiveness, preventing abuse of dominant or monopoly position of economic entities and their effective control, strengthening of financial intermediation, etc. will be maintained in the frames of the current program.
115. Their main result, in addition to creation of favorable conditions for economic growth, will include increase of the country's international competitiveness as the main aggregate estimate of the framework policies' implementation effectiveness.

#### **8.1. COUNTRY'S INTERNATIONAL COMPETITIVENESS AS AN INTEGRAL INDICATOR OF FRAMEWORK POLICIES**

116. International competitiveness is the country's productivity level, which depends on the institutional level of the country (quality of institutions), productivity factors, as well as policies enacted (The Global Competitiveness Report 2011 – 2012 World Economic Forum). Based on the above-mentioned, enhancing the international competitiveness of the country means increasing the productivity, which depends on the quality of institutions and policies, as well as improvement in productivity factors, and consequently is the main precondition for creating quality modern jobs.
117. Country's international competitiveness level will be calculated using the benchmarks of annual Global Competitiveness Report published by Global Economic Forum and the methodology for their calculation (For international comparison of benchmarks the last report "The Global Competitiveness Report 2013 – 2014 World Economic Forum 2013"). According to that report, in 2013 Armenia ranked 79 among 148 countries, with overall international competitiveness index value of 4.1 (maximum is 7 and minimum is 1) (According to the two previous reports, Armenia in 2012 ranked 82 among 144 countries and 92nd in 2011 among 142 countries).
118. A total of 113 benchmark indicators are calculated for all countries characterizing 12 "pillars" of the economy - institutions and their quality, infrastructures, macroeconomic environment, healthcare and basic education, higher education and human resources training, goods market efficiency, labor market efficiency, financial markets development, technological readiness level, market size, business sophistication level, innovation level.
119. Thus, this system of benchmark indicators almost totally characterizes the economic situation and policy, including also social policy on education and healthcare and can be a very good tool for assessing the results and the quality of the enacted policy in comparison with other countries.



120. It is envisaged that policy drafted and enacted in programming period and its expected results will enhance the international competitiveness of the country significantly and improve the indicators for all the 12 “pillars”. In particular, in 2017 Armenia shall rank 65-70 with an overall international competitiveness index of 4.20-4.25, and in 2025 its rank shall be 50-55 with an overall index value of 4.35-4.40.

## **8.2. BUSINESS ENVIRONMENT AND INVESTMENT CLIMATE**

121. In the program period, the continuous improvement of business environment and investment climate will remain the main priority of the state framework policy to increase the employment, and will be aimed at facilitating the establishment of businesses and investments and reducing significantly undue state intervention. From the viewpoint of foreign strategic investment attraction steady growth of investors’ protection level is important.

122. The benchmark indicators of the World Bank “Doing Business” annual reports, both for individual sectors as well as for the overall quality of the business environment, will be used as a toolset for planning and assessing the policy measures undertaken to improve the business environment<sup>11</sup>.

123. Effective protection of investors’ interests and further development of corporate governance are important also in the light of introduction of compulsory funded pension scheme in Armenia since 2014. The effectiveness of the system will largely depend upon demand by corporate sector for longterm money. Transparent management system is a necessary condition for existence of such demand, which will enable large companies to attract investments not only from pension funds, but also from other participants of the financial market.

124. Despite the large number of activities aimed at improvement of business environment during the recent years and reduction and simplification of state regulations, only in the recently published Doing Business 2013 Report, Armenia succeeded in improving its position both in terms of overall business environment quality indicator and with respect to previously problematic sectors’ indicators. Similar trend was observed in the last “Doing Business 2013” report. Thus, according to 2014 indicator Armenia occupies the 37<sup>th</sup> position for the integral ease of doing business indicator (vs. 55<sup>th</sup> position recorded in 2012). More serious progress was recorded in tax administration (103<sup>rd</sup> position vs. 153 in 2012) and investment protection (22<sup>nd</sup> position vs. 97 in 2012).

125. Further improvement of indicators, particularly of those already enjoying comparatively high ranks, will be conditioned with the enforcement level of already acting laws.

126. It is worth underlining that the negative dynamics observed for the previous years was not because of the deterioration of business environment in Armenia, but due to faster compared to Armenia reforms of the business environment in a number of developing and developed countries<sup>12</sup>.

127. Taking into account the abovementioned, the main priority of the government in this area will be the stark acceleration of the reforms, particularly for the indicators for which Armenia occupies low ranks (tax and customs administration, contract enforcement). The main target is

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<sup>11</sup> Data from the last “Doing Business 2014” (published in 2013) report will be used as the basis for forecasting performance indicators.

<sup>12</sup> According to the methodology, negative movement in the country’s position may be observed even if there are reforms implemented. This may happen in particular, when wider reforms were implemented in the countries occupying adjacent positions in the ranking.

that Armenia ranks among 20 leading countries in 2017 and among 15 countries with the most favorable business environment in 2025 (as of 2012).

128. Regarding the investment climate, the planning and progress assessment of the policies implemented will be based on the benchmark indicators of BEEPS<sup>13</sup> surveys implemented by the World Bank and the European Bank for Reconstruction and Development.
129. The comparison of the BEEPS-2009 and BEEPS-2005 surveys' results reveals that notwithstanding the change in classifications of the main barriers for the entrepreneurship and the investments have changed<sup>14</sup>, according to the enterprises' opinions there has not been recorded an overall improvement in the effectiveness of state governance and regulations from the viewpoint of businesses, despite the obvious progress in some spheres<sup>15</sup>.
130. In the frames of ADS a target indicator of investment environment reforms is Armenia's position among ECA countries, which is defined based on aggregated indicator of investment climate (The aggregate indicator is calculated as the summary of cumulative describing all seven sectors. The latter were calculated as the sum of values of indicators describing these sectors. The indicators' values have been calculated as ECA countries' average and the difference of that indicator related to ECA average). It is expected that in 2017 Armenia will be among the second top 5 countries and in 2025 among the first top 5 (among 26 countries).
131. The main policy elements for continuous improvement of business environment and investment climate for the upcoming years will be the following ones:
- 1) significant reduction in direct contacts of businesses and citizens with the state through the introduction of interagency electronic information exchange systems
  - 2) as a one-time measure reduction and simplification of state regulations (by about 50%) relating to businesses and citizens
  - 3) implement inspections system reform, particularly rationalize their number and functions, and pay greater focus on education and training of human resources, introducing contemporary training processes and evaluation standards.
  - 4) complete implementation of regulatory impact assessment, which will allow for avoiding new regulations creating additional burden
  - 5) regular study of the business regulation and investment climate best practices and their introduction in Armenia with consideration for specific local characteristics.
132. Improvement of the competitive environment plays a critical role in further development of business and investment environment. According to the Global Competitiveness Index Armenia has recorded a positive shift with respect to indicators of intensity of local competition and effectiveness of the anti-monopoly policy. Though recent years saw significant increase of the role and position of the State Commission for the Protection of Economic Competition (SCPEC), nonetheless legislative issues/loops and lack of resources limit effective enforcement of competition policy.
133. As a rule existence of economic entities with dominant or monopoly position and high rate of concentration hinder the formation and consequent development of competitive

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<sup>13</sup> Data from the last BEEPS 2009 report will be used as the basis for forecasting performance indicators.

<sup>14</sup> In particular, the first top three issues in 2005 were tax administration, tax rates and access to financial resources, while in 2009 the issues are as follows: tax rates, access to financial resources and corruption. Crimes, robberies and disorderly conduct, which were the last factor by importance in 2005, became fourth in 2009.

<sup>15</sup> In particular tax administration, which was considered the main hindrance to the development of businesses in 2005, ranked seventh in 2009, and certification and issuing of permissions moved from the sixth placed to the 14<sup>th</sup>.

environment. High concentration rate in some product markets in Armenia has also objective reasons, such as geographical position of RA, closed borders, small economy, high transportation costs that make more efficient larger entities. At the same time there are institutional problems that affect the well functioning of markets for goods and services related to restrictive regulation, distortive state aid, and ineffective enforcement of competition rules and public procurement systems.

134. Effective competition policies and competition protection should not be limited only to the SCPEC activities but should also concern other line ministries and sectoral regulators in order to ensure pro-competition policies in all sectors of the economy. This also requires consistent reforms in addressing problems such as independence of judicial bodies and their capacity building to enable them examine anti-trust cases in line with international practice. It is necessary to improve enforcement of policies in various fields. Widening mechanisms for detecting anti-competitive agreements and regulation of state aid which limits competition will be favorable for the improvement of competition environment in products' and services' markets. In this respect the role of the SCPEC in enabling market competition will continue to remain critical, which makes crucial widening the scope of authorities of the SCPEC and capacity building of its staff. At that, the following measures are singled out to be implemented through relevant legislative changes and revision of the SCPEC functions. Main reforms should include the following:

- 1) Improve the competition legislation and its enforcement. The RA Law "On preservation of economic competition" and the changes in the normative acts based on this law must be aimed at: a) define unified approach of imposing fines based on the turnover of the economic entity in the previous year and ensure their accordance to international practice, b) improve fines payment mechanisms, c) clarify main provisions of the law, explain nature of anticompetitive agreements and the provisions relating to definition and abuse of dominant position, concentrations, unlawful competition practices and administrative actions applied to such entities, d) strengthen the investigation powers of the SCPEC (e.g. wider power to conduct unexpected checks - dawn raids).
- 2) SCPEC needs to move away from focusing on price fluctuations in favor of focusing on actual and potential barriers to entry and market contestability (including during public procurement), given that besides prices, other factors determine effective competition, such as the economic characteristics of the production process, the functioning of the supply chain, and the strategic behavior of firms. As a result, the level and behavior of prices do not necessarily indicate the intensity of competition, and it becomes necessary to look at market behavior.
- 3) Widen SCPEC's advocacy mandate to prevent possible anticompetitive interventions and regulations by state authorities which do or might limit, prevent or prohibit economic competition or result in unlawful competition practices. It is necessary to promote a better understanding of competition principles vis-à-vis other government bodies, public procurement officials and judges. Expansion of the mandates of the Commission in reviewing all sectoral policies and legal acts from the competition point of view is required and it is to enable the suspension by the Commission of decisions or orders (already issued or in draft) by other public administration bodies which restrict competition.
- 4) Strengthen the state aid legal provisions and their enforcement to minimize potential distortive effects on competition.
- 5) Introduce transparency and access to data to guarantee competitive neutrality between market participants to avoid market distortions.

- 6) Remove barriers to entry and competition and mainstream competition principles within broader government policies.
135. The Government will pursue the goal of revealing and eliminating obstacles hampering access to the market for both domestic producers and importers.
136. In order to assess the improvements of competitive environment two figures from Sixth Pillar of the Global Competition Index were taken as an indicator (goods market efficiency), i.e. the intensity of local competition and effectiveness of anti-monopoly policy. Armenia, being in the group of countries in the transition from first to second (efficiency driven) stage, in spite of serious improvement of position in 2013 with respect to previous year, is still far from desired level. Thus, for the intensity of local competition indicator Armenia occupies 102<sup>nd</sup> position, while for the efficiency of anti-monopoly policy 97<sup>th</sup> among the total of 148 (in 2012 for the mentioned indicators Armenia was holding 130th and 116th positions accordingly among a total of 144 countries).
137. It is expected that implementation of activities geared at improvement of the general framework policies and the competition level will result in the following improvements: in 2017 Armenia's rank in intensity of local competition will range between 4.7-4.9, which for 2013-2014 will correspond to 80-90 position and in 2025 the country will have an indicator between 5.0 and 5.1 (60-70 position for 2013-2014 ranking). Value of efficiency of anti-monopoly policy will show similar improvement.

### **8.3. MONETARY POLICY AND FINANCIAL INTERMEDIATION DEEPENING**

138. The main indicators of monetary policy for 2012, taking into account the GDP decline in 2009-2010, were basically in line and in relative terms (as a percentage of GDP) even exceeded SDP forecasts. The observed indicators suggest that the economy's financial sector, not having significant external obligations, recovered from the crisis more rapidly compared to the real sector.
139. In particular, the money supply at the end of 2012 amounted to 33.7% of the GDP, compared to 29.6% forecasted by the SDP, whereas the domestic bank loans constituted 39.8% of the GDP, compared to 25.3% forecasted by the SDP.
140. Interest rate spread (difference of deposit and loan interest rates) has also outperformed SDP forecasts – it was 5.9% by the end of 2012 (SDP forecast – 7.8%), but nonetheless remaining high compared to international standards. Considering the importance of credit resources for job creation, the Government and the Central Bank policy should be targeted at decrease of the interest rate spread, aiming to reduce it to 3-4% by the end of programming period. The Central Bank in terms of policies has got as a constraint its primary function of controlling level of prices. But it plays an important role in achieving ADS targets, while a number of important policies and reforms, such as new pension system, banking sector supervision, enhancing financial literacy are under the CBA mandate. As a result cooperation between the Government and the Central Bank will have a crucial importance to achieve the targets.
141. In particular, Central Bank's policy must be directed at developing non-banking institutions – lending agencies and insurance companies, as well as at promoting further development of the stock market.
142. When it comes to banking regulation, it should take into account the collusion possibilities among the banks and must implement a clear policy for promoting competition. Measures

directed at the promotion of competition must not anyhow endanger stability of the financial system and must be implemented at the detriment of consumers' interests.

143. It is necessary to investigate the main reasons for banking spread remaining at such a high level. In particular, it is important to discover the factors which are not directly associated with the financial system, such as existence of problems in the collateral evaluation process of lending transaction, lack of competition in the economy or lack of transparency due to weak corporate governance that translates into higher riskiness of borrowing organizations.
144. Thus, regardless of the rapid development of the financial sector and the banking sector in particular, the new policy, maintaining the current development rates, should mainly aim to significantly reduce the prices of financial resources. In this regard the transition to mandatory contributive pension system is expected to produce positive effect, since in mid-term period investments made by fund managers within the territory of Armenia will create favorable conditions for decrease of interest rates.

#### **8.4. PUBLIC REVENUES POLICY**

145. In recent years the policy implemented in the taxation and customs spheres was aimed at the solution of the following two important issues:
- 1) expansion of the tax base and thus ensuring the necessary tax revenues for state and community budgets;
  - 2) creation of favorable business environment for businesses.
146. The investigation of the experience of countries that have had successful results from their public revenue policy reveals that by application of efficient models of tax and customs systems it is possible to enact a balanced policy which will contribute to the creation of preconditions for implementation of the above mentioned objectives in parallel.
147. The principles of the RA public revenues policy are derived from the overall direction of the social-economic policy being implemented and its logic. In particular, when drafting and implementing public policies in the tax and the customs sectors the following targets are always accounted for: ensuring sustainable and long-term economic growth, promotion of investment, improvement and modernization of the production-technical basis of the economy, fair distribution of incomes among different social groups of the population.
148. The modest level of tax revenues collection, which is also reflected in the tax/GDP ratio, has always been and continues to be the main challenge of the public revenues system. In the future, the reorientation of the state revenues policy and the strengthening of country's fiscal position become objective necessities and serious challenges.
149. The study of possibilities and limitations for the additional tax revenues collection reveals that additional tax revenues, and thus expansion of the economy potential, will be ensured with the following two directions:
- 1) change of the sectoral structure of the economy ensuring the prevalence of more taxable sectors
  - 2) selection of types of taxes with additional potential (not yet used) for tax revenue collection and revision of the tax policy with regard to those taxes, so that horizontal and vertical justice principles of taxation are further strengthened and the optimum level of taxation is defined.

150. Considering that the transformation of the sectoral structure of the economy assumes the implementation of systemic changes, long-term development, as well as the fact that the priorities of the economic policy might not require the development of taxable sectors, but rather sectors with higher significance from the viewpoint of the long-term and sustainable development of the national economy (which do not have large potential for ensuring tax revenues), it is more realistic that additional tax revenues, until 2025, are linked to the selection of tax types with additional potential for collection of tax revenues as well as with the improvement of their tax base and taxation procedures. In this regard, the selection of property and excise taxes is more realistic, taking into account that their role and potential in the current tax system are significantly undervalued.
151. Within the abovementioned context, until 2025, the public policy in the taxation system will attach special importance to implementation of horizontal and vertical equity principle of the taxation, increase in tax administration efficiency in the context of business environment and application of grounded tax rates.
152. Horizontal equity principle of the taxation envisages application of similar rules and regulations to the taxpayers operating in identical economic circumstances. Main directions for implementing the mentioned principle will be:
- 1) **Narrow the frames of currently applied tax exemptions.** Decrease of particularly those exemptions must be emphasized, which are not approved to be suitable according the results of “cost-benefit” analyses. That is, all those tax exemptions, as a result of application of such the “benefits” accruing to the consumers and the business entities are not commensurate with the “costs” incurred by the state (tax income foregone by the state), must be gradually diminished. At the same time granting new exemptions to separate taxpayers or to the group of taxpayers must be in exceptional cases and be derived from the country’s strategic development objectives and programs.
  - 2) **Maximum broadening of the tax base.** Specific measures must be taken to eliminate disparities of tax burden among different spheres of the economy. Particularly steps will be taken to eliminate VAT exemptions for some non-margin based services provided in the financial services sector, taking into account best international practice in this field.
  - 3) **Expanding the circle of goods subject to excise tax.** Studies of the international experience in excise tax policy revealed that the circle of goods subject to excise tax in our country is relatively limited and thus has certain potential for expansion. The government has already adopted the policy for expanding the circle of goods subject to excise tax and will continue to carry out this policy in the medium-term. And the selection of goods subject to excise tax will be made in a way that will ensure the full accomplishment of the purpose of excise tax – limiting the consumption of harmful goods, redistribution of incomes in the society and ensuring tax revenues for the state budget.
153. Implementation of taxation vertical equity principle will enable the state to collect additional financial resources in order to carry out its social programs at the expense of population share with relatively higher income and to solve other problems of social nature. Main directions for strengthening vertical equity principal of the taxation will be:
- 1) **Higher taxation of visible wealth.** To implement the vertical equity principle the taxation of visible wealth or luxury will be applied. In this regard, the Government of the RA attaches high importance to the taxation of the visible wealth. Moreover, the first step has been taken with the legislative amendments in force since 1st of January, 2012, when the luxury cars has been included in the list of goods subject to excise tax. With this regard, the future

steps of the Government of RA will be aimed at defining the luxury criteria of the property and application of higher tax rates to the properties satisfying those criteria.

- 2) **Introduction of capital gain taxation.** The new value (capital gain) emerging as a result of transactions with the securities, acquisition and disposal of real estate property is substantially similar to all other types of values arising as a result of other types of passive income. Consequently, capital gain must be taxed similar to the other types of passive income. In this regard, legislative amendments in the forthcoming years must be directed at the improvement of the capital gain taxation procedures (particularly for the residents of RA).

154. To create a viable mechanism of taxing both the visible wealth and the capital gain it is very important to implement regular and massive re-evaluation of the real estate properties with the purpose of decreasing the gap between their cadastral and market values to the possible extent and as a result broaden the property tax base.

155. Revisions of the tax legislation must be aimed at further improvement of the business environment in RA as a logical continuation of the activities being undertaken during the recent years. Main target of this policy direction must be at least the preservation of the competitiveness and attractiveness of our tax system in the region. In this regard, it is very important, that prospective legislative amendments are directed at the elimination of irrelevant and economically ungrounded limitations for the taxpayers. Main directions for the implementation of these principles are:

- 1) Specification of the procedures of returning to the taxpayers in a specified time period the conditional overpayments (debit balances) arising as a result of VAT calculations.
- 2) Determination of jointly accepted principles of calculating the VAT liabilities.
- 3) Improving the system of delaying the dates of VAT payments calculated by customs bodies at the date of import.

156. From the viewpoint of business environment, great importance is attached also to further improvement of tax administration. In this regard use of new toolsets should, to the extent possible, exclude putting additional burden on taxpayers including the time and human resources needed to meet the new requirements. In addition, further improvement of the administration and the use of new tools should be coupled with clear evaluation of their effectiveness.

157. Refraining from further tightening of tax administration and transition to risk based supervision is considered as a factor for improving business environment. The main approach in the improvement of tax administration is that tax control tools will be applied to those taxpayers which are identified as risky based on the results of analysis carried out. This will ensure targeted and efficient tax control. Other taxpayers will enjoy minimum level of tax control interventions. As a consequence, for 2014-2015 period tax to GDP ratio is expected and to stabilize around 23.8 percent. Another administrative improvement direction is considered to be identification of tax evasion cases, in particular putting special emphasize on cases when the breach of laws and regulation is carried out with the special purpose of evasion. It is expected to decrease the size of informal economy, to foster culture of autonomous tax liabilities calculations and payments by the taxpayers, to ensure fair and competitive economic environment.

158. Tax rates are one of the main tax policy tools and must be determined in such a way, that:

- 1) Their application would be maximum neutral for the business activities. In cases, when the taxation object is the economic rent, neutrality can be achieved directly, while for the remaining types of taxes the rates must be neutral to the possible extent.
- 2) They would be harmonized to the possible extent with the tax rates applied in CIS and in the countries which are competitors of RA in the respective spheres. Moreover, for the spheres considered to be priority for the economy of the Republic of Armenia the comparisons in tax policies, including the tax rates, must be implemented with respect to the countries which are leaders in those spheres. In all types of comparisons effective tax rates must be considered, which take into account the taxation factual rules and all kinds of allowances.
- 3) The goods which have low price elasticity of demand and which are not primary consumption goods (mainly goods subject to excise tax such as alcoholic drinks, cigarettes, fuel) should be taxed with relatively higher rates, taking into account that price increase of those products due to tax factors will not cause drastic changes in the market conditions.

159. Taking into consideration the economic development strategy, an important element of tax policy will be mechanisms for development of special tax and customs regimes (exemptions, diversified administrative treatment) for priority economic sectors, as an important component of direct policy toolset in those sectors.

160. Until 2025, as a result of the implementation of an effective tax policy in the above-mentioned directions, it is expected:

- 1) to increase considerably the shares of property tax in the overall composition of tax revenues. In particular, it is expected to increase the ratio of property tax/GDP from 0.4% to 0.7%;
- 2) starting from 2016 to increase tax revenue collection by 0.3-0.4 percents of GDP annually;
- 3) to combine the continuous improvement of the business environment in the Republic of Armenia with the strengthening of the country's fiscal position, and thus ensuring the stability of the fiscal system;
- 4) to increase the financial stability of local communities, contributing to the implementation of more responsive, targeted and effective programs and application of the relevant tools for resolving social-economic problems of at the community level.

161. Customs policy is the next important element of public revenue system. At the same time, customs policy has a direct impact on the business environment by affecting the efficiency of across border trade transactions.

162. The revisions of the legislation regulating customs relationships in the Republic of Armenia in the forthcoming years will be based on the revised Kyoto Convention "Simplification and Harmonization of Customs procedures" adopted in 1999 and at the same time will be oriented towards Armenia's membership in Customs Union and subsequent implementation of responsibilities assumed as a party to Eurasian economic community.

163. Improvement of the risk management system might be an important input for the enhancement of the business climate as well as for the increase in the efficiency of customs bodies' operations. In particular, application of the simplified and faster customs procedures for the conscientious and not risky business entities will decrease the customs clearance time and will enable the customs body to use the administrative resources with higher efficiency.



164. In the context of customs system development an important issue is also the improvement of the customs post clearance control system taking into account that the latter can contribute to the minimization of control at the customs border on the date of import. In this sense, it is noteworthy that the gradual transfer of some control functions from the customs border and their adaptation in the frames of post clearance control systems is in line with the international experience in this sphere and can be successfully implemented also in our country.
165. Apart from the legislative and procedural reforms, special importance will be paid to the infrastructure improvement. Bavra-Bagratashen-Gogavan border improvement program as well as the implementation of integrated border management system will be finalized. Those are very important both for the overall success of the export oriented industrial policy and the development of tourism.

## **9. DIRECT POLICIES AIMED AT VARIOUS SECTORS AND AREAS**

166. According to the concept of this program, direct policies will be implemented along with the framework ones, and these direct policies will contribute to the long-lasting, jobs creating economic growth.
167. Given the economic development goal, as well as the potential for jobs creation, the direct policies will be geared at creation of jobs in relevant sectors, branches and areas, through creation of adequate conditions for their development and elimination of obstacles.
168. The peculiarities of each sphere will dictate the special policy and the policy enacted will differ from sector to sector. Taking into account the short- and long-term potential for job creation, as well as the input in ensuring quality economic growth, the program's priority sectors and areas subject to the direct policies include:
- 1) Industry and export promotion;
  - 2) Tourism development;
  - 3) Information technologies' sector development
  - 4) Agriculture and rural development
  - 5) SME creation and ensuring their adequate activities;
169. Direct policies will complement the corresponding framework policies for business environment and investment climate improvement as well as competitiveness promotion. The mixture of direct and framework policies will be the main tool for job creation in the economy and will be implemented using PPP (public-private partnership) tools, in particular through direct involvement of private sector in the sectoral and branch development policy.
170. At the same time direct policies should create relevant environment for development of innovative and knowledge-based economy. Policies oriented at export and promoting development of IT already assume promotion of innovative measures. However direct policies promoting innovative developments cover not only priority sectors but will be implemented throughout the entire economy.

## 9.1. INDUSTRY AND EXPORT PROMOTION

171. Classical industrial policy is a mixture of framework and direct policies of interventionist nature, which aims to create new economic sectors and enterprises, protect them from external competition, as well as ensure and expand export possibilities. Armenia has never had such policy developed and implemented<sup>16</sup>.
172. In a wider sense<sup>17</sup>, the industrial policy is a part of the state's sector policy. The sector policy, in its turn, is interventionist policy promoting growth and development of different economy sectors, where the level of state intervention is determined based on specific aspects of development, the level of competitiveness of those sectors, as well as the nature and necessity of government regulation.
173. The economic crisis revealed the serious problems of the Armenian economy's real sector competitiveness. Before that the economic policy was based on the creation of favorable framework conditions for the development of the private sector. But the deep structural problems of the economy, limitations for the growth and the export, low level of business sophistication and innovations (which are confirmed by the estimations of Global competitiveness report) called for the necessity of states active participation in correcting the "market failures".
174. In the period preceding this program, the relative decline in the volumes of exports of goods and services (as a share of GDP) continued, while the relative and absolute volumes of imports increased. In the crisis year of 2009, the absolute volumes of both exports and imports declined considerably, although recovering in the post-crisis year of 2011.
175. Export and import volumes in 2008-2011 are significantly far from the SDP plan indicators and the accelerated growth of exports planned by SDP happened only in 2011 (27.7% increase in exports with respect to the previous year, and 10.7% increase in volume of imports), which was mainly the result of higher prices for main groups of goods exported from Armenia - processed food (40.3% increase), metals (9.7% increase), mining products (30% increase), precious stones and metals (46.5% increase).
176. During 2006-2012 period 90 to 95 percent of exports constituted 10 large product groups (three of which - live animals and products of animal origin, products of plant origin and vegetable and animal oil - are presented as agricultural products) (Table 3).

**Figure 2. Exports, imports and balance of goods and services in 2006-2012, % of GDP**

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<sup>16</sup> Certain elements of industry or more precisely interventional 'direct' policy were applied by the government in 2009-2010 in industry, construction and financial sectors of economy in order to protect them from crisis consequences.

<sup>17</sup> See How to Compete and Grow: A Sector Guide to Policy. McKinsey Global Institute, 2010



Source: NSS.

**Table 3. Exports actual structure, by main product groups in 2007-2012, % of total exports**

	2007	2008	2009	2010	2011	2012
	<i>% of total</i>					
Total	100	100	100	100	100	100
Agricultural products	2.2	3.0	5.0	3.8	4.0	4.9
Processed food	12.5	15.9	14.0	12.6	13.8	18.5
Mining products	15.1	16.3	20.5	29.5	30.3	29.2
Construction materials	1.8	1.3	1.9	1.5	1.3	1.3
Chemical products, plastics, rubber	1.8	3.4	2.3	2.4	1.5	1.8
Precious and semiprecious stones and metals	18.1	16.4	14.8	12.9	14.7	12.5
Non precious metals and products made of them	33.9	32.8	32.5	31.9	27.3	24.8
Machinery, equipment and mechanisms	3.4	3.8	3.0	2.9	2.5	3.0
Other*	11.2	7.1	6.0	2.5	4.6	4.1

\*Total, according to trade statistics

Source: calculated based on NSS of RA data.

177. It is worth to be underlined that for all the product groups mentioned above, including those which are primarily exported products, Armenia is a net importer.

178. One of the main export risks is the extreme concentration, both by products and by geographical destinations. In 2012, three product groups -mining products, food products and non-precious metals and items manufactured from them amounted to more than 70 percent of total export. On the other hand, three largest trade partners – Russia, Bulgaria and Belgium – accounted for 38.8% of total exports in 2012. Thus the export promotion policy must be directed at the diversification of the export both in terms of product groups and geographical destinations.

179. Based on the country's development specifics during 2003-2008, the 2009-2011 crisis and post-crisis realities, ADS considers the export, its advanced growth and correspondingly drastic increase of its role and importance, as the main driving force for the development during the period of 2014-2025.

180. With adoption of its industrial policy strategy aimed at Armenia's export, approved by the 2011 Government Protocol Decree N 49, the Government of Armenia announced implementation of its new industrial policy. According to the strategy, the export-oriented industrial policy of Armenia includes a group of well-balanced and phase activities aimed at enhancing spheres with potential of developing export and improvement of international competition, which is targeted at export expansion and diversification. The long-term goal of the export-oriented industrial policy is development of new driving areas of economic growth by enhancing development of currently exporting area and those with export potential. Development of processing branches and complexes is seen as the direct target of industrial policy.
181. The guiding vision of industrial policy is to make Armenia a country producing high-value and knowledge-based goods and services, anchored on the creative human capital. Implementation of this vision requires phase approach assuming gradual transition from resource-intensive industry to those based on capacities and skills, afterwards focusing more on knowledge-based industries in the long-term perspective. Given the importance of systemic development of the economy the industrial strategy is viewed in the context of comprehensive economic development vision and priorities of development of other spheres of economy.
182. The initial stage of the strategy includes the following processing industry sub-branches: diamond cutting, goldsmithery, producing of watches, light industry, brandy and wine production, pharmaceuticals and biotechnologies, production of canned foodstuff, production of mineral waters and juices, engineering/precise engineering, processing of non-ferrous mineral. State support in each area will be temporary, according to preliminarily defined targets and gradually new areas may be involved over time.
183. Membership in Customs Union is crucial for export promotion. In particular it is important to take steps in the period preceding the official membership to the Union for achieving favourable regulations and developing projects that will enable full utilization of export growth and diversification potential.
184. It is expected that most job places in the sphere of industry will be created in the above branches with maximal potential on the basis of replacement of export or import.
185. The industrial policy will be implemented through sector strategies and relevant triennial action plans, which will be approved by sector councils and the Industrial Council by the Prime Minister. The industrial policy will be implemented by application of general actions and special toolkits.
186. Implementation of general actions aimed at creation of favorable environment and improvement of productivity (improvement of business regulating environment, ensuring favorable external regimes, elimination of trade obstacles, modernization of infrastructures, promotion of foreign investments)
187. Application of special toolkits to include the following:
- 1) Special tax and customs regimes
    - a) Special tax and customs regimes for exporting companies,
    - b) Deferred VAT for goods imported under investment goods and programs,
    - c) A number of free trade zones with use of PPT toolkit (particularly on the area of Zvartnots airport and Mars company) with application of relevant tax and customs regimes.

- 2) Financial support and ensuring access to financing:
  - a) Loans at special terms (e.g. for investments aimed at implementation of quality assurance system, export expansion, creation of jobs),
  - b) Provision of export guarantees,
  - c) Provision of credit guarantees,
  - d) Own capital funding,
  - e) Participation in investment funds.
- 3) Access to markets:
  - a) Identification of goods with export potential and potential partners,
  - b) Presentation and protection of interests of exporters through trade representations,
  - c) Support to participation in exhibitions,
  - d) Organization of incoming and outgoing business visits and conferences,
  - e) Branding of countries and specific sectors in target markets,
  - f) Support to involvement of trade representatives in target markets.
- 4) Capacity building/increase of competitiveness:
  - a) Co-funding of human resources training programs,
  - b) Provision of technical and financial assistance to companies in implementation of internationally recognized quality assurance systems,
  - c) Support to sharing technologies and knowledge, including using potential and contacts of the Diaspora.
- 5) Promoting research studies and developments:
  - a) Foundation of technoparks and industrial parks,
  - b) Provision of grants for joint researches and developments by companies and higher educational institutions,
  - c) Creation of venture funds.

188. Special sector support tools and structures will be created within the framework of sector development strategies. In 2012 the Industry Development Fund and the Armenia Export Financing Insurance Company were created within the framework of the industry policy.

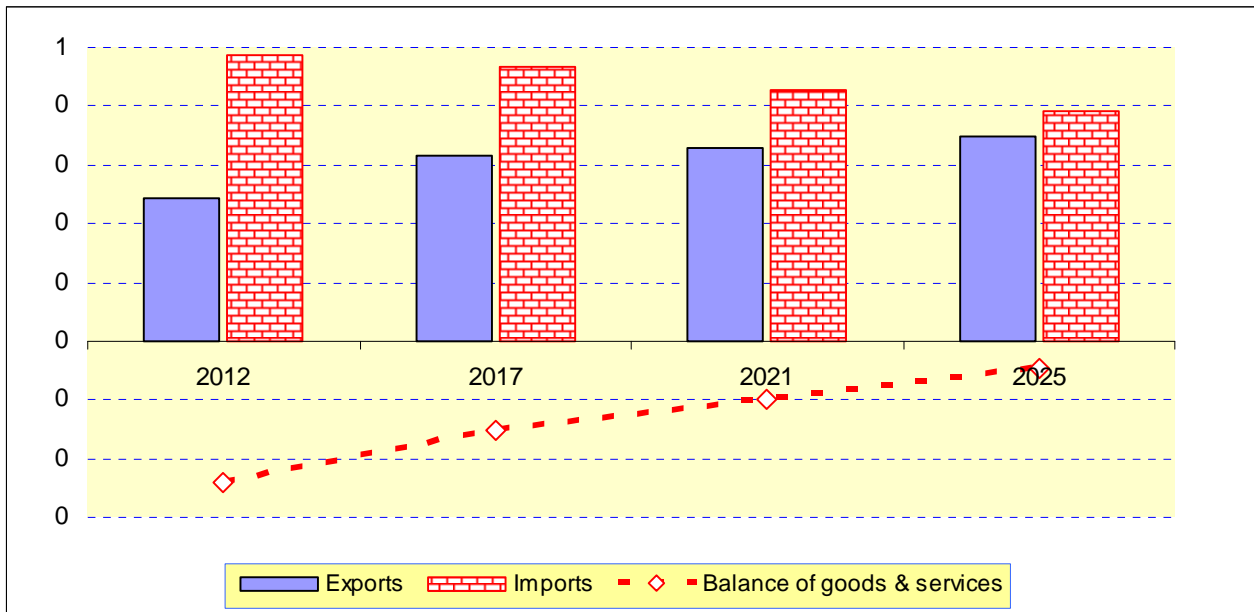
189. In terms of improvement of the effectiveness of export promotion and foreign investments attraction policies and activities a key role is assigned to implementation of functional mechanisms for agreement of cross-structure activities, considering the alternative of creation of a relevant unified structure over time. Among possible advantages of this approach are development of an agreed policy, maximally effective use of capacities, and the application of the 'single-window' principle.

190. As a result of accelerated exports growth policy and imports moderate suppression policy<sup>18</sup> it is planned to essentially reduce dependence of the country from external financing during the program period, by bringing the products and services balance deficit to 15,1% of the GDP by 2017 as opposed to 24,8% in 2012, followed by 9.8% in 2021 and 4.5% in 2025.

**Figure 3. Exports, imports and balance of goods and services in 2012-2025, % of GDP**

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<sup>18</sup> ADS envisages that the average import growth rates should correspond to GDP growth rates which will result in approximately unaltered import ratio in GDP.



Source: calculated based on NSS data; ADS projections.

191. At the same time, during the forecasted period, the openness of the country's (Is measured as the ratio of the foreign economic turnover of the country to the GDP) economy will not change significantly, as along with the increase in exports volume the import will relatively decrease. This indicator will fluctuate around 74-78% percent of GDP during the programming period, as opposed to 73.8% in 2012.
192. Economic growth in some sectors and branches will occur due to expansion of the domestic demand (including import substitution).
193. Main tools for moderate import suppression policy under liberal external economic policy conditions will include:
- 1) Relevant monetary policy which should not be aimed at import promotion but be rather neutral in that regard.
  - 2) Import replacement policy which by applying different tools will support the local producers. In particular, increase in transparency and efficiency of public procurement can be an example of such a tool.

## 9.2. TOURISM DEVELOPMENT

194. Incoming tourism is Armenia's second export line item after mining and metal industry and covers more than half of services export. In addition, about 20 thousand people are employed in the spheres of incoming, outgoing and domestic tourism, which totals around 3% of non-agricultural employment.
195. The incoming tourism will retain its role as the second export sector and will cover around 24% of export throughout implementation of ADS. It is estimated that the number of directly tourism-related jobs will increase by 7.7 thousand compared with 2011 and during the programming period will continue to constitute 3.0% of non-agricultural jobs.

**Table 4. Tourism sector development in 2011-2025**

	2011	2017	2021	2025
Incoming tourism, thous. persons	757.9	1351.2	1907.3	2692.3
Index, 2008=100	100.0	178.3	251.6	355.2
Outgoing tourism, thous. persons	715.0	1232.9	1677.3	2282.0
Index, 2008=100	100.0	172.4	234.6	319.2
Incoming tourism expenses, mln. USD	513.0	1030.0	1573.7	2404.5
% of total export	21.6	25.5	24.9	24.1
Outgoing tourism expenses, mln. USD	513.5	1130.2	1869.0	3090.7
% of total import	10.7	18.9	22.8	27.4
Employment in tourism sector, thous. persons	20.6	23.9	26.0	28.3
% of non-agricultural employment	2.9	3.0	3.0	3.0

Source: Calculated based on NSS, Ministry of Economy publications, World Bank World Development Indicators 2010, 2011, 2012 yearbooks, ADS forecasts.

196. ADS envisages that incoming and outgoing tourism will keep their growth rates of 2008-2012, around 8-9 percent, which will result in the number of incoming tourists reaching 1,35 million in 2017, and 2.7 million in 2025 as opposed to 758 thousand in 2011.
197. The main sector policy directions ensuring the abovementioned high development rates in the sector of tourism will be the improvement of relevant infrastructures through PPP toolsets, particularly the policies of reduction of high transport costs related to entry to and exit from Armenia.
198. Diligent implementation of already initiated strategies on touristic centers' development (Jermuk, Tsakhkadzor, Dilijan and others) will play an important role. Implementation of such projects is important from the viewpoint of balanced development of the regions.
199. The latter policy includes implementation of 'open sky' approach with involvement of low-cost airline companies, demonopolization of railway market, and ensuring competitiveness, creation and upgrading of tourism infrastructures out of Yerevan, as well as promotion of involvement of international hotel operators.
200. On 23<sup>rd</sup> of October, 2013 RA Government approved the Project on ensuring competitive and sustainable air transportation services in Armenia and program implementation measures. According to the project Armenia is implementing air transportation liberalization and adopting open air policy. Facilitation of air transportation creates additional possibilities for economic development given the existing strict constraints on land transportation. Positive impact on GDP and employment is expected as a result of implementing the newly declared policy, which is mainly due to expected increase in financial resources obtained from tourism. Open air will have positive economic impact on majority of beneficiaries. In particular the new policy in the field will promote incoming tourism and diversification of its geography. On top of that, Armenian Diaspora will have more possibilities to strengthen the ties with the homeland, both by private and business visits. The airport will have higher turnover of flights and can involve higher frequency flights, offering decreased fees as well as assisting in marketing of new routes. Business sector representatives will have more convenient conditions (in terms of times and expenses) and extended possibilities for business communications.

### 9.3. INFORMATION TECHNOLOGIES DEVELOPMENT

201. In 2000 information technologies (IT) were recognized one of the priority branches of Armenian economy and its development will be an essential contribution to the transition towards knowledge-based economy.
202. In 2008 the RA Government adopted a new 10-year IT sector development strategy which includes objectives of infrastructure development, increase in the quality of IT sector graduates, creation of venture and other financial mechanisms for the start-ups, etc. Among particular goals of the new strategy are building of new technoparks and incubators, creation of a big venture fund, expansion of local market for local IT products and services, increase the volume of foreign direct investments.
203. In the period preceding the ADS the Government participated in a number of initiatives aimed at achieving the above goals. In 2007 the National Instruments Corporation founded an engineering and research office in Yerevan. In 2008 the Gyumri technopark construction was initiated and it is currently in the process. The latter hosts the regional software development laboratory of D-Link International. In May 2011, within the framework of the Cooperation Memorandum signed between RA Government and Microsoft Corporation, the Microsoft Innovations Center was opened in Yerevan, which is aimed at creation of an environment promoting development of professional skills and capacity building through application of Microsoft tools and programs.
204. The mentioned and other initiatives launched by the government, as well as the active participation of the private sector resulted in significant growth of IT sector indicators in 2011 compared with 2008. Particularly, the total revenue increased by 84%, whereas the share of IT sector in GDP reached 2% in 2011 versus 1% in 2008. The number of employed in the sector increased by 38% and by around same percentage productivity growth was recorded.
205. During ADS implementation period direct policies in IT sector will include:
- 1) Continuation of establishment of technoparks, incubators and other IT infrastructures being implemented through PPP toolsets,
  - 2) Support to universities in implementation of modern curricula and acquisition of necessary laboratories, through promotion of their cooperation with private sector,
  - 3) Implementation of favorable tax policy promoting export potential in the sector,
  - 4) Implementation of state-support programs for SMEs and start-ups involved in the IT sector, including access to markets, professional trainings and ensuring access to information,
  - 5) Direct support to IT companies offering innovative products or services.
206. In addition to general framework policies, implementation of direct policies in the sector is expected to contribute to the creation of 10 to 15 thousand new jobs by 2025. Export will increase along with the sector growth: it is expected to export around 60% of products in 2017. The share of IT sector in GDP will be around 6-7% in 2025. ADS forecasts are in line with target indicators set in 2008 IT sector strategy and take into account the dynamics of recent years.

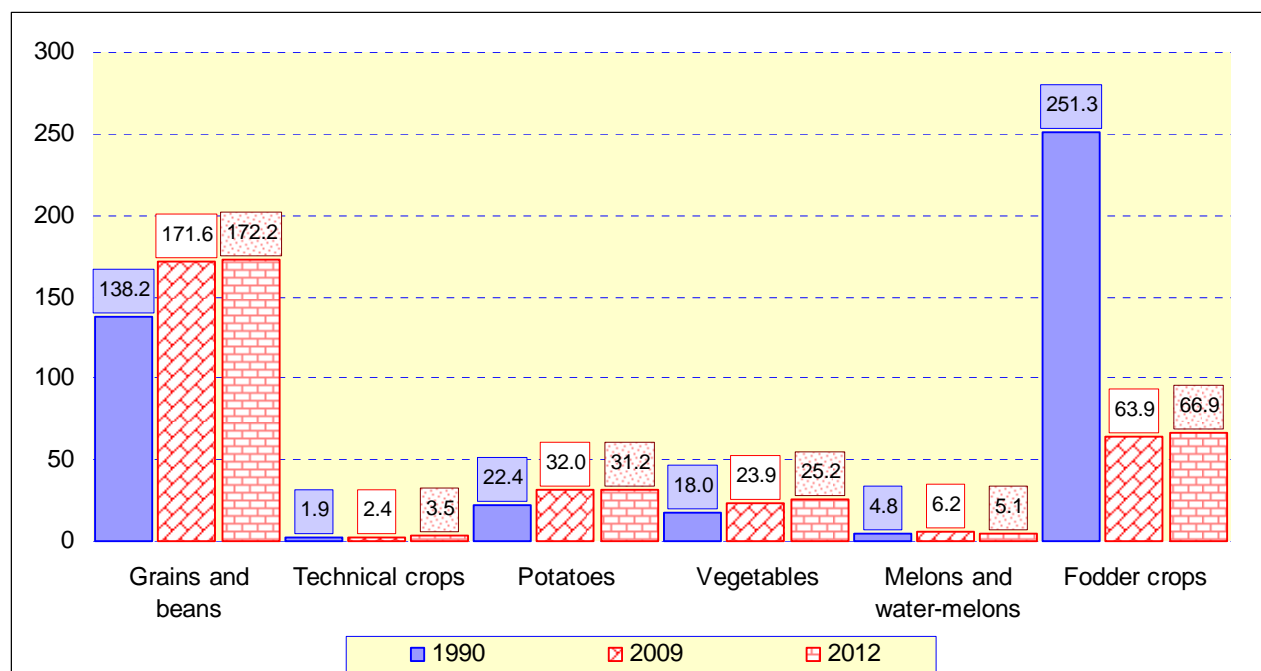


## 9.4. AGRICULTURE AND RURAL DEVELOPMENT

### 9.4.1 SECTOR OVERVIEW

207. In 2012 value-added in agriculture accounted for 19.1 % of the GDP, while combined with agriculture processing it comprised around 26% of GDP. As of 2012 the gross agriculture produce makes up AMD 764 bln (equivalent of USD 1.9 bln), with plant cultivation counting for 60% and animal husbandry 40%. Agriculture shares a unique place in the country's food security. Today, in terms of energy value, the self-sustainability of first-need foodstuffs comprises around 60 %.
208. Out of total 915 communities of Armenia 866 are rural (around 36.0% of the country population resides in villages), hence agriculture plays an important strategic role also in terms of rural area development. As of 2012, agriculture employs 437.2 thousand people, which accounts for 37% of the country's total employment and 80% of rural area employment. In the external commodity turnover structure the share of vegetable- and animal-origin products in 2011 was 18.6, and in the structure of exported goods - 17.8%. According to 2012 data, these indicators improved reaching 19.9 and 22.6% correspondingly.
209. Recognizing agriculture as a priority sector is dwelled on two principle reasons. Firstly, agriculture is the key link of the food industry value chain, which is one of the sub-branches with export potential. Secondly, development of agriculture is critical for increase of productivity and creation of non-agricultural jobs in rural areas, thus contributing to balanced regional development.
210. The lion's share of revenues of the rural population comes from agriculture products and hired labor. Hence, poverty in this sector is largely contingent on agriculture development.
211. According to the 2012 land balance data arable lands covered 448.4 thousand hectares and the areas under crops 304.2 thousand hectares (Figure 4), meaning that 144.2 thousand hectares of arable lands are not used at their designated purpose, and the level of designated use is 67.8 % as opposed to 63.0 % recorded in 2010. Poor use of arable lands is essentially dependent on the lack of financial resources of businesses employed in agriculture, low profitability, difficult access to machine works, fragmented land parcels, difficulties in marketing agricultural products, etc. In some boarder communities, designated use of arable lands is affected by dangers associated with borderline land cultivation. In addition, out of 232.9 thousand ha irrigable lands of the country only around 155 thousand ha are actually irrigated.

**Figure 4. Land area under agricultural crops, thousand hectares**



Source: NSS

212. There are problems with coordinated and targeted use of natural feeding areas particularly pastures and hayfields.

213. Due to a number of factors, marketing of agricultural products continues being a problem. The level of agricultural produce marketability during the past years varies around 56% (Figure 5). The existing situation is the result of the lack of agencies responsible for marketing of agricultural products or their imperfect activities.

214. Currently, around 95% of agricultural machinery has expired term of use, which resulted in low functioning and productivity and high maintenance costs.

215. Despite aforementioned challenges, the agriculture-related goals defined in SDP were mostly achieved during the recent years (Table 5). GDP in agriculture in 2011 exceeded the SDP target and in 2012 credits in agriculture exceeded the SDP target for 2015 (11 % of GDP).

**Table 5. Agriculture and rural development, 2008-2012**

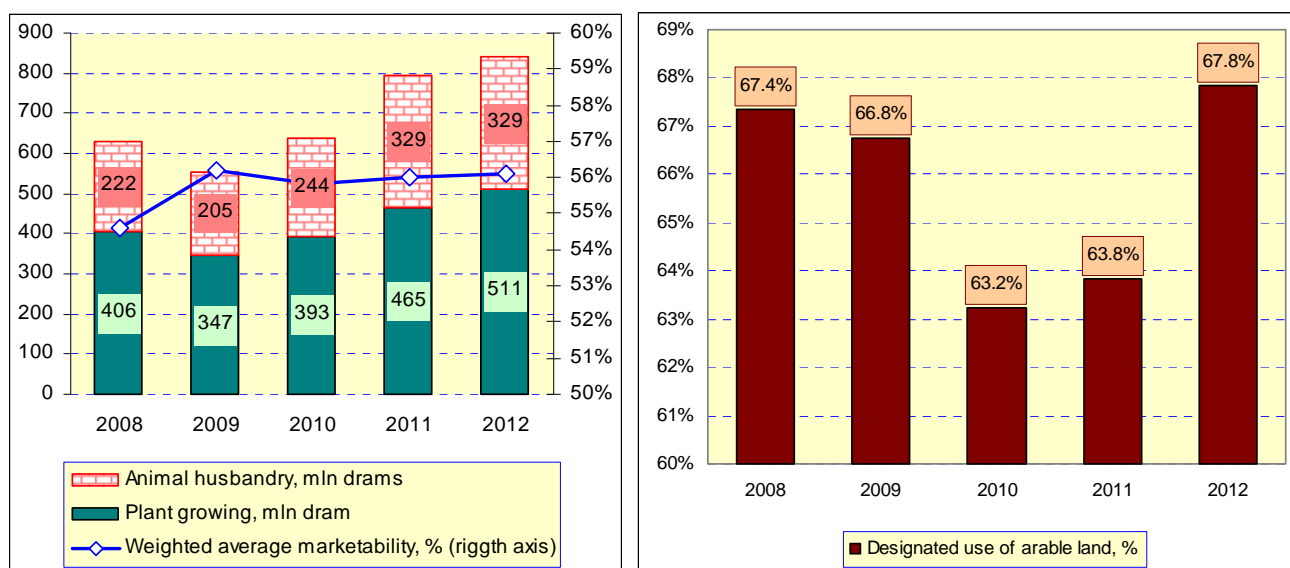
	2008	2009	2010	2011	2012
Value added in agriculture, y-o-y % change	3.3%	6.0%	-16.0%	14.0%	9.5%
Value added in agriculture, % of GDP	16.3%	16.9%	17.0%	20.3%	19.1%
Employment in agriculture, thousand persons	...	...	457.4	457.4	437.2
Non-farm employment in rural area, thousand persons	...	...	100.1	85.9	108.2
Labor productivity in agriculture, thousand drams	...	...	1,286	1,679	1,748
Non-farm labor productivity, thousand drams	...	...	3,946	4,193	4,396
Credits to agriculture, mln drams	36,467	44,177	52,365	73,440	91,890
Credits to agriculture-to-GDP ratio, %	6.3%	8.3%	8.9%	9.6%	12.0%

Source: NSS, Ministry of Agriculture, Central Bank of the Republic of Armenia

216. The share of animal husbandry has increased in the structure of agriculture branches from 35% (in 2008) to 39% (in 2012). The average weighted marketability level almost did not undergo changes staying within 55-56 %. As for designated use of arable lands in 2012 the

negative trend of past years has improved and the share reached 68% slightly exceeding the figure for 2008 (Figure 5). Agricultural products continue to be produced by individual farms and only 3% of the 2008-2012 gross product came from commercial organizations.

**Figure 5. Structure of agriculture by branch, marketability and designated use of arable land in 2008-2012**



Source: NSS, Ministry of Agriculture of the Republic of Armenia

#### 9.4.2 SECTOR DEVELOPMENT PERSPECTIVES

217. Agriculture and village perspective development visions include:

- 1) Development of commercial agricultural organizations, cooperatives and family farms integrated with market infrastructures through application of intensive technologies;
- 2) Stable food security of the population and meeting demands of agriculture processing raw materials through realistic combination of food security interests and comparative advantage of external trade of agriculture and food products;
- 3) Increase of gross product in agriculture due to increase of labor productivity, comparative reduction of the number of people employed in agriculture and use of part of surplus workforce in nonagriculture sphere through agriculture service and trainings.
- 4) Processing of produced agriculture raw materials at SME production units;
- 5) Domination of production of agriculture products with high added value in the plant cultivation and animal husbandry intra-branch structure;
- 6) High level of food security of the country population, ensuring self-sustainability for basic foodstuffs, reduction of rural poverty and migration.

218. Industrialization is seen as the key approach to modern agriculture development, which means increased intensity level, compliance with the agro technical requirements, application of modern technologies and management systems. The following can enable addressing this issue:

- 1) Improved use of resource potential of farms, particularly full use of arable lands, increase of crop and animal productivity and through intensified production;

- 2) Promotion of nonagriculture employment, crafts, processing of agricultural products, support in creation of agriculture services and agrotourism in rural areas can also be helpful.

219. In the future more importance will be attached to the support to seeds production development, pedigree animal husbandry, and implementation of state-supported programs in those spheres, as well as to the improvement and quality increase of plants' protection and veterinary assistance mechanisms. To solve the problems associated with the development of cattle breeding and cropping following will be implemented:

- 1) Public assistance projects in the spheres of primary seeds production, renewal of plants' sorts and seeds provision.
- 2) Complex measures to ensure plants' protection, including those aimed at fight against pests.
- 3) Technical recovery of currently acting artificial insemination stations in the Republic of Armenia and full utilization of their capacities
- 4) Widespread application of artificial insemination, training for the specialists in the field and exchange of experience
- 5) Development and implementation of projects of agricultural animals deceases control, activities aimed prevention of deceases and revision of strategic measures applied with that purpose, taking into account international experience and efficiency of its application in local conditions.

220. To improve designated use of arable lands it is important to:

- 1) restart implementation of programs introducing targeted subsidies earmarked for land cultivation in most unfavorable areas; continue subsidizing prices of most important resources used in the sector, as well as improvement of the mechanisms for their implementation,
- 2) improve servicing of agricultural equipment,
- 3) implement projects for mutual utilization of segmented lands, applying different motivating techniques (loans, grants, state programs and others),
- 4) carry out measures for inclusion into agricultural turnover degraded land areas,
- 5) found field protecting forests in communities.

221. Addressing the problem of coordinated and targeted use of natural feeding areas particularly pastures and hayfields includes:

- 1) Development of programs to improve effectiveness of the use of natural feeding areas,
- 2) Implementation of schemes on coordinated and effective use of pastures and hayfields,
- 3) Implementation of state-supported programs on irrigation of pastures, ensuring access to and from pastures (road rehabilitation), and
- 4) Promoting creation of 'cooperatives of pasture users' and supporting their activities.

222. Agriculture policy should envisage improvement of business forms, particularly the policy of encouraging and promoting cooperation. Below four directions for development of cooperation are considered most appropriate:

- 1) Improvement and supplementing of the legislation,
  - 2) Application of mechanisms for economic promotion of cooperation development;
  - 3) Improvement of awareness of farmers on the principles and advantages of cooperation;
  - 4) Creation of institutional structures promoting development of cooperation in agriculture.
223. The following is planned to address marketing of agricultural products:
- 1) Development of regulated wholesale markets of agricultural products, collection spots, promotion of activities of agricultural product marketing information centers,
  - 2) Creation of agricultural product fairs in big cities of the country and ensuring their proper activities,
  - 3) Establishing long-term and mutually beneficial contractual relationships between processors of agricultural products and their producers, and
  - 4) Promotion of export of agricultural products.
224. Activities geared at addressing agriculture production and technical services include:
- 1) Continue negotiations with international companies producing and supplying agricultural machinery in order to provide businesses involved in agriculture with affordable adequate machinery under leasing mechanisms, particularly applying leasing prepayment and interest subsidizing mechanisms.
  - 2) Creation of local representations of international agricultural machinery producing companies, and structures/agencies dealing with maintenance and assembling of agricultural machinery.
  - 3) Promoting creation of structures for joint use of agricultural machinery in rural areas.
225. For the effective use of agricultural resource potential a special focus should be made on promotion of creation of greenhouses in farming entities. The following activities are planned in this regard:
- 1) Provision of tax privileges for import of main equipment and construction materials needed for creation of greenhouses,
  - 2) Provision of affordable targeted loans for creation of greenhouses for farmers.
226. One of the key challenges faces by agriculture is improvement of the registration /census system. The following is needed to address the problem:
- 1) Implementation of general agriculture census program, which is aimed at collection of reliable information on the structure of agriculture, particularly farming lands, number of animals, agriculture machinery, farming structures and potential (human, material) and reliable information of their use, with marz and community breakdown;
  - 2) One of the ways to improve the registration system is implementation of a general system of agriculture administrative register; and
  - 3) Implementation of agricultural animal recording /inventory and numbering system.
227. Stabilization and development of agriculture requires improvement of the irrigation water supply system, which can be achieved through the following:
- 1) Transition from pumping to gravity water supply system;

- 2) Implementation of new irrigation technologies, in particular drip irrigation, leading to use of water-saving regimes.
228. Implementation of the system of guaranteed prices for key agricultural products is one of the forthcoming goals in agriculture. The following activities are needed to address the goal:
- 1) Development of mechanisms for implementation of the system of guaranteed prices for key agricultural products, and
  - 2) Development and enforcement of legal basis for application of guaranteed prices.
229. One of the priority issues is implementation of modern technologies in seed production, animal breeding, processing of agriculture products. This can be achieved through application of the following tools:
- 1) Provision of affordable target loans,
  - 2) Implementation of competition grant programs;
  - 3) Providing for a component to promote modern technologies in credit programs;
  - 4) Technical modernization/upgrading with application of leasing mechanisms in line with specifics of agriculture.
230. Development of food safety system is attached a special attention. Main directions include:
- 1) Revision of the RA legislation, implementation of relevant actions and exchange of information within the framework of interstate and international cooperation in food security, veterinary and plant health areas, as well as affiliation with the Customs Union.
  - 2) Customizing food safety, as well as veterinary and fitosanitary international and interstate standards, implementation of safety systems, procedures and principles;
  - 3) Implementation of proper food production hygiene and manufacturing practices, analysis of risk sources and control of critical point (HAACCP) system or quality and safety ISO 22000 standard, with state support;
  - 4) Capacity building of food safety laboratories and accreditation of ISO 17025 standard;
  - 5) Proper organization of training and education of food safety human resources.
  - 6) Construction and utilization of slaughterhouses or slaughter points across the whole territory of the Republic,
  - 7) Improvement of regulations regarding genetically modified organisms (GMOs) in the respective legislations to ensure absence of threat to human life and health, animals and biodiversity, as well as protect consumer rights.
  - 8) Development and implementation of monitoring programs for control over remainings of pesticides, hazardous organisms, veterinary remainings, alergetics, food additives and GMOs in imported and locally produced food.
231. One of the best ways to address challenges faced by agriculture is improvement of access to credits, which requires the following activities:
- 1) Improvement of mechanisms for subsidizing interests to increase access to credits, implementation of programs for diversified approaches dependant on businesses and zones,
  - 2) Implementation of targeted credit programs to increase the food safety level, technical upgrading, and modernization.
232. The following is important to mitigate agriculture risks:

- 1) Introduction of an insurance system, which requires implementation of a program to evaluate insurance-related risks in the sector of agriculture: based on the findings of the evaluation develop mechanisms for the introduction of the insurance system and implementation of its phase-by-phase approach.
  - 2) Expansion of areas under protection from unfavorable atmosphere events, particularly hail protection stations, improvement of their effectiveness, support in implementation of other hail protection measures.
233. With respect to rural development, the main issue remains creation of non-agricultural jobs and the growth in the share of nonagricultural incomes for the rural population, especially related to processing of agricultural products and agriculture servicing.
234. The following steps will enable improving effectiveness of the sector:
- 1) Targeted and consistent investments in road building (especially to connect boarder villages with regional centers).
  - 2) Addressing the problem of regular electricity supply at relatively low cost through effective use of solar, land, underground, water energy alternatives in mountainous and border villages.
  - 3) Purchase of special agriculture machinery to meet needs of mountainous landscape, development of their maintenance and assembling capacities in Armenia.
  - 4) Foundation of small and nature-friendly farms processing agricultural products (particularly processing of agricultural products, packaging, freezing and storing).
  - 5) Promoting set up of small productions, particularly carpet woving, embroidery, pottery, wood carving, ceramics shops.
  - 6) Renovation of small domestic service centers.
235. The following is needed to boost agriculture product processing and export:
- 1) Application of a simplified customs clearance regime for import of specimen;
  - 2) Develop Armenian trademark and place orders for goods considered competitive by the state,
  - 3) State support and co-funding for selection of the most attractive pavilions at international exhibitions to exhibit Armenian goods,
  - 4) Provision of long-term loans under state guarantees,
  - 5) Simplify documentation used in agriculture goods production and processing, exclude false documentation or their forced acquisition (creative accounting),
  - 6) Support marketing of products of food processing companies in foreign countries; create a structure supporting export of the products,
  - 7) Regulate and align with European standards border crossing points' operations.
236. It is expected that implementation of the above activities will help improving productivity in agriculture and constant employment (absolute) rates. Particularly in 2021 the sector productivity should exceed twice the level of 2012. Development of related sectors /areas in the value chain of agriculture will definitely improve and increase nonagriculture employment in rural areas.

**Table 6. Agriculture and rural development, 2012-2025**

	2012	2017	2021	2025
Value added in agriculture (GDP, bln. dram),	764.0	1,116.7	1,524.7	2,046.8
Value added in agriculture, y-o-y % change	9.5%	4.0%	3.8%	3.5%
Value added in agriculture, % of GDP	19.1%	17.9%	16.3%	14.6%
Labor productivity in agriculture, thousand drams	1,748	2,554	3,487	4,682
Non-farm labor productivity, thousand drams	4,396	6,440	9,009	12,562
Non-farm employment in rural area, thousand persons	108.2	116.2	121.2	126.2
Credits to agriculture, mln drams	91,890	162,229	251,982	379,206
Credits to agriculture-to-GDP ratio, %	12.0%	14.5%	16.5%	18.5%
Designated use of arable land, %	67.9%	74.0%	82.0%	90.0%
Weighted average rate of marketability, %	56.1%	60.0%	67.0%	75.0%

## 9.5. SMALL AND MEDIUM-SIZE ENTERPRISES

237. SMEs occupy important positions in all economic sectors of Armenia, moreover are the foundations of some sectors. During 2008-2011, according to the average of different estimates, SMEs have been providing around 100 thousand jobs. Especially in sectors where SMEs' productivity is comparable with that of large enterprises (e.g. industry, especially processing companies, construction, services and individual services), the formers are considered to be an important source of economic and export growth, as well as job creation. Thus, the promotion of SME establishment and successful performance in the aforementioned sectors of economy is one of the government's economic policy priorities. This policy toolset will comprise both direct support activities, and relevant framework policies.
238. Differentiated policy must be formulated and applied to micro and to small and medium enterprises. The later are important from the viewpoint of perspective growth and development and in order to implement efficient policies it is necessary to analyze the factors contributing to the growth of SMEs.
239. Direct assistance to SMEs is stressed also because the increase in the number of small and medium entrepreneurs is an important factor for formation of the middle class in the country. In this regard, Government will consistently implement policy measures supporting the formation of the middle class.
240. Main policies for direct support to SMEs will include:
- 1) Continue and expand loan state guarantee practices for acting and start-up SMEs that have potential in export, import substitution or knowledge production, giving priority to businesses acting in Marzes.
  - 2) Support to development of beginner businesses including measures directed at capacity building and skills development, business planning, and ensuring access to finance for beginners. Particular programs will be targeted at promoting business among women and young people.
  - 3) Provide access to finance, through elimination of obstacles and application of adequate management tools in situations with inadequate or illiquid collateral and high risks.



- 4) Educational and counseling support, especially if acting market mechanisms fail providing them or involve big transaction costs. Specific state programs will be aimed at capacity development of companies rendering business services.
  - 5) Direct support to acting and beginner SMEs to ensure access to markets and to provide information related assistance. Enterprises will receive support for developing websites, advertising billboards, product packaging, and branding.
  - 6) Ensuring access to state procurement system for SMEs. Procurement procedures which create unjustified obstacles for relevant sector SMEs will be revised.
241. It is expected that the above-mentioned policies and general framework activities will result in the increase of the role of SMEs in the economy. Thus, it is expected that in 2025 the share of SME value added in GDP will reach 60% as opposed with the 40% in 2012.
242. In addition, the labor productivity - a key indicator describing SME competitiveness will increase. Currently, depending on the economy branch, productivity of SMEs of the EU countries is from 3 to 5 times higher compare with their Armenian counterparts. The average productivity of Armenian SMEs will increase 2-3 times by 2025, thus contributing to the increase of SMEs' share in the export.

## **10. LABOR MARKET AND EMPLOYMENT**

### **10.1. LABOR MARKET OVERALL DESCRIPTION**

243. Effective use of labor resources and increase in the level of employment are the priorities of the development strategy program. Increase in the number of employed and the entry of people who have been left out of the labor market for various reasons back into the market, together with the implementation of the relevant minimum wage policy, are the key mechanisms for reducing the poverty level.
244. Labor market of Armenia faces a number of challenges, which have worsened due to the economic downturn. The high economic growth of the 2000s did not lead to significant growth of employment, because it was mostly due to productivity increase and structural changes in the economy. Particularly, the weight of construction drastically increased, however employment rate in the field of construction went up due to reduction of those employed in industry.
245. The Armenian labor market is also distinguished with low labor force participation rate. The consistent high unemployment rate affects the likelihood of finding a job in the market, which naturally has a direct impact on the participation rate. Meanwhile, extensive labor migration (around one-third of households have labor migrants) and revenues received from migrants increase the minimum wage level (reservation wage) with which household members left in Armenia will agree to take a job. This in its turn negatively impacts the labor market activity level.
246. Armenian labor market has an important specific aspect - a large army of labor migrants, who are statistically recorded basically as economically passive labor resource. Changes of migration flows and conditions may have different impacts on the labor market, depending on the character of such changes. Particularly, if increase of economic activity in Armenia makes the migrants return, the unemployment and labor force participation indicators may slightly adjust upwards. It is assumed that they will return because of economic incentives in order to

find a job in Armenia or with an already found job. However, if the return of migrants creates negative shock in the recipient country, the change of their actual status may not happen.

247. Labor migration is affected by factors not influenced by the source country, in particular change of the recipient country's migration policy. In this regard, migration policies of forthcoming years adopted by the Russian Federation, as the main recipient, will be essential for Armenia. Another key aspect of labor migration is the age-occupation structure. Positive flow of migrants during 2005-2007 was due to construction boom in Armenia and the labor migrants were mainly involved in construction. The strategy predicts a qualitatively different growth, which may also lead to a different reaction of migrants. In general, even if positive economic consequences of labor migration are neglected, and it is viewed as negative event in long-term perspective, there are actually no other effective control measures than implementation of correct economic incentives. Economic growth, even territorial development, and creation of jobs far are more functional ways of addressing the issue.
248. Another important indicator of Armenian labor market is the inequality between the demand and offer due to quality requirements set for the labor force. According to BEEPS 2008, the lack of qualified workforce in the labor market is an essential obstacle for about one-third of companies introducing innovations.
249. Finally, like elsewhere, in Armenia also, the economic crises worsened problems related to unemployment among young people. Declining rate of new job openings directly impacts those first time entering the market. Besides, the lack of functional mechanisms ensuring proper transition from study to labor market, as well as the low level of feedback between the general educational system and the labor market deepen the problem.

## **10.2. LABOR MARKET DEVELOPMENT PROJECTIONS**

250. As mentioned earlier, it is expected that by 2025 the program implementation will result in increase of non-agricultural employment by around 220 thousand people compared to 2012, of which 60 thousand by the year 2017.
251. The labor market dynamics is dependent on the overall economic development trend and characteristic cyclical fluctuations. Thus, during 1995-2012, the GDP growth elasticity of the employment rate was on average 0.2<sup>19</sup>. Other than long-term relationship, there is also a link of cyclical nature that is the "sensitivity" of the employment rate with respect to the cyclical fluctuations of the GDP has been around 0.47 in 1995-2012<sup>20</sup>.
252. Also in the future it is expected that the positive correlation between economic growth and level of employment (nonagricultural) will be maintained. In particular, based on sectoral forecasts, which take into account the impact of changes in the productivity level, an elasticity factor of 0.20 of employment growth/economic growth is expected – in 2014-2025, one percentage of economic growth will result in 0.20 percentage points of growth of the employment rate.
253. Increase of employment rate in the programming period due to 'quality' job places is one of the specific aspects of increasing employment, which implies expansion of opportunities for

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<sup>19</sup> The calculations exclude year 2004 having considerable deviations from the overall trend. If 2004 is taken into account the elasticity coefficient would be 0.1.

<sup>20</sup> For OECD countries in 1960-1990 the indicator amounted to 0.48 (source: Elmeskov, J., Pichelmann, K., "Interpreting unemployment: the role of labor-force participation", OECD Economic Studies No 21, 1993).

qualified workforce on the one hand and creation of relatively better paid jobs on the other hand.

254. Table 7 presents the forecasts of the employment and unemployment rates, as well as labor force participation rate (economic activity level). Employment growth in the future will be mainly associated with decrease in unemployment, though a positive dynamics in labor force participation is anticipated. Presented labor market indicators can be reached only if real GDP growth of around 6 percent is maintained in the midterm.

255. Employment rate in 2025 is comparable with the EU developed countries' indicator – around 70 percent with respect to working age population (WaP).

**Table 7. Employment, unemployment and labor force participation rates in RA, 2012-2025**

	2012	2013	2014	2015	2016	2017	2021	2025
Employment rate (16+)	48.8%	48.7%	49.1%	49.5%	50.1%	50.7%	53.9%	57.2%
Employment rate (WaP)	57.0%	56.8%	57.3%	58.0%	58.7%	59.6%	64.7%	71.1%
Unemployment rate	17.3%	17.3%	17.2%	16.9%	16.5%	16.0%	13.1%	10.0%
Labor force participation rate	59.0%	58.8%	59.2%	59.6%	60.0%	60.4%	62.0%	63.6%
Real GDP growth	7.2%	3.5%	5.5%	5.7%	5.9%	6.1%	6.4%	6.5%

256. The economic activity (labor force participation rate) indicator clearly responds to the cyclical changes of the employment rate. Although the time series available are for short period and this creates problems with accuracy level, nonetheless a small indicative analysis reveals that the cyclical changes of the employment rate and the labor force participation rate in the last 10 years are quite interrelated, which witnesses high level of flexibility of the Armenian labor force in moving from passive to active status (Figure 6)<sup>21</sup>.

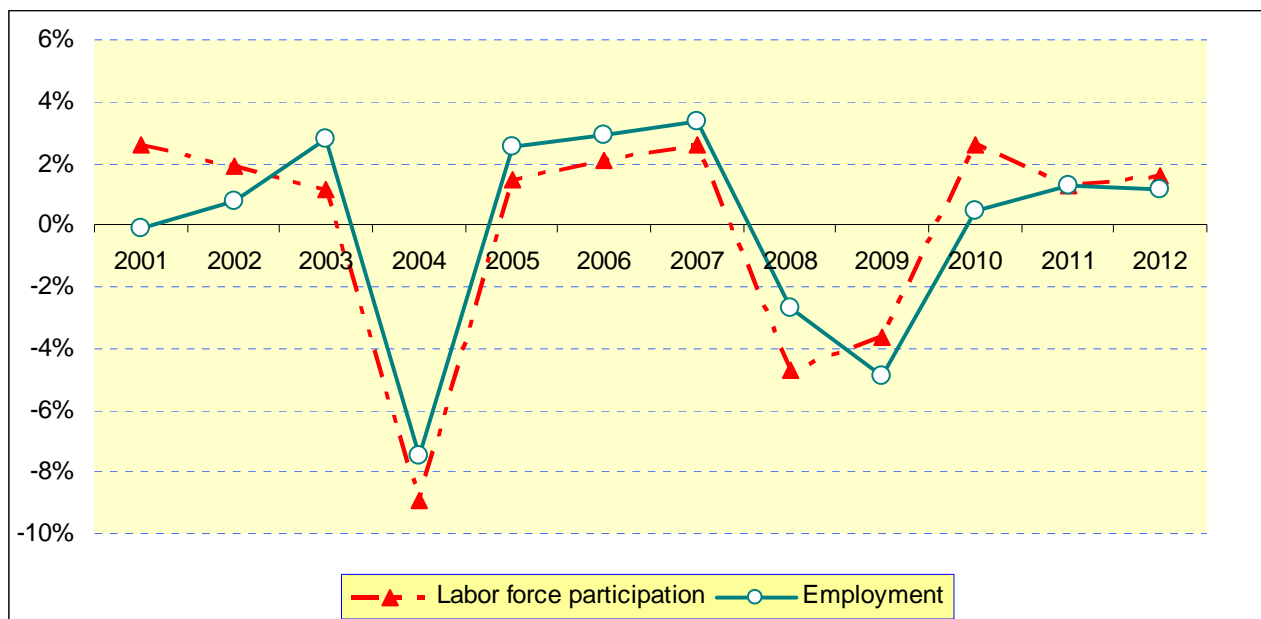
257. Another absolute indicator conditioning the participation and employment rates – the population above 16 years of age, will not change significantly in the program implementation period.

258. Tangible changes are envisaged in the employment sectoral structure. The share of employed in agriculture will decline over time, contributing to increase in the share of the employed in the industry and construction sectors. Thus, by 2025 the share of employed (in total employment) in industry will reach 15.4% and in 2025 compared to 11.8% in 2012, whereas in construction the share will reach 8.2% compared to 6.3% in 2012.

259. Neither are expected considerable changes in the sources of population's income. The share of income received from waged labor in the total income has increase around 1.7 times in the last 12-13 years and has reached around 53% in 2012. Until 2017, this indicator will reach 55%, and according to the forecasts will be 58% in 2025.

<sup>21</sup>Hodrick-Prescott filter was applied to determine the trend.

**Figure 6. Trend deviations of labor participation and employment rates (%)**



260. From the viewpoint of unemployment structure, it is important to refer to the data by age groups. Regardless of the significant decline, the level of unemployment among young people up to 25 years of age still remained very high in 2010 at around 40%, twice exceeding the average unemployment rate. One of the explanations for such a large difference could be the high level of informal employment among young people, but the comparisons presented below do not allow qualifying that as an important factor (Figure 7). Informal employment among people up to 19 years of age actually exceeds the same indicator for other age groups, but this is not the case for the age group of 20-24 years, while unemployment rate is extremely high among the latter age group as well.

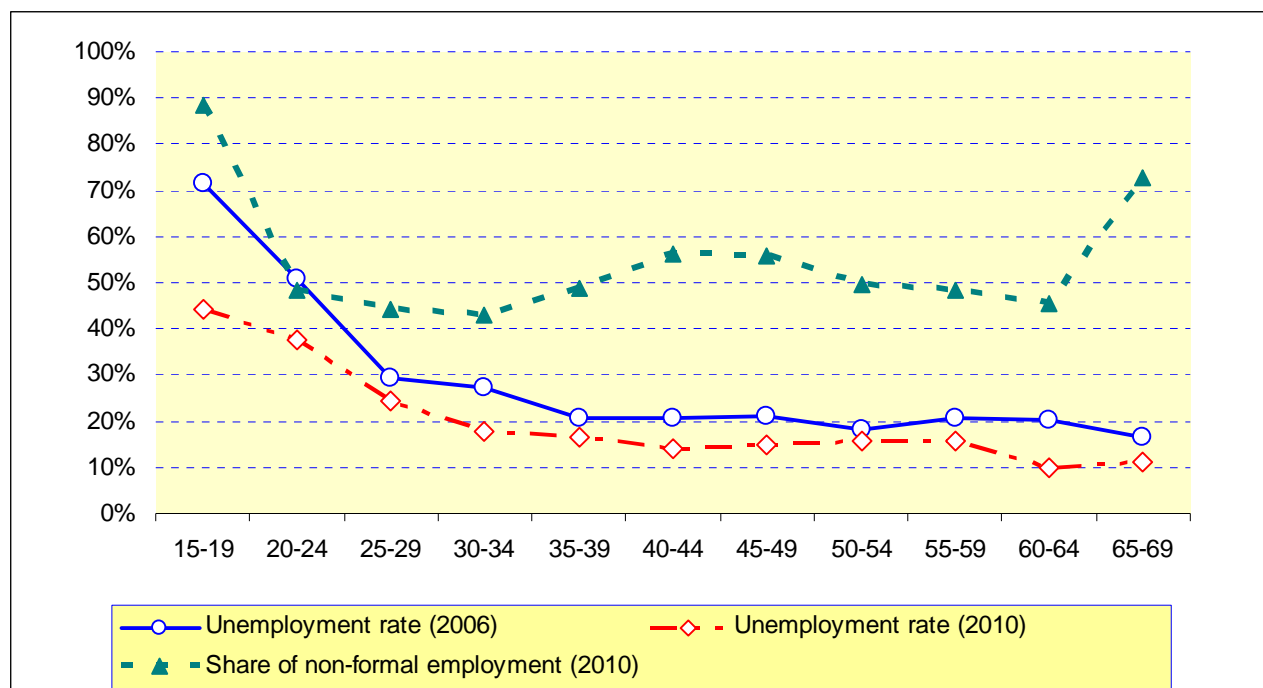
261. When developing labor market active policies in the future, special attention will be paid to the problems of unemployment among young people. In particular, the reasons for high unemployment among young must be studied in detail. Results of such an investigation will serve as a basis for a targeted policy measure development. Examples of such policy measures are internships ensuring transition from study to work or education financing special schemes, which presupposes social works for the recipients of the scholarships. In general, labor market active policies' implementation efficiency will be assessed also by the reduction of the difference between the youth unemployment rate and the average rate of unemployment.

262. Informal employment in non-agricultural sectors, according to the results of the survey conducted in 2010, amounted to around 28%, which is six percentage points lower than the 2006 level. The largest number of people informally employed, as could be expected, is recorded in construction and trade and services sectors – 55% and around 29% respectively.

263. The increase in employment formalization level will be conditioned on the improvements of tax administration, as well as the transition to the funded pension system. Changes of the norms regulating the relationships between employers and employees stipulated in the Labor Code and making them more flexible, will also contribute to the increased level of formal employment. It is important to emphasize that formalization primary refers to existing jobs, though it doesn't exclude growth in formalization rate due to opening of new formal working positions. The mentioned measures will increase formal employment in all sectors and according to the forecasts it will constitute 52% in the construction sector in 2017 (45% in

2010), 93% in industry (88% in 2010) and 76% in trade (71% in 2010). In general, it is forecasted that the level of formalization of non-agricultural employment will reach 78% in 2017 and 83% in 2025, or respectively 6 and 11 percentage points higher than the levels assessed for 2010.

**Figure 7 . Unemployment and non-formal employment by age group in 2006 and 2010**



Source: The Informal Sector and Informal Employment in Armenia, Country Report-2010 (NSS, ADB, 2011), Labor Force in Armenia in 2001-2006 (NSS, 2007).

### 10.3. LABOR MARKET POLICIES

264. The employment rate and the welfare of the employed will depend not only on the sectoral dynamics of economic development, but also on the nature of policies enacted by state bodies in the labor market. In particular, it will be important to introduce new policies designed for the promotion of employment (specially aimed at new jobs creation), to increase the number of efficiently implemented programs, to ensure their flexibility taking into account the regional development peculiarities and the necessity to respond fastly to economic development trends and cyclical deviations.

265. An important element of labor market regulation should be the minimum wage policy. Though minimum wage is not a primary tool for combating poverty, one of its functions should be to exclude situations when citizens are employed but at the same time are below the poverty level<sup>22</sup>. And in the long run, this should extend not only to the very individual employed, but rather should guarantee a minimum welfare for an average family with one employed member<sup>23</sup>. Thus, due to increase of minimum wage scheduled in 2013-2014 ratio of minimum to average wage will reach around 40 percent in 2014, coming closer to the indicator envisaged by the revised European Social Charter<sup>24</sup>. Limited increase of minimum wage can have also positive impact on activation of labor resources. In any case, the increase in

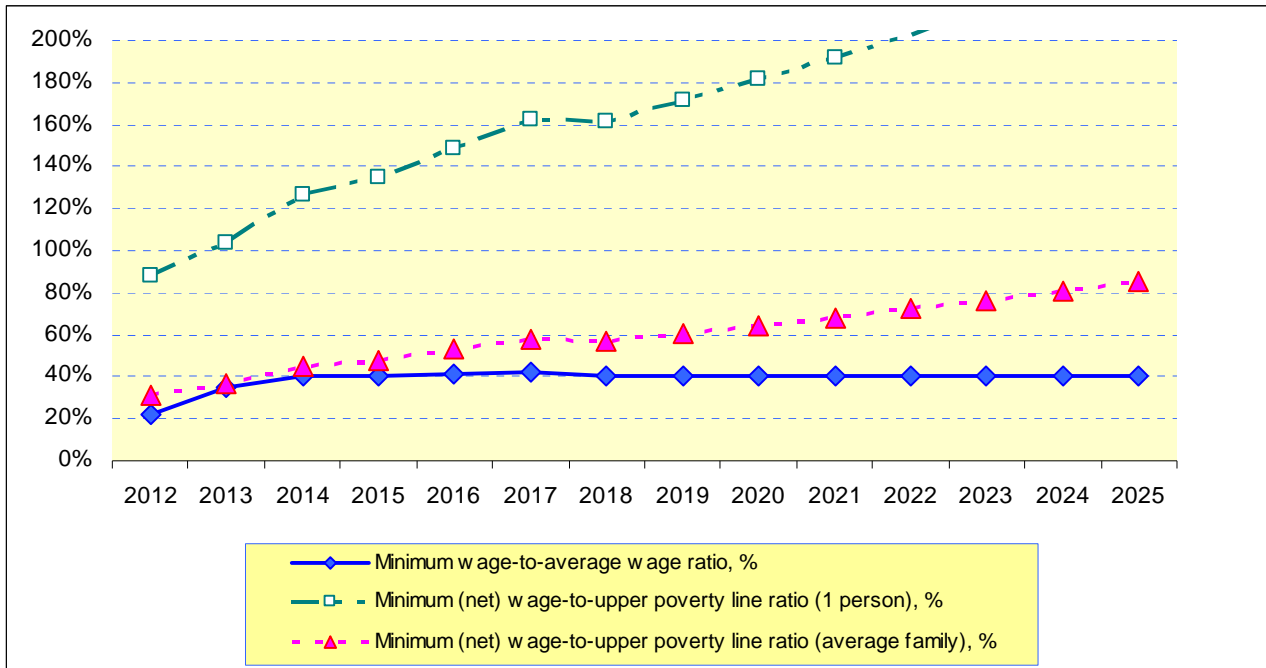
<sup>22</sup> According to NSS as of 2012, around 26.1 percent of employed at the age of 15-75 are below the poverty line.

<sup>23</sup> Typical here is defined as a family of four (two children) with one employed member.

<sup>24</sup> Minimum wage – median wage ratio in 2014 will be around 69 percent and will reach 70.2 percent in 2018. In case such statistics exists and if there will observed widening of the gap between the mean and median wages, minimum wage corrections must be conditioned on the median wage trend.

minimum wage should be in line with the dynamics of the average wage and exclude, to the extent possible, the imbalance between the demand and supply of the labor force.

**Figure 8. Minimum wage ratio to average wage and upper poverty line in 2012-2025, %**

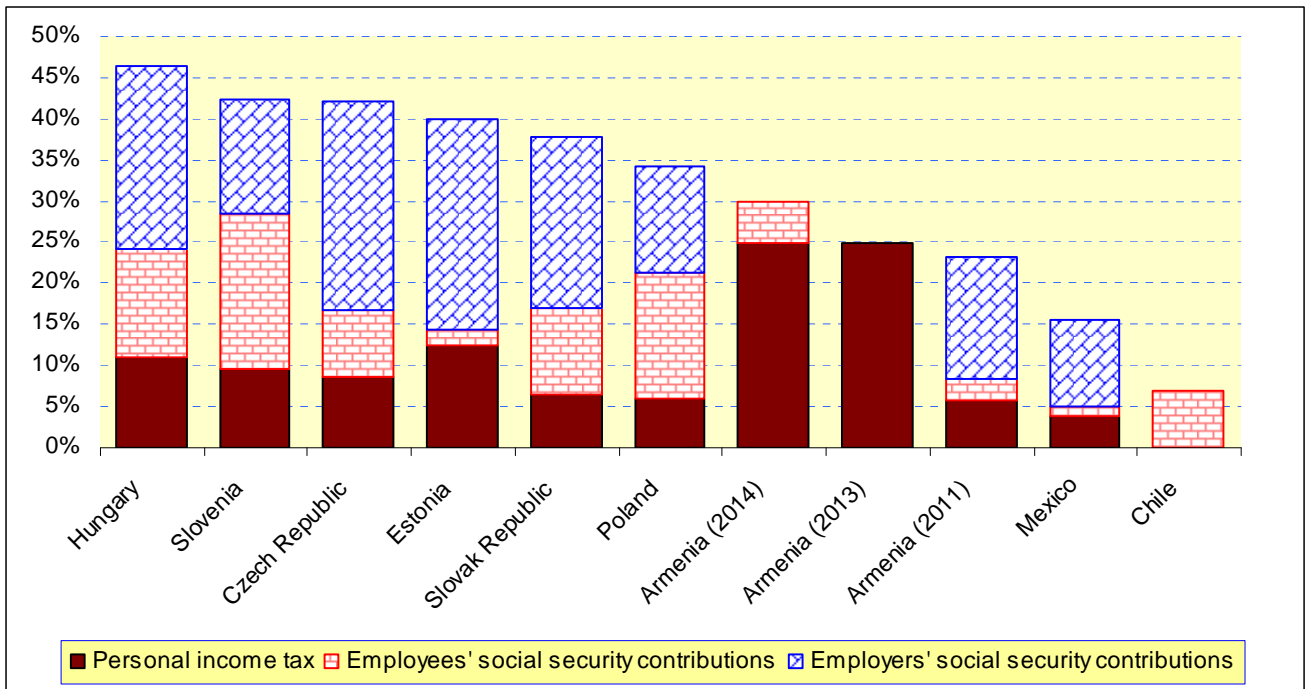


266. The labor market environment should be regulated not only by defining the minimum wage, but also by the policy of taxing incomes received from employment. The new law for taxing incomes will enter into force on 1 January 2013, which in its first application year almost will not increase the tax burden on employment incomes. The tax burden in overall labor costs increased from 23.1% in 2011 up to 24.8% in 2013 (calculations are done based on the average wage). Even if the contributions associated with the transition to the funded pension system in 2014 are accounted for, the tax burden of employment related income in Armenia continues to be lower compared to the OECD developing countries. It must be noted that regardless of these changes, the tax burden of labor costs in Armenia still remains lower compared to the OECD developing countries level. In the future, the increase of tax revenues should take place by expanding the taxation basis and/or increasing the rates for non-distortionary taxes.

267. The next important component of labor market regulation is the entirety of the norms regulating the relationships between employers, employees and state bodies, which define the rules for entering and exiting employment, as well as the working conditions for the employed.

**Figure 9. Labor taxation in OECD countries (2010) and Armenia, % of total labor costs<sup>25</sup>**

<sup>25</sup> For the OECD countries average nominal wage of the non-agricultural sector was used, whereas for Armenia the average nominal wage for the economy was applied.



Source: OECD countries - OECD Tax Database (2012 edition).

268. The ease of entry into and exit from the labor market, as well as the flexibility of working hours were formerly measured with the help of “employment rigidity” index published annually by the World Bank. According to that index, Armenia’s rank among 143 countries dropped from 20 in 2004 to 40 in 2010<sup>26</sup>. But it is important to note that during that period there hasn’t been introduction of stricter labor market regulations and this suggests that the decline in the rank resulted from the liberalizing reforms implemented in many other countries. Table 8 presents a number of indicators characterizing the flexibility of labor relationships in selected countries. Regulations in Georgia are the most flexible and give contractual freedom to the employer and the hired employee. Norms applied in Armenia, in general, are comparable to the regulations in other CIS countries presented in the table.

269. In the future, the strategy of Armenia’s government will be liberalization of the administrative regulations of labor relationships, with the purpose of ensuring comparable level of regulations with respect regional countries and countries considered to be Armenia’ competitors. In particular, all the regulations which create problems for both employers and employees must be abolished. At the same time, whenever implementing changes the feedback from the beneficiaries of the regulations should be taken into account to the possible extent.

**Table 8. Norms characterizing labor relationships in Armenia, some CIS countries and Latvia (2011)**

	Armenia	Georgia	Moldova	Ukraine	Latvia
Fixed-term contracts prohibited for permanent tasks	Yes	No	Yes	Yes	Yes
Maximum overtime limit in normal circumstances (hours)	4 hours/ 2 days, 8 hours per week/180	No	4 hours per week; 120 hours	No	144 hours for 4 months

<sup>26</sup> The calculation was done for 143 countries, the date on which was included in the database of “Doing Business” published already in 2004.

	Armenia	Georgia	Moldova	Ukraine	Latvia
	hours annually		annually		
Premium for overtime work (% of hourly pay)	50%	Left to the sides discretion	50% for the first 2 hours; 100% afterwards	50% for the first 2 hours; 100% afterwards	100%
Paid annual leave, days (working days)	20 <sup>27</sup>	24	20	18	20
Notice period for redundancy dismissal (in salary weeks) <sup>28</sup>	8	0	8.7	8.7	1
Severance pay for redundancy dismissal (in salary weeks)	4	4.3	13.9	4.3	8.7

Source: Doing Business – Employing workers, www.doingbusiness.org

270. It is expected that the minimum wage policy and increase in minimum wage envisaged by that policy will not have material negative impact in terms of increase of informal employment or decrease in labor demand. Any such result is expected to be offset by more efficient administration and liberalization of regulations.

271. Policies and specific measures for promoting employment implemented by state bodies should have clear effectiveness evaluation procedures. In this regard, the role of the State Employment Agency it is extremely important, since it possesses data on the unemployed at individual level. The availability of such databases allows for applying modern methods for assessing the effectiveness of training courses and other types of measures, regardless of the unemployed person participating in those measures voluntarily or mandatorily. Administrative data (at individual level) are also important for analyzing the duration of unemployment and the probability of the unemployed to find a job, and thus assessing not only the measures implemented by the state, but also the role of the individual's characteristics. In general, there is a scope to improve labor market information and improving the labor market monitoring system to guide employment policies and programs.

272. The effectiveness of active labor market programs to a large extent depends on the number of job vacancies reported by employers to Public Employment Agency (PEA). All else being equal, the lower the unemployment/vacancies (U/V) ratio is, the higher the job placement rate (which is the main indicator of the effectiveness of PEA). Given the number of registered unemployed, the U/V ratio is determined by the capacity of PEA to reach out to employers and collect information on vacancies. This capacity is reflected in the vacancy penetration ratio, which is the number of vacancies reported to PEA as a proportion of all job vacancies. The Public Employment agency must work to improve this indicator by strengthening the links between PEA and the employer community. Consequently, it will enable to improve the job-worker matching.

#### **10.4. EMPLOYMENT IN THE PUBLIC SECTOR AND AGRICULTURE**

273. The possibility for increasing employment in the public sector is not considered. The surplus of human resources in sectors such as healthcare and basic education is a limitation to increasing the number of employed in those sectors in the future. Decrease in the employment rate is possible in the case of implementation of the community amalgamation

<sup>27</sup> 20 working days in case of 5 days working week and 24 working days in case of 6 days working week.

<sup>28</sup> The weeks referred to in the current and the following points are based on the average indicator for the employees with 1, 5 and 10 years of employment record, in case the legislation in force envisages such differentiation.



program for improving the efficiency of the system of local authorities, but significant changes to the number of employed in the public governance sector are not expected.

274. In general, neither an increase in the number of employed in the agricultural sector is planned. The future development of the sector will basically depend on the increase in the level of productivity. At the same time, parallel to the increase in the level of productivity of agriculture, or as the basis for ensuring that increase, possibilities for non-agricultural employment in the agricultural production chain should expand. Possibilities for creating new jobs will be opened in the supply chain (seeds, seedlings, machinery and equipment), as well as services and sales in the production process. In this regard, it is important to note that the government of Armenia should draft an exit program for subsidizing measures it currently implements, which will create the basis for the private sector to take on those functions. In case of agricultural value full chain formation, it is expected that the number of non-agricultural employed in rural areas will grow by 8 thousand by 2017 and by additional 10 thousand during 2017-2025 period.

## 11.INFRASTRUCTURES

### 11.1. DRINKING WATER

#### 11.1.1 CURRENT SITUATION

275. In the SDP, further reforms of water supply and sewerage systems aimed to enhance the reliability and efficiency of operations of those systems, reduce water losses and improve the quality of water supply and drainage services.

276. During the implementation of the SDP, the reliability of centralized water supply systems was improved significantly, especially in rural settlements (Table 10). Data presented reveals that the reliability of centralized water supply systems in rural settlements improved by 1.3 percentage points in 2011, compared to the level of 2008 and reached 93.7%.

277. As of 2011, transported potable water problem was solved for the households. If in 2008 1.1 percent of households was consuming transported water, the respective indicator according to 2011 data was 0 percent.

278. According to the results of the survey, the average daily duration of water supply in 2011 improved by around 3.6 hours, compared to the same indicator for 2008, and amounted to 16 hours per day thus reaching the 2012 target set by SDP.

**Table 9. Access to drinking water in 2008-2017, %**

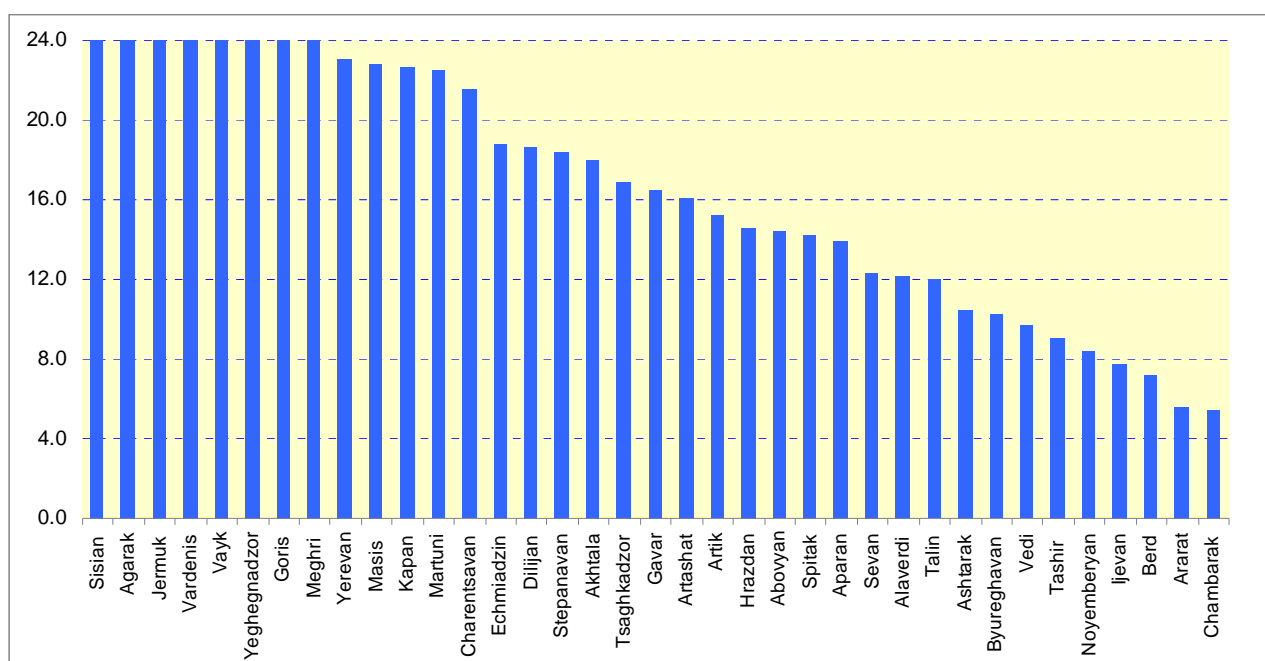
Water supply source	Total population				Urban population				Rural population			
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011

Water supply source	Total population				Urban population				Rural population			
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Centralized water supply	97,0	97,5	97.5	97.5	99,4	99.6	99.5	99.5	92,4	93.6	93.5	93.7
Less than 1 hour	0,7	0.4	0.5	0.1	0,2	0.2	0.3	0.1	1,9	1.0	0.9	0.1
1-5 hours	31,3	30.0	26.6	18.6	31,2	26.8	23.7	16.4	31,4	36.5	32.4	23.3
6-12 hours	28,7	17.5	20.1	22.6	32,5	19.3	22.5	24.0	20,5	13.8	15.2	19.6
13-23 hours	5,7	3.8	4.3	5.5	5,9	4.9	3.9	5.3	5,3	1.4	5.2	5.8
24 hours	33,6	48.3	48.5	53.2	30,2	48.8	49.6	54.2	40,9	47.3	46.3	51.2
Water well, spring	1,2	1.6	1.4	1.3	0,1	0.2	0.2	0.1	3,2	4.3	3.6	3.6
Local source	0,6	0.5	1.0	1.1	0,2	0,2	0.3	0.4	1,2	1.3	2.5	2.6
Transported water	1,1	0.3	0.1	0.0	0,2	0,0	0.0	0.0	3,0	0.6	0.4	0.0
Other sources	0,1	0.1	-	0.1	0,1	0,0	-	0.0	0,2	0.2	-	0.1

Source: NSS - Integrated Survey of Living Conditions (ISLC) 2007, 2008, 2009, 2010 and 2011.

279. At the same time, the duration of water supply still continues to be characterized by significant regional disparities. In 9 out of 36 cities serviced by Armenian Water Sewerage CJSC the average daily duration of water supply in 2012 was less than 12 hours. The average daily durations of water supply by cities in 2012 are presented in Figure 10.

**Figure 10. Average daily duration of water supply in urban communities in Armenia, 2012 (hours per day)**



Source: State Water Committee of the Ministry of Territorial Administration.

280. The average daily duration of water supply in rural areas is also characterized by significant inequalities. In rural settlements serviced by Armenian Water Sewerage CJSC the average daily duration of water supply in 2012 amounted to 14.6 hours, while, for around one fourth of the rural population the average daily duration of water supply was five hours or less (Table 10).

### 11.1.2 MAIN DIRECTIONS OF PROGRAM POLICIES

281. The program plans to continue the reforms of drinking water systems in order to enhance the reliability and effectiveness of the operations of those systems and improve the quality of water supply and drainage services, at the same time focusing on mitigation of regional disparities.

282. **Investment policy.** Drinking water systems will continue to remain a priority for public investments. For the entire period of the program, annual investments in the system will amount to 0.4% of the GDP.
283. The targets for the investment policy will be the duration of services provided<sup>29</sup> and improvement of the quality of those services and mitigation of the existing regional disparities. The investment policy should also aim to enhance the efficiency of drinking water systems, focusing particularly on the issue of reducing water losses. In the sphere of wastewater removal of special importance are the reconstruction of wastewater removal systems in cities and major rural areas and construction of wastewater treatment plants for those systems.
284. The investment policy will adopt a special approach also to the around 560 rural communities, where water supply is not provided by specialized organizations possessing the relevant permits for water supply services provision. These communities will be included in the investment program of the government through their inclusion in the service area of already operating or future specialized organizations which have the corresponding permits for provision of water supply services. At the same time, water supply problems of communities, the inclusion of which in the service area of specialized organizations providing water supply services is technically difficult, or economically not viable, will not be ignored either.
285. **Tariff policy.** Throughout the period of the program, the tariff policy will be aimed at gradually increasing tariffs to the levels of cost recovery, taking into account the affordability issues for households in the lowest income groups. The maximum level of affordable tariffs for water supply and wastewater disposal services will be defined<sup>30</sup>, and the services provided with higher tariffs for poor families will be subsidized by the government to cover the difference.
286. **Management reforms.** Management reforms in the drinking water sector will continue by increasing the participation of the private sector. The government will encourage the widening of the service areas of specialized organizations with permits for provision of water supply services, as well as the establishment of new specialized organizations for provision of water supply services to rural communities which have been left out of the service areas of the operating specialized organizations. With this purpose country's water system comprehensive analysis will be conducted, including the rural areas currently out of service area.

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<sup>29</sup> According to preliminary assessments, the proposed level will allow for increasing the average national indicator for continuous water supply by 0.5 hour annually.

<sup>30</sup> 2.5 percent of consumer expenditures of the poorest quintile of the population. The calculated daily consumption volume per capita is 70 L. According to the assessments in 2010, the affordable calculated tariff was 190 drams / cubic meter.

### 11.1.3 PROGRAM TARGET INDICATORS

287. The main target indicators for drinking water systems are presented in Table 10.

**Table 10. Drinking water system main target indicators**

Indicator	Base year	2014	2017	2021	2025
Transition indicator (published by EBRD)	2.67 (2013)	3.0	3.67	4.0	4.33
Water supply duration indicator improvement with respect to the base year, hours/day					
“Yerevan Water” CJSC service area (Includes city of Yerevan and adjacent 32 rural settlements)	23.0 (2012)	0.2	0.5	0.8	1.0
“Shirak Water and Sewerage” CJSC service area (Includes city of Gyumri and adjacent 36 rural settlements)	13.7 (2012)	1.0	2.5	4.5	6.3
“Lori and Sewerage” CJSC service area (Includes city of Vanadzor and adjacent 16 rural settlements)	12.1 (2012)	1.5	3.0	5.5	7.9
“Nor Akunq” CJSC service area (Includes city of Armavir and adjacent 10 rural settlements.)	22.4 (2012)	0.2	0.5	0.8	1.0
“Armenian Water and Sewerage” CJSC service area, including by group of cities and rural areas <sup>31</sup>	16.2 (2012)	0.9	2.2	3.4	4.5
Group of cities 1	22.6 (2012)	0.2	0.5	0.8	1.0
Group of cities 2	16.1 (2012)	0.8	2.0	3.0	3.9
Group of cities 3	12.1 (2012)	1.6	4.0	6.0	7.9
Rural areas	14.6 (2012)	1.0	2.5	4.0	5.4
Public investments level, % of GDP	0.37 (2012)	0.4	0.4	0.4	0.4

## 11.2. IRRIGATION

### 11.2.1 CURRENT SITUATION

288. The expansion of irrigated land areas was quite slow in recent years. In particular, compared to 2008, irrigated land areas in 2012 increased by only 1 percent and amounted to 130.7 thousand ha.

**Table 11. Irrigated areas and volume of supplied water 2008-2012**

	2008	2009	2010	2011	2012
Irrigated land serviced by WUAs, thous. ha	128.9	128.1	128.8	129.4	130.7
Volume of the supplied water, mln. cub. meters	576.7	412	396.5	415.3	472.1
Water consumption level, thous. cub. meters / ha	4.47	3.22	3.08	3.21	3.61

Source: State Water Committee of the Ministry of Territorial Administration.

289. During the recent period the volume of water used per hectare has decreased. In 2008 it amounted to 4.47 thous. cubic meters. In 2012, it reduced by around 19% down to 3.61 thous.

<sup>31</sup> The first group includes the cities with average daily water supply duration exceeding 20 hours in the base year, the second group includes the cities with average daily water supply duration of 10 to 20 hours in the base year, and the third group – cities with less than 10 hours of average daily water supply duration.

cubic meters. The decline in the per unit use of water mainly resulted from the changes in natural-climatic conditions and due to decrease in water losses in primary irrigation system.

290. At the same time, positive developments are recorded in recent years with regard to the indicators characterizing the level of satisfaction of water users with irrigation water supply services. In particular, in 2009-2011, the results of the representative sample survey of around 1500 water users revealed that the value of the satisfaction index of water user households with irrigation water supply services was around 50 in 2011, compared to 40 in 2009 (Table 12).

**Table 12. Dynamics of satisfaction with irrigation water supply services 2009-2011**

	2009	2011
Percent of h/hs which indicated that the irrigation water was supplied in timely manner in the total number of WU h/hs, %	57.2	70.8
Percent of h/hs which indicated that the irrigation water was supplied in enough quantity in the total number of WU h/hs, %	60.9	72.8
H/hs which have indicated that the irrigation water supply improved compared to the previous year, % of WU h/hs	17.0	12.2
H/hs which have evaluated the condition of the irrigation system in their village as very good and good, % of WU h/hs	23.5	35.7
<b>WU's satisfaction with the irrigation water supply index (ISI)</b>	<b>39.7</b>	<b>47.9</b>

Source: results of 2009 and 2011 survey of WUA member households (MCA Armenia SNCO/ AVAG Solutions Ltd).

### 11.2.2 MAIN DIRECTIONS OF PROGRAM POLICIES

291. **Investment policy.** Irrigation systems also will continue to remain a priority for public investments. For the entire period of the program, annual capital investments in the system will amount to 0.3% of the GDP. At the same time, the Government will take steps to ensure sufficient funding for the operation and maintenance expenses of the system.

292. The target of the investment policy will be the expansion of irrigated land areas and higher efficiency of the system. Expansion of irrigated land area is assumed to take place in the frames of existing irrigation systems.

293. **Tariff and subsidy policy.** The tariff policy will aim to gradually increase the current cost recovery level of the tariffs.

294. Provision of financial support to WUAs will be in the form of current grants in accordance with the relevant regulations for provision of public financial support<sup>32</sup>.

295. **Management reforms.** Management reforms of the irrigation system will continue and will aim to further deepen the already formed participatory management schemes.

### 11.2.3 PROGRAM TARGET INDICATORS

296. The main target indicators for irrigation systems are presented in Table 13.

**Table 13. Main target indicators for irrigation systems**

Indicator	Base year	2017	2021	2025
Transition Indicator (EBRD)	2.67 (2013)	3.67	4.0	4.33

<sup>32</sup> Order of the government of Armenia No. 398-N dated 10 March 2011 "Regulating the process of provision of state financial support in the form of current grants to water user associations in 2012-2016".

Irrigated land services by the WUAs, thous. ha	130 (2012)	132.4	135	138
Public capital investment level, % of GDP	0.18 (2012)	0.3	0.3	0.3
Tariff current cost (accrued), % recovery rate	46 (2012)	100	120	120

### 11.3. TRANSPORT

#### 11.3.1 CURRENT SITUATION

297. The Sustainable Development Program planned to increase the volumes of public resources allocated to the current operation and maintenance of motorways in order to prevent the accelerated deterioration of the road network and ensure safe, quick and easy transportation, and enhance the effectiveness of the use of allocated resources.

298. Public expenditures on road network operation and maintenance in 2007-2012 are presented in Table 14.

**Table 14. State budget expenditures on road systems 2007-2012**

	2007	2008	2009	2010	2011	2012
State budget expenditures on road systems <sup>33</sup> , mln. AMD	44243	41901	57792	32540	24647	29474
Percent of GDP	1.40%	1.17%	1.84%	0.93%	0.64%	0.73%

Source: Reports on execution of Armenia's state budget

299. As presented in the table, during the first years of the implementation of the sustainable development program, especially in 2009, state budget expenditures on road systems were increasing significantly, but a sharp decline was recorded in 2010-2012, as a result of the economic decline in 2009 caused by the financial crisis. Nonetheless, despite the decline, state budget expenditures on road systems as a share of the GDP was close to the target defined in the SDP (1% of the GDP in 2012).

#### 11.3.2 MAIN DIRECTIONS OF PROGRAM POLICIES

300. The public expenditure policy in the sector will focus on increasing the volumes of public resources allocated to the current maintenance and capital repair of motorways, and enhancing the effectiveness of the use of those resources.

301. Starting from 2015 contributions to the sphere from consolidated budget will comprise around 1.4-1.5% of GDP annually on average, 85% of which will be aimed at road network<sup>34</sup>, and the remaining 15% at other programs.

302. The primary target of the investment policy will be to repair segments of at least one traffic road connecting each settlement to the corresponding regional center, North-South road corridor construction, as well as roads and segments of roads with high economic effectiveness.

303. To increase effectiveness of budget allocations and strengthen program budgeting in the sector of road construction the government plans to implement modern management systems, among them:

<sup>33</sup> "Consolidated budget expenditures on road systems" article includes both current maintenance and capital investment expenditures.

<sup>34</sup> According to preliminary estimations the offered amount of investments will enable recovering/rebuilding about 6-7% of road network of national significance annually (interstate, national and local).

- 1) Development of systems for program (unified) planning of operating and capital expenses in road building programs in the budget area;
- 2) Development and implementation of a methodology for determination of priorities in road building programs /directions to serve as the basis for medium-term expenditure planning and budget decision-making;
- 3) Improvement of the system for outcome planning and performance indicators, including contracts on works and services based on such indicators;
- 4) Development of mechanisms for evaluation of road maintenance /exploitation services;
- 5) Study and development of alternative approaches to financing of sector exploitation and investment programs.

304. Developments in civil aviation will be associated with “open air” policy declared by the Government of RA. The new policy envisages complete revision of institutional, legal and regulative bases of the sphere. As a result it is expected to have a competitive and sustainable air transportation services in Armenia. The reforms are directed towards improvement of air connection to and from Armenia, which will create additional possibilities for sector and general economy development and contribute to better national security. Expected positive effects of civil aviation reforms will be noticeable after some time, while usually airlines have got upto 2 years planning period. Though international experience shows that 2 years period is enough to obtain main expected outcomes.

305. In January 2013 kick-off ceremony of “North-South Railways” and “Southern highway of Armenia” projects has taken place. Connection of Armenian railway system to the Iranian railway network as well as construction of North-South road corridor have strategic implications for developing transit capacities of the Republic of Armenia and ensuring its food security. The Government of RA pays particular attention to these projects which will be implemented in the frames public-private partnership projects. In particular economic feasibility studies are planned to be implemented based on concession contracts and based on the results obtained also the construction process will be carried out by cooperation of public and private sectors.

306. The following programs and measures will be implemented in the transport sector.

- 1) Accessibility of common use transport, operation of buses with big seating capacity, improvement of transport station services, implementation of policies promoting development of nature-friendly transports (metro, electro-transport).
- 2) Big investment-requiring programs for construction of new metro stations, modernization and expansion of carriages, refreshment of trolley-bus parks, and improvement of the trolley power lines.
- 3) Measures on ensuring accessibility of transport means for disabled persons (slide platforms for wheelchairs on bus stops and pave ways, special vehicles with wheelchair lifters).
- 4) Program on construction of the new Vanadzor-Fioletovo railway.
- 5) Program on elimination of landslide consequences of Hrazdan-Ijevan railway Dilijan-Ijevan section and restart of communication.
- 6) Program of building a railway to Zvartnots airport, the international logistical center and the free economic zone to be created on airport’s territory.

- 7) Telecommunications digitalization project<sup>35</sup>.
- 8) Project of launching Armenian space satellite.

### 11.3.3 PROGRAM TARGET INDICATORS

307. The main target indicators for the transport sector are presented in Table 15.

**Table 15. Target indicators for transport sector**

Indicator	Base year	2014	2017	2021	2025
Transition Indicator (EBRD)	2.67 (2013)	3.0	3.67	4.0	4.33
Communities with at least one adequate road connecting them to the regional centre, % of total number of communities		30	50	80	90
Ratio of length of roads and segments in at least satisfactory condition to the overall length of roads of the same category, %	39% <sup>36</sup> (2009)	45%	50%	57%	65%
Interstate	85% (2009)	89%	92%	96%	100%
State	34% (2009)	41%	47%	53%	60%
Local	10% (2009)	16%	21%	31%	45%
Level of public investments in road system, % of GDP	0.49 (2012)	1.4	1.1	1.0	1.0
Level of public investments in transport sector (excluding road system), % of GDP	0.14 (2012)	0.15	0.15	0.15	0.15
Level of public expenditures on current and winter maintenance of roads having state and interstate status, % of GDP	0.24 (2012)	0.21	0.25	0.25	0.25

## 11.4. ENERGY

### 11.4.1 CURRENT SITUATION

308. Currently, the energy system fully meets the domestic demand for electricity and maintains certain potential for electricity export.
309. Electricity is distributed and sold by a private company, and is produced by 6 independent large companies, one wind power plant, two cogeneration plants and numerous private small hydropower and micro plants.
310. During the implementation of the SDP, the government continued its policy for developing small hydropower plants. After 2008, 86 small hydropower plants started operations with a total design capacity of around 169.2 megawatts, producing average of 524.11 million kilowatt hours of electricity per annum. As of January 1<sup>st</sup>, 2014 electricity is produced by 154 small hydropower plants, with a aggregate design capacity of around 260 megawatts and actual average annual energy supply of around 720 mln. Kwt.hour.
311. In 2009 the Government of RA approved a “Development scheme for small hydropower plants”, which envisages construction of additional 90 small hydropower plants with aggregate design capacity of around 110 megawatts (as of January 1<sup>st</sup>, 2012). As of 1st of January 2014,

<sup>35</sup> The project has been approved by point 34 of RA Government decree number 22 dated on 6 June, 2013.

<sup>36</sup> Source: Fiscal consolidation and recovery, WB, June 2011



71 small hydropower plants are in construction phase with total design capacity of around 145 megawatts and expected annual average energy supply of around 515 mln. kWt.hour.

312. During the implementation of the SDP, the construction work on Iran-Armenia gas pipeline was completed and regular supply of gas from Iran started on 13 May 2009 together with the supply of electricity from Armenia to Iran, based on mutual agreement on the volumes and regimes, which are constantly growing.

313. ArmRusgasard CJSC has started the work for restoration of the underground storage of natural gas. The capacity of the underground gas storage facility has increased by around 1.8 times and, as of 2010, the volume of actually stored gas amounts to 132.7 million cubic meters. It is planned to increase the volume up to 140 million cubic meters. The volume of gas to be stored must be determined by the Government of RA.

314. Improvements have also been made to the electric energy systems, which has a key role in further strengthening of the reliability of the electricity system and promotion of regional cooperation, in particular:

- 1) As of 2010 with the assistance of international financial organizations 3 out of 14 electric energy sub-plants of 220 kw have been re-equipped fully and further 8 have been re-equipped partially.
- 2) In February of 2014 restoration of Gyumri-2 220 kw sub-plant has been completed and the project was implemented using loan fund provided by the KfW.
- 3) The work for restoration of 17 substations of 110 kilowatts implemented with the support of the Japanese government was completed in September 2010.
- 4) The work for the first phase of introduction of SCADA/communication system was completed in October 2010.
- 5) In 2010 and 2011 in Yerevan have been set in exploitation energetic blocks “Yerevan thermoelectrocentre” closed joint stock company and “ArmRusGazprom” of Hrazdan thermopower plant working with thermogas cycles of correspondingly 243.2 and 467 megawatt equipped with modern technologies.

#### **11.4.2 MAIN DIRECTIONS OF PROGRAM POLICIES**

315. During the implementation of the program, the main directions of the policy implemented in this sector will be as follows:

- 1) maximum use of own sources, specially renewable sources of energy;
- 2) further development of nuclear energy, in particular construction of new energy block and enhance in security of Armenian nuclear power station's 2<sup>nd</sup> energy block and extension of its utilization period;
- 3) replacement of physically and morally depreciated power plants with those furnished with new technologies;
- 4) diversification of energy supplies and regional integration;
- 5) promotion of energy efficiency in all sectors using energy resources;
- 6) Increase of the level of safety and reliability of the electroenergetic system.

316. For the entire period of the program, the level of annual public investment in the system (excluding large projects such as the construction of the new nuclear power plant) will amount to 0.3% of the GDP.

317. The new nuclear power plant with 1000 megawatts capacity (which is already provided for by the RA Law) will require an investment of USD 4-5 billion.
318. Targets of investment policy will include replacement of producing stations, construction of new producing and regulatory stations, maintenance and development of the electricity transportation system, also for integration with regional energy systems, as well as implementation of energy-saving measures and maximal use of renewable energy and alternative energy resources.
319. The following programs and activities will be implemented in the sphere of energy.
- 1) Full implementation of the SCADA /communication system;
  - 2) Construction of new 400kW electric power lines on Armenia-Georgia and Armenia-Iran directions and interconnection of those systems with 220 kW energy networks. As well as construction of 400 kW sub-plant ensuring constant energy supply to Georgia.
  - 3) Replacement of 220 kW sub-plants with those with the capacity of 450/500 kW;
  - 4) Restoration and re-equipment of Vorotan hydropower plant;
  - 5) Implementation of deep perforation activities in the geothermal systems discovered during geophysical researches;
  - 6) Institutional reforms of the sector, including implementation of a sustainable statistical system;
  - 7) Implementation of quality and performance indicator standards for energy market participants.

#### 11.4.3 PROGRAM TARGET INDICATORS

320. The main target indicators for the energy sector are presented in Table 16:

**Table 16. Target indicators for energy sector**

Indicator	Base year	2014	2017	2021	2025
Transition indicator (EBRD)	3.33 (2013)	3.67	4.0	4.33	4.67
Level of public investments, % of GDP	0.17 (2012)	0.3	0.3	0.3	0.3

## V. PROPORTIONATE REGIONAL DEVELOPMENT

### 12. SITUATION AND TRENDS

321. A country's regional socioeconomic development disparities are defined as deviations in social and economic development levels, which as a result hampers economic development and sustainable human development in both regions and the entire country. Nature and climate specifics of Armenia's region, uneven distribution of production forces and resources, as well as their economic development, social, demographic and cultural differences contribute to uneven development of territorial units. In the phase of transition to market economy (since early 2000s) these disparities have continuously deepened reaching alarming levels. Economic development has focused in Yerevan and in a limited number of regions (mainly Syunik and Kotayk), thus creating clearly articulated differences in population wellbeing/poverty and human development indicators across regions of Armenia.

**Table 17. Industrial per capita output at current prices in RA regions and Yerevan city between 2004 and 2012, thousand drams**

	2004	2011	2012
Yerevan	217.0	399.4	424.2
Aragatsotn	45.4	152.0	147.0
Ararat	153.3	288.4	401.8
Armavir	96.6	146.4	167.1
Gegharkunik	81.3	74.1	92.0
Lori	113.2	260.5	339.7
Kotayk	213.5	370.4	569.3
Shirak	46.1	151.7	161.5
Syunik	582.6	1,166.6	1,401.4
Vayots Dzor	84.2	138.7	173.7
Tavush	32.8	47.0	60.8
Average for Marzes and Yerevan city	151.5	288.5	358.1
Index, 2004=100	100.0	190.5	194.7
<i>Characteristics of regional disparities</i>			
Interval of disparity	549.9	1,119.5	1,340.6
Index, 2004 = 100	100.0	203.6	243.8
Average absolute aggregated deviation	101.9	192.7	248.1
Index, 2004=100	100.0	189.1	243.4

Source: Marzes of the Republic of Armenia and Yerevan City in Figures, NSS, 2010, 2012 and Demographic Handbook of Armenia, NSS, 2012

322. Economic development disparities across regions and Yerevan city continue growing for all main indicators. This means that the average regional (including Yerevan) indicator of per capita industrial output has increased 1.9 times between 2004 and 2012. However the disparity interval<sup>37</sup> and the average absolute deviation<sup>38</sup> of the same indicator has increased

<sup>37</sup> The interval of inequality in regions and Yerevan is the difference between maximal and minimal values of per capita industrial output.

<sup>38</sup> The average absolute aggregated deviation is the arithmetic mean of the absolute values of deviations of per capita industrial output in regions and Yerevan from their average.

about 2.4 times during that period. Per capita industrial production is the highest in Yerevan, Syunik and Kotayk marzes.

323. A similar picture is observed in agriculture gross produce indicator. The regional per capita indicator has increased 1.6 times between 2004 and 2012. However the regional development disparity indicators' growth is more rapid. The regional disparity interval has increased 1.7 times and the average absolute deviation 2.1 times. Compared with per capita volumes of industrial output, regional disparities of per capita agricultural produce are smaller and grow slowly. These are the highest in Gegharkunik, Ararat and Armavir marzes.

324. Analysis of territorial inequality aspects of other main economic indicators suggest that they all have increased, however the biggest growth is seen in services delivered to the population. The inequality media of this indicator and its mean absolute aggregated deviation across marzes between 2004 and 2012 has increased around 5.6 times, and the mean marz indicator has increased 3.4 times. In terms of these indicators Yerevan again appeared in the most favorable position.

**Table 18. Per capita gross agriculture output at current prices in RA regions in 2004-2011, thousand drams**

	2004	2011	2012
Yerevan	5.9	6.1	7.7
Aragatsotn	275.9	384.4	539.3
Ararat	242.4	320.6	416.5
Armavir	261.8	385.0	472.4
Gegharkunik	300.2	390.2	630.4
Lori	194.7	130.6	202.4
Kotayk	162.6	142.0	180.1
Shirak	171.5	198.4	329.8
Syunik	322.7	218.4	329.6
Vayots Dzor	424.7	202.5	301.8
Tavush	206.3	181.2	289.0
Average for Marzes, excluding Yerevan	256.3	255.3	369.1
Index, 2004=100	100.0	155.2	165.1
<i>Regional disparity characteristics (excluding Yerevan)</i>			
Interval of disparity	262.2	450.3	440.5
Index, 2004 = 100	100.0	171.8	168.0
Average absolute aggregated deviation	60.8	118.7	128.3
Index, 2004=100	100.0	195.3	211.0

Source: Marzes of the Republic of Armenia and Yerevan City in Figures, NSS, 2010, 2012, 2013 and Demographic Handbook of Armenia, NSS, 2012

**Table 19. Per capita values of commissioning of fixed assets, retail trade turnover and services rendered to population in Yerevan city and Marzes (at current prices) in 2004 – 2012 and characteristics of their regional disparities**

Indicators	Commissioning of fixed assets			Retail trade turnover			Services rendered to population		
	2004	2011	2012	2004	2011	2012	2004	2011	2012
Regional average (including Yerevan), thousand drams	28.5	76.1	79.0	115.7	187.6	197.5	39.6	119.1	132.8
Index, 2004=100	100.0	267.6	277.7	100.0	162.2	170.8	100.0	300.9	335.4
Interval of disparity, thousand drams	145.0	244.0	244.0	625.4	976.6	1,0409	137.8	671.2	763.3
Index, 2004=100	100.0	168.3	168.3	100.0	56.2	166.4	100.0	487.0	553.8
Average absolute aggregated	22.7	61.7	65.9	98.0	153.0	163.9	21.6	106.4	120.8

deviation									
Index, 2004=100	100.0	272.0	290.5	100.0	156.2	167.3	100.0	493.1	559.9

Source: Calculations based on NSS data.

325. According to estimates of the Ministry of Territorial Administration, per capita investments by all sources in Yerevan during 2011 - 2012 have exceeded the indicator for marzes by 2.2 times. However, as opposed to 2007-2008, this difference has decreased around six times, which means that territorial inequality aspects have improved for this indicator.

**Table 20. Per capita capital investments from all sources in Yerevan and marzes during 2008-2012 (thous. dram) and the related characteristics of regional disparities,**

	2008	2009	2010	2011	2012
Total RA	234.6	142.5	153.6	123.2	126.2
Total marzes	44.9	79.4	98.9	87.2	89.5
Yerevan	595.6	262.5	257.6	191.7	196.0
Aragatsotn	46.6	51.7	217.0	89.1	156.1
Ararat	36.6	62.8	75.1	72.4	31.9
Armavir	23.1	35.3	48.5	60.7	50.2
Gegharkunik	21.6	77.8	54.9	70.8	50.5
Lori	22.5	50.5	72.3	79.8	47.5
Kotayk	57.7	104.6	122.5	99.3	144.4
Shirak	38.6	154.2	92.3	89.4	85.4
Syunik	130.8	106.1	200.9	93.3	104.2
Vayots Dzor	173.8	80.5	86.1	119.4	95.4
Tavush	31.4	60.4	119.4	167.2	255.6
Marzes average, including Yerevan	107.1	95.1	122.4	103.0	110.7
Marzes average, excluding Yerevan	58.3	78.4	108.9	94.1	102.1
Characteristics of disparities					
Disparities' range	574.0	227.2	209.1	131.0	223.7
Index, 2004 =100	127.6	50.5	46.5	29.1	49.7
Average absolute deviation	105.2	44.9	56.1	30.8	56.3
Index, 2004 =100	135.4	57.7	72.1	39.6	72.4

Source: RA Ministry of Territorial Administration

326. Armenia does not officially publish its GDP indicators across marzes. Nonetheless, analysis of expert evaluations of marz GDPs witness that economic development is focused mainly in Yerevan and Syunik marz, where the correlation of per capital GDP and the mean national indicator is the highest. In 2012, it made up approximately 152% of the mean national per capita GDP in Yerevan and 133% in Syunik. In other marzes it was lower than the national average – counting for around 67%. The most unfavorable situation was recorded in Lori, Tavoush, Vayots Dzor, Shirak and Tavush marzes, where the per capita GDP in 2012 shared 53%, 58%, 60% and 63% of the mean national figure correspondingly. Hence, advanced development of these marzes should be viewed as a priority goal of territorial development programs. During 2009-2012 the quickest economic growth was seen in the Syunik and Tavoush marzes.

**Table 21. Per capita GDP ratio of Yerevan and Marzes to republican average, 2009-2011, %**

	2009	2010	2011	2012	2012 Per capita GDP index (2009 = 100)
<b>Total, RA</b>	100.0	100.0	100.0	100.0	133.5
Yerevan	172.3	162.3	148.7	151.7	117.6
Aragatsotn	65.0	85.4	78.6	82.6	169.8
Ararat	68.2	74.2	73.8	71.1	139.2
Armavir	67.4	62.1	70.6	67.0	132.9
Gegharkunik	63.9	68.2	74.6	69.7	145.7
Lori	42.4	47.5	59.3	52.7	166.1
Kotayk	66.9	65.3	70.5	78.4	156.5
Shirak	57.6	54.4	65.0	59.7	138.4
Syunik	97.1	133.9	140.2	133.5	183.6
Vayots Dzor	52.1	55.1	59.5	57.7	147.8
Tavush	39.5	46.4	54.8	62.6	212.0

Source: Calculated and estimated based on NSS data

327. These economic development trends contribute to the increase of regional disparities in key social indicators, such as employment and poverty. Between 2004 and 2011 the interval of regional disparity as regards employment<sup>39</sup> has increased 1.4 and poverty - 1.7 times<sup>40</sup>. Yerevan appeared in the most favorable situation vis-à-vis this indicator. Dominating part of the country's general economic growth is focused in Yerevan, which explains the highest nonagricultural employment and the lowest poverty rates.

328. Community-level development disparities should be explained by both objective specifics of communities (mainly geographic specifics - climate, nature) and their socioeconomic development pace. Socioeconomic development disparities of communities are due to fundamental factors like community population number, and sociodemographic composition, altitude above sea level, distance from the borderlines, distance from closest economic development center, availability and status of socioeconomic infrastructures, distance from in subnational and national roads, quantity and quality of farming lands, irrigation specifics, quantity of functioning industrial capacities, local financial resources, etc.

329. Some 5.35% of RA communities are urban and 94.64% are rural. Of them 16.5% are mountainous (1700-2000 m above sea level) and 12.2% high mountainous (2000m and higher above sea level), 20.5% are border communities. Equal development requires consideration of community population number. According to survey findings community population number is very closely co-related to the poverty level, i.e. the likelihood of poverty is higher among small communities. Out of the country's 915 communities 440 (438 rural and 2 urban) (or 48%) have population below 1000 people. Two hundred of 866 rural communities (or 23% of all communities) have population below 300. Urban communities are also rather inequal in terms of population number. In particular, 2 (4.1%) of 49 cities have below-1000 population, 6 cities - 1001-5000 population (12.2 % of total), 18 cities - 5001-15000 population (36.7%). In total, 26 urban communities have below-15000 population (53% of urban communities). Regional

<sup>39</sup> Employment rate is the share of employed in the labor resources.

<sup>40</sup> For detailed analysis of territorial inequalities of these indicators see relevant sections.

breakdown of the said factors shows strong differences, which in its turn affects development of regional disparities.

**Table 22. Characteristics of communities in Armenia by Marz in 2012**

	Number of communities	of which:		Number of border communities	Number of mountainous communities	Number of villages with population below 1000 persons
		Cities	Villages			
Yerevan	1	1	-	-	-	-
Aragatsotn	114	3	111	2	22	75
Ararat	97	4	93	9	2	18
Armavir	97	3	94	8	-	12
Gegharkunik	92	5	87	23	28	44
Lori	113	8	105	5	18	64
Kotayk	67	7	60	-	15	20
Shirak	119	3	116	15	50	68
Syunik	113	7	106	67	7	86
Vayots Dzor	44	3	41	12	8	24
Tavush	62	5	58	47	1	27
Total	915	49	866	188	157	438

Source: NSS publications

330. Sharp differences in financial capacities of communities should be attributed to objective aspects as well as their economic development pace. These differences are reflected in the community socioeconomic infrastructures' development and maintenance, as well as unequal capacities for delivery of community services. Small communities, as a rule, have small budgets, and the revenues do not enable addressing not only community development issues, but even meeting population's basic social needs. This situation results in significant differences across communities as regards human development and poverty levels.

331. Summary analysis of RA regional development specifics reveals the following challenges, which once again confirms the need of a targeted regional development policy.

- 1) Deepening economic development regional disparities.
- 2) Deepening social development and wellbeing/poverty regional disparities.
- 3) Need for improvement of the quality, accessibility and effectiveness of infrastructures and delivered local and public services in regions, particularly rural communities.
- 4) Need for coordination and improvement of effectiveness of public, donor and private investments in regional development and implementation of relevant programs.
- 5) Need for regional administration system reforms, in particular expansion of intercommunity cooperation and enlargement of communities.
- 6) Need for financial and institutional capacity building of regional administration and local self-government bodies.
- 7) Implementation of general methodology of complex local government development programs and the introduction of their development practice.
- 8) Need for development of mechanisms for multi-dimensional credit assessment of socioeconomic development of administrative and regional units.

### 13. OBJECTIVES AND PRIORITIES

332. Further deepening of regional socioeconomic disparities will hamper the country's internal socioeconomic stability and even security and will promote undesirable migration from economically less developed regions. **Hence, overcoming regional development disparities, ensuring even regional development** and implementation of a targeted policy are seen as the country's regional development priority in both medium- and long-term perspectives.
333. Targeted regional development policy should be geared at encouraging and promoting economic growth and social development outside the Yerevan city - in marzes and communities. It should ensure accelerated economic development for the most depressed territories and in the mid-term perspective enable them to approach the average economic development level of the Republic. At the same time, this policy should ensure similar development paces across regions and their equal development in the long-term perspective.
334. Such development policy should include a number of fundamental activities that will promote economic and investment activities in the territories. Among those an essential role will be assigned to redirection of public and particularly private investments from Yerevan to regions –other cities and villages in order to promote development of regional growth poles. Promotion of economic growth in regions of Armenia will enable mitigating regional disparities in well-being, employment and human development. Thus, the policy should be targeted at complex development of Armenia's regions.
335. Regional growth poles can be developed in both urban and rural locations. They can cover certain individual communities and/or community groups. Those are the communities or groups where promotion and ensuring of advanced socioeconomic development rates will help to step up development of nearby communities and the general region. Hence, overcoming regional development disparities will require cooperation and consolidation of territorial units, particularly communities in order to jointly address socioeconomic development problems.
336. At the same time, the policy will include special support programs aimed at most vulnerable communities that have small objective capacities for advanced development.
337. Implementation of this development policy will require clear mechanisms for the assessment of development disparities and development of growth poles. In particular, a system of multidimensional assessment criteria for territories, communities and/or groups thereof, as well as the regions' socioeconomic development level will be needed. The system will help revealing reasons and expressions of regional development disparities, identifying the most unfavorable (in terms of development) communities and areas on the one hand, and potential/emerging growth poles on the other hand. At the same time, implementation of the policy will require complex programs for socioeconomic development of areas, communities and their groups, which will enable evaluating the implementation impact on speeding up the territory's general development.
338. Meantime, implementation of the policy requires complex socioeconomic development programs of certain territories, communities and/or their groups, which will enable assessing their implementation impact on speeding-up the general development rates those territories.
339. The development policy must ensure also restoration and/or development of economic, productive and social infrastructure predominantly in the territories (out of Yerevan) based on close cooperation with the private sector, as well as equal access to and affordability of basic services, giving the priority to communities and areas that lag behind in their development



rate and are more vulnerable. It should ensure direction of public investment programs towards elimination of bottlenecks of economic, industrial and social infrastructures, which currently or in the near future may hinder socioeconomic development of the region or area.

340. Given the low socioeconomic growth rates of small and medium-size towns of Armenia, which have resulted in quite high poverty rates in these communities as opposed to the mean national, Yerevan and rural communities as well as migration, the targeted regional development policy should maximally contribute to their development. Economic development rates of those urban communities should, in medium-term perspective, gradually reach the mean national development level. Consequently, small and medium-size cities are considered a priority and main target of the policy aimed at mitigation of the regional development disparities.
341. Taking into consideration current specifics of economic development of rural areas, the policy on mitigation of development disparities across rural communities should be targeted at promotion of economic and investment activities, development of community and inter-community infrastructures, access to and improvement of the quality community and public services, and improvement of community financial autonomy. At the same time of special importance are the issues related to the development and broadening of the application of the delegated authorities' institute.
342. The targeted complex policy on mitigation of regional disparities should ensure on the one hand radical improvement of regional business and investment environment, as well as of the quality of public administration and local government and on the other hand encourage and develop cooperation between the state, local governments and the private sector within the context of implementation of complex regional development programs.
343. Implementation of the policy requires improvements of regional development financial system, which implies coordination of public and donor/private allocations for regional development. Actually, ad hoc funds can serve as financial tool for implementation of the complex regional development policy.
344. Ad hoc funds can serve as a general tool for implementation of a complex territorial development policy. The funds will be based on close cooperation with the public, donor and private sectors. Particularly, in medium-term perspective, it is appropriate to create a territorial development fund, which will enable addressing the following territorial development problems:
- 1) Contribute to improvement of the material and non-material wellbeing of the population and their employment;
  - 2) Contribute to improvement of economic and investment activities in territories and development of territorial 'growth poles'.
  - 3) Improve and develop the quality of local infrastructures and delivered community and public services, their accessibility and effectiveness.
  - 4) Improve commitment and effectiveness of territorial socioeconomic development public, donor and private investment and programs,
  - 5) Support implementation of territorial administration reforms, particularly expansion of inter-community cooperation,
  - 6) Contribute to building local governments' financial and institutional capacities,
  - 7) Support development of complex community and territorial development programs.

345. Prognosis on results of implementation of the territorial inequalities compensation policy suggest the following. If further development happens according to the base scenario (i.e. the said policy is not implemented), then based on the current economic development (2009-2011), the mean marz development rates will be retained, in the medium-term perspective the marz per capita GDP inequalities in 2017 will increase about 1.6 times, as opposed to 2011 and about 4 times in 2025. Half of marzes will ensure 60-70% of the mean national per capita GDP level.

346. Implementation of the complex territorial development policy will enable essentially improving the situation. Implementation of the policy, if the average development scenario is taken, envisages that the development rates of lagging marzes will accelerate so that their development level in medium-term perspectives will come closer to the average national development level. Meantime the current average annual growth of the most developed marzes will be retained during that period with almost similar proportions. According to defined targets, in 2017 the marz per capita GDP levels (excluding Yerevan), provided they show continuing growth, will approach the average national level and will share around 85% of it. In long-term perspective, in 2017 they will make up 85% of the average national per capita GDP, 90% in 2021 and 94% in 2025. This will help to the extent possible minimizing territorial development inequalities.

**Table 23. Per capita GDP ratio of marzes and Yerevan to republican average, development base and policy scenarios, %**

	Actual	Development base scenario				Policy scenario			
	2012	2015	2017	2021	2025	2015	2017	2021	2025
<b>Total, RA</b>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Yerevan	151.7	151.5	152.4	154.0	155.3	136.0	127.6	123.5	121.8
Aragatsotn	82.6	81.7	80.1	77.1	74.1	79.0	79.3	84.6	92.0
Ararat	71.1	71.4	71.0	70.2	69.7	74.3	81.1	84.1	87.1
Armavir	67.0	66.5	65.2	62.8	60.6	68.3	74.6	77.4	80.2
Gegharkunik	69.7	68.7	66.9	63.3	60.0	75.9	83.3	85.6	87.1
Lori	52.7	53.1	53.2	53.4	53.7	58.3	69.3	91.5	100.5
Kotayk	78.4	79.3	80.0	81.5	83.1	83.4	90.2	91.9	93.5
Shirak	59.7	59.3	58.5	56.9	55.4	61.4	70.4	79.7	85.6
Syunik	133.5	136.7	139.0	143.8	149.1	130.6	125.8	119.5	115.8
Vayots Dzor	57.7	57.3	56.7	55.4	54.2	62.7	71.6	79.6	83.3
Tavush	62.6	61.8	60.9	59.0	57.2	68.2	78.3	81.2	84.2
<i>Memorandum item</i>									
Per capita GDP program targets in Armenia, thous. dram						1,684	2,037	3,054	4,612

## VI. POVERTY AND INEQUALITY

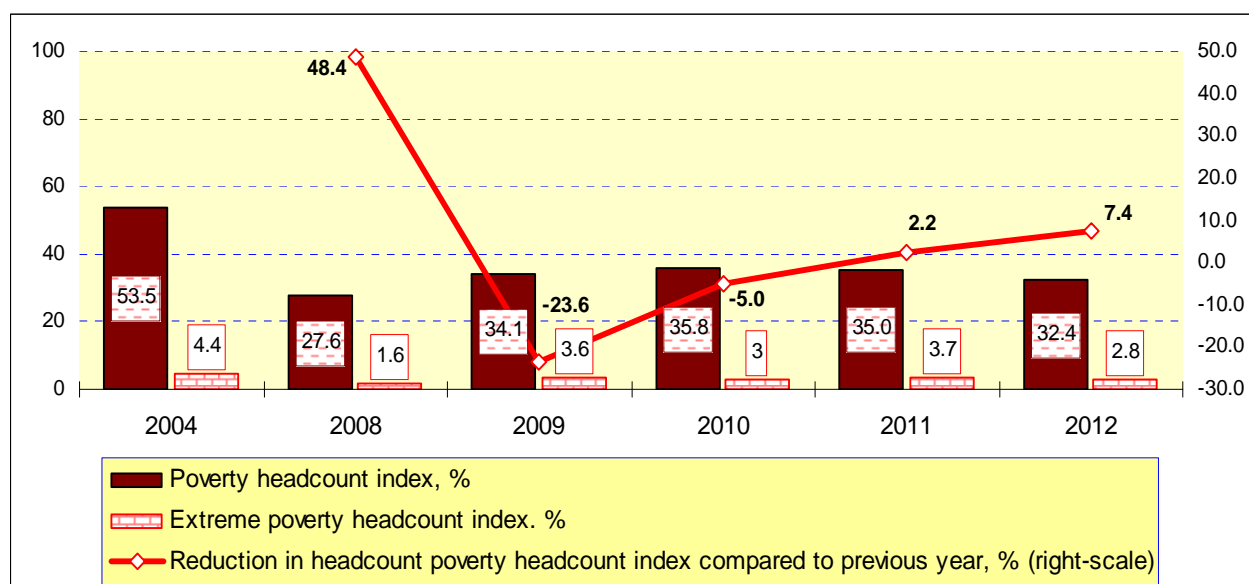
### 14. CURRENT SITUATION AND TRENDS

347. Improved well-being of the population and poverty reduction are guaranties of human capital development in the country and main objectives of the ADS.

348. Prior to the crisis, Armenia was recording uninterrupted reduction in the level of poverty year after year<sup>41</sup>. In 2004-2008, the share of population living under the general poverty line reduced by 48.4 percent, amounting to 27.6 percent in 2008, compared to 53.4 percent in 2004<sup>42</sup>.

349. Reduction of poverty in the pre-crisis period was largely due to continuous economic growth. The average elasticity of poverty level with respect to GDP in 2004-2008 amounted to -0.57, which means that one percentage point of GDP growth reduced poverty by 0.57 percentage points.

**Figure 11. Poverty and extreme poverty level trends in Armenia in 2004-2012**



Source: Social Snapshot and Poverty in Armenia, NSS 2013.

350. As a result of the economic decline because of the crisis, the reverse trend was recorded in 2009 - increase in the level of poverty. In 2009, the share of poor population increased by 23.6 percent with respect to 2008 and reached 34.1 percent<sup>43</sup>. In 2010 it continued to grow and comprised 35.8 percent, while in 2011 and 2012, due to economic recovery process, it decreased and comprised 35.0 and 32.4 percents respectively, but still not reaching the level of 2008. Similar trends were recorded with regard to extreme poverty. The share of population living under the food poverty line, which was reduced by 2.8 times in the period of 2004-2008,

<sup>41</sup> All the analysis of poverty rate are based on data from "RA social snapshot and poverty" published by RA NSS. The respective indicators are calculated using internationally accepted methodology using the results of "Integrated Household Living Standard Survey". Methodological clarifications of poverty rate calculation are presented in the RA NSS "RA social snapshot and poverty" publications.

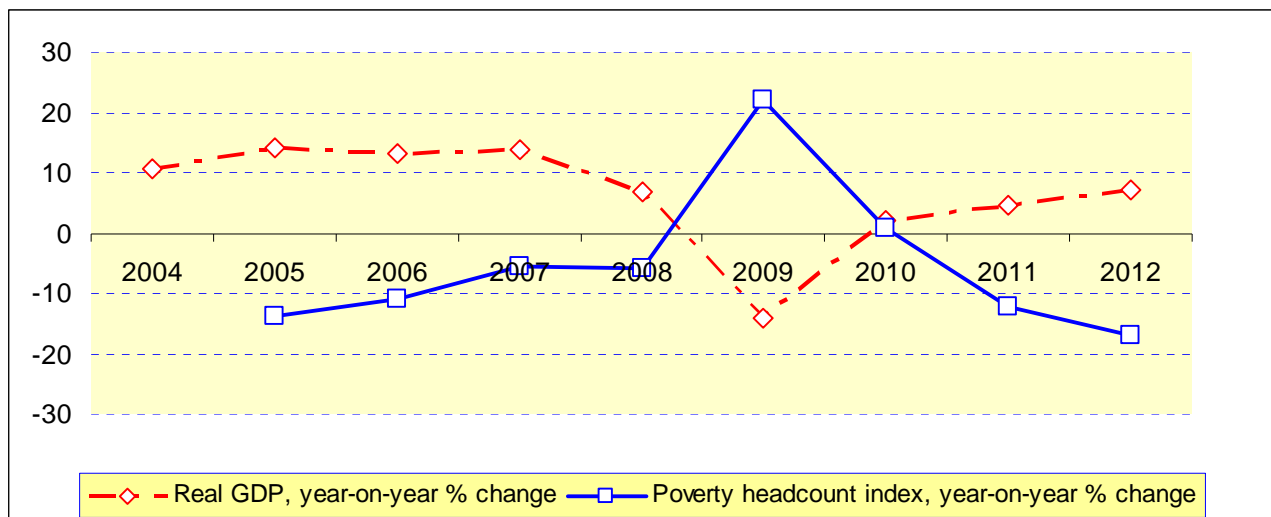
<sup>42</sup> According to the results of "Integrated Household Living Standard Survey" of the NSS, see "Social Snapshot and Poverty in Armenia", NSS, 2013

<sup>43</sup> Presented here are poverty level calculations for 2004 and 2008-2012 based on the "new methodology" used by NSS since 2009. See "Social Snapshot and Poverty in Armenia", NSS, 2013, page 37.

dropping to 1.6 percent in 2008, increased in 2009 up to 3.6 percent, but then decreased again to 2.8 percent in 2012. Thus, as of 2012, somewhat more than one third of RA population – 32.4 percent was poor, with 3 percent living in extreme poverty.

351. In 2008-2012 elasticity of poverty rate with respect to GDP increased considerably. Each percentage point of economic decline in 2008-2009 increased poverty rate by 1.61 percentage points, in 2009-2010 by 2.35 points, in 2010-2011 by 3.20 points and in 2011-2012 by 11.29 percentage points<sup>44</sup>

**Figure 12. Dynamics of GDP and poverty headcount index in Armenia in 2004-2012**



Source: Social Snapshot and Poverty in Armenia, NSS, 2013.

352. Such developments greatly hinder the development of human capital of the country in medium and long-term perspective. The increase in poverty comprises high risk of poverty reproduction and increase in polarization of society. It hampers the human and, as a consequence, the economic development. Therefore, the reduction of poverty is one of the most important guarantees of the country's development.

353. In the period prior to the crisis, due to sustainable economic growth, population incomes rose uninterruptedly. In 2004-2008, the average monthly monetary income per capita, compared to the previous year, increased by an average of 17 percent throughout the period. Around 70 percent of the incomes were received from employment and sales of the produced agricultural products. The share of incomes from employment in the total monetary incomes of the population showed an accelerated growth. However, starting in 2008, growth rates of monetary incomes, including also employment incomes, declined. In 2009, the average monthly monetary income per capita increased only by 4.4 percent compared to 2008 and employment incomes even shrunk both nominally and as a share of monetary incomes. In 2010, as a result of economic recovery, the growth of average per capita incomes, compared to the previous year, amounted to 12.5 percent. In 2011 growth rate declined a bit, while in 2012 reached 14.2 percent. Share of employment income in 2012 comprised 66% of average per capita monetary income.

<sup>44</sup> "Social Snapshot and Poverty in Armenia", NSS, 2012, page 33

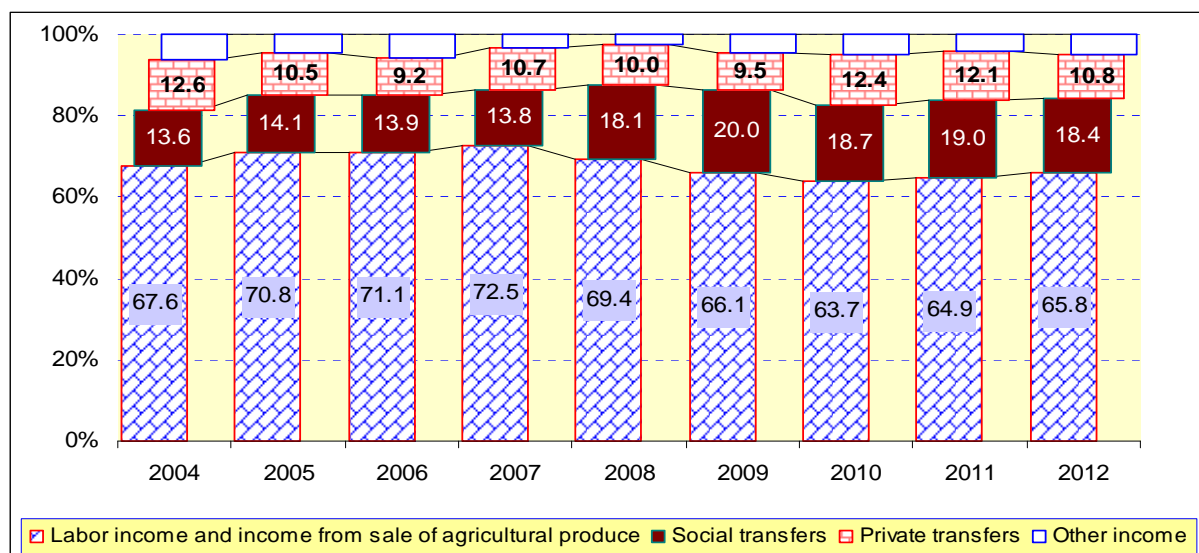
**Table 24. Dynamics of average monthly monetary per capita incomes in 2004-2012**

	2004	2008	2009	2010	2011	2012
<b>Per capita overall average monthly monetary income, AMD</b>	<b>14,450</b>	<b>26,866</b>	<b>28,038</b>	<b>31,553</b>	<b>34,206</b>	<b>39,056</b>
Year to year growth rate, %	--	20.5	4.4	12.5	8.4	14.2
<b>Of which:</b>						
<b>Labor incomes, including sale of agricultural products, AMD</b>	<b>9,770</b>	<b>18,647</b>	<b>18,529</b>	<b>20,112</b>	<b>22,191</b>	<b>25,714</b>
Percent in overall monetary incomes, %	67.6	69.4	66.1	63.7	64.9	65.8
Year to year growth rate, %	--	15.5	-0.6	8.5	1.8	15.9
<b>Social transfers, AMD</b>	<b>1,962</b>	<b>4,870</b>	<b>5,615</b>	<b>5,888</b>	<b>6,502</b>	<b>7,192</b>
Percent in overall monetary incomes, %	13.6	18.1	20.0	18.7	19.0	18.4
Year to year growth rate, %	--	58.7	15.3	4.9	10.4	10.6
<b>Private remittances, AMD</b>	<b>1,817</b>	<b>2,692</b>	<b>2,669</b>	<b>3,927</b>	<b>4,127</b>	<b>4,223</b>
Percent in overall monetary incomes, %	12.6	10.0	9.5	12.4	12.1	10.8
Year to year growth rate, %	--	13.4	-0.9	47.1	5.1	2.3
<b>Other monetary incomes, AMD</b>	<b>901</b>	<b>657</b>	<b>1,225</b>	<b>1,626</b>	<b>1,386</b>	<b>1,927</b>
Percent in overall monetary incomes, %	6.2	2.4	4.4	5.2	4.1	4.9
Year to year growth rate, %	--	-5.7	86.5	32.7	-14.8	39.0

Source: Social Snapshot and Poverty in Armenia (NSS publications for 2009-2013).

354. State social policy in 2008-2012 aimed to reduce the risk of poverty, in conditions of economic decline and reduction of employment incomes, and particularly expanding the opportunities of the poorer segments of population. Despite lower rates of growth of employment incomes in conditions of economic crisis, the government continued to fulfill its social obligations in a difficult fiscal situation. In 2008-2012, the nominal value of public social transfers and their share in the monetary incomes of the population increased sharply. In 2004-2007, social transfers amounted to 14 percent of monetary per capita incomes, while in 2008-2012 the same indicator amounted on average to 19 percent. The mentioned increase resulted from higher average pensions, as well as family benefits and other benefits.

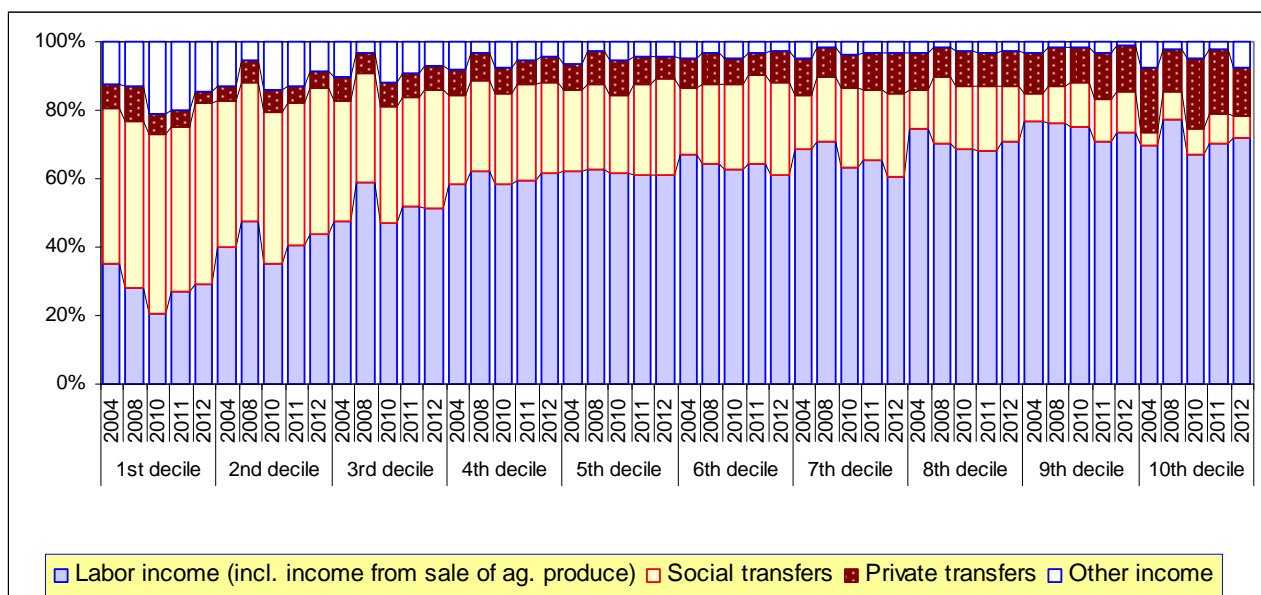
**Figure 13. Structure of average monthly per capita monetary income in 2004-2012**



Source: Social Snapshot and Poverty in Armenia (NSS publications for 2009-2013).

355. The social policy being enacted also aims to mitigate the inequality of income distribution. Social transfers, as a source of income and subsistence, are especially important to the poorer segments of the population. In 2012, they amounted to about half, or 48 percent, of per capita monetary incomes of the poorest 20 percent of the population, while the labor incomes comprised only about 36 percent of the latter. In 2012 the share of social transfers increased by 4 percentage points in the per capita monetary incomes of the poorest two deciles, compared to 2008. In the richest deciles the share of social transfers and their increase in 2008-2012 were incomparably lower. Thus, in 2012 the share of social transfers amounted to about 9.5 percent of per capita monetary incomes of the richest 20 percent of the population; and compared to 2008 their share has almost remained unchanged.

**Figure 14. Dynamics of per capita monetary income structure in 2004-2011 by population income decile groups, %**



Source: National Statistical Service of the Republic of Armenia (results of ILCS for various years).

356. Although the nominal value of average per capita incomes of population has increased continuously, studies revealed that in 2009, compared to 2008, average monthly per capita consumer expenditures had declined by 4.2 percent, and the average increased somewhat in 2010, but did not reach the level of 2008. But after that these expenditures have grown such that in 2012 they exceeded 2008 level by 21 percent (34,921 drams in 2012, 28,646 drams in 2010, compared to 27,667 drams in 2009 and 28,878 drams in 2008)<sup>45</sup>. In 2008-2012 more than half of consumer expenditures, or around 50 percent, were expenditures on foodstuff.

357. Economic decline and increased poverty have caused higher levels of poverty among the target social groups. In 2009-2010, the poverty of children under five, pensioners, the employed, including waged employment, and the self-employed has increased. In 2011 the poverty levels in the mentioned groups were slightly reduced, except the children under five. In this group the level of poverty was around 39 percent in 2012. In 2012 around 29 percent of the self-employed, 23 percent of those with waged employment and 38 percent of

<sup>45</sup> See Social Snapshot and Poverty in Armenia, NSS 2009-2013.

pensioners were poor. Meanwhile, special policies for reducing poverty among pensioners and those with waged employment were continuously implemented in the country. In particular, they focused on increased employment, pensions and benefits, as well as rise of average and minimum wages and their gradual equalization with the minimum consumer basket value. Those policies should have indirectly also reduced poverty among children. Naturally, as a result of the decline and the crisis, it was not possible to fully implement the mentioned policies. Consequently, higher levels of poverty among target groups are, in particular, explained by the mentioned fact. However, it is also explained by the composition of families who have become poor - representation of working members, children and pensioners in those families.

**Table 25. The dynamics of poverty indicators of target groups of population in 2004-2012, %**

	Poverty in the specific target groups of population, %			
	Children under 5	Pensioners	Wage earners	Self-employed
2004	41.9	33.2	27.5	31.0
2005	34.9	30.0	22.7	27.3
2006	35.3	26.5	21.3	23.9
2007	33.2	27.6	20.0	20.8
2008	32.0	34.5	20.7	23.3
2009	39.6	39.9	25.5	29.7
2010	42.7	38.7	28.0	29.8
2011	45.3	35.3	26.8	28.7
2012	38.8	37.5	23.4	28.9

Source: "Social Snapshot and Poverty in Armenia", NSS, 2005, 2008-2013.

358. In the period prior to the crisis, economic growth was channeled to the poor. Although in 2004-2008, in the composition of incomes of the poorest 20 percent of the population, the share of incomes resulting from economic growth (employment and sales of agricultural products) was relatively small (at around 37 percent), nonetheless, they increased more rapidly than their overall monetary incomes. And on the other hand, the total monetary incomes of the poor have increased more rapidly, compared to the incomes of the non-poor population. In 2004-2008, the average monthly monetary income per capita of the poorest two deciles of the population increased by 2.3 times, and the same indicator for the richest two deciles was around 1.7 times. In the same period, the average monthly per capita income resulting from economic growth among the poorest two deciles of the population increased by 2.4 times, while the same indicator for the richest two deciles was 1.8 times. In the same period, income inequality and income gap between the non-poor and the poor reduced – monetary incomes of the richest 20 percent in 2004 exceeded the incomes of the poorest 20 percent by 10.6 times, and this difference shrunk in 2008 to 7.8 times. In 2004-2008, Gini coefficient of income distribution also declined (see Table 4). In 2009-2012, together with the increase in poverty, the indicators of inequality also increased. Monetary income of 20% richest population exceeded monetary income of 20% poorest population by 8.5 times, Gini coefficient of income concentration was 0.372. This means that the economic crisis had a larger impact on the poorer segments of the population. The latter was due to sharper decrease in incomes and private transfers for the poorer segment of population as a results of economic downturn after 2008.

**Table 26. Indicators for inequality of income distribution 2004-2011**

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Monetary incomes of richest 20% of population to the incomes of poorest 20% of population, times	10.6	9.5	7.6	8.0	7.8	8.0	8.0	8.0	8.5
Monetary incomes of richest 10% of population to the incomes of poorest 10% of population, times	20.8	17.9	13.9	15.6	14.1	14.5	14.2	14.8	15.9
Gini coefficient of income inequality	0.395	0.359	0.369	0.371	0.339	0.355	0.362	0.371	0.372

Source: "Social Snapshot and Poverty in Armenia", 2007, 2008, 2010-2013, NSS.

## 15. POVERTY AND INEQUALITY BY REGIONS

359. Essential differences of poverty level across regions of the country, rural and urban settlements, are still evident and even deeper. In Armenia, poverty and extreme poverty, in both pre-crisis and post-crisis periods, as a rule are most common in small and medium-size urban settlements (all urban settlements, except for Yerevan). Here, in 2012, the poverty level was higher compared with the national indicator by 7.8 percentage points, being around 40%. In this regard Yerevan continues facing the most favorable situation: poverty level in 2012 was the lowest there (25.6%). This resulted in even greater living standard differences across Yerevan and other cities and villages of Armenia.

**Table 27. Poverty level territorial dynamics in Armenia during 2008-2012**

	2008	2009	2010	2011	2012	2008-2012 growth, percentage points
	<i>Poverty, %</i>					
Yerevan	20.1	26.7	27.1	27.5	25.6	5.5
Other cities	35.8	41.5	45.4	43.6	40.2	4.4
<b>Total urban settlements</b>	27.6	33.7	35.7	35.2	32.5	4.9
<b>Rural settlements</b>	27.5	34.9	36.0	34.5	32.1	4.6
<b>Total for Armenia</b>	27.6	34.1	35.8	35.0	32.4	4.8
	<i>Of which: extreme poverty, %</i>					
Yerevan	1.1	2.1	2.2	2.7	2.2	1.1
Other cities	2.8	7.4	6.1	6.6	4.4	1.6
<b>Total urban settlements</b>	1.9	4.6	4.1	4.6	3.2	1.3
<b>Rural settlements</b>	1.2	1.7	1.1	2.2	2.1	0.9
<b>Total for Armenia</b>	1.6	3.6	3.0	3.7	2.8	1.2

Source: Social Snapshot and Poverty in Armenia, RA NSS, 2011 and 2013.

360. Territorial differences of poverty level and their aggravation highlights the need of viewing development and implementation of targeted policy on mitigation of territorial development inequalities as the territorial development policy priority. The program aims at ensuring economic development and essential reduction of territorial differences of poverty levels



through implementation of long-term active territorial development policy. In the long-term, the macroeconomic framework envisaged by the program, and policies geared at mitigation of economic, social and territorial development differences should lead to quicker and more significant reduction of poverty in small and medium-size cities and villages, which will translate into mitigation of territorial differences of population's living standards.

361. It should be noted that during 2008-2012<sup>46</sup> poverty level increase was recorded in all regions of Armenia, and the inter-region disparity increased too.

**Table 28. The territorial dynamics of poverty level in 2008-2012**

	2008	2012
Total, Armenia	27.6	32.4
Yerevan	20.1	25.6
Aragatsotn	20.3	21.2
Ararat	31.3	34.6
Armavir	24.5	34.3
Gegharkunik	32.0	35.5
Lori	34.2	38.7
Kotayk	39.5	42.5
Shirak	42.4	46.0
Syunik	20.3	25.6
Vayots Dzor	21.1	20.7
Tavush	23.2	27.5
<b>Characteristics of regional disparity</b>		
<b>Average across marzes (including Yerevan)</b>	28.1	32.1
<i>Index, 2008 = 100</i>	100.0	114.2
<b>Disparity range</b>	22.3	25.3
<i>Index, 2008 = 100</i>	100.0	113.5
<b>Average absolute deviation</b>	7.1	7.2
<i>Index, 2008 = 100</i>	100.0	101.4

Source: Social Snapshot and Poverty in Armenia, RA NSS, 2013.

362. The poorest is the earthquake zone including Shirak, Kotayk and Lori regions, as well as Gegharkunik region. Here the poor share 39-46% of the population. More favorable is the situation in Yerevan, Vayots Dzor and Aragatsotn regions, where 20-25% of the population is poor. Hence, development and implementation of targeted territorial development policy is necessary also for settling out the regional differences in living standards.

## 16. POVERTY REDUCTION OBJECTIVES

363. As of 2012, 32.4 percent of the population was poor, and 2.8 percent were extremely poor, The Gini coefficient of inequality increased up to 0.372. This situation creates serious social problems, which, on the one hand, can endanger country's social stability, and on the other hand hinder the future economic development in medium and long-term perspectives.

364. The emerging new trends, as well as the dynamics of poverty and inequality, revealed that economic and social policies should channel economic growth and its redistribution to the direct and indirect increase in the incomes of the poorer groups of population in a more targeted manner and thus reduce poverty and inequality. At the same time, policies on

<sup>46</sup> The NSS poverty level indicators for regions are not comparable for 2004-2007 and 2008-2012, hence only 2008-2012 trends were considered only.

mitigation of territorial socio-economic development disparities and territorial inequalities in poverty levels should be developed.

365. Polarization of income in the society is not only a social fairness problem, but also creates impediments from the point of view of economic incentives. Direct social policy measures aimed at the mitigation of the problem will be coupled by such tools and measures of economic policy as direct assistance for development of SMEs, as well as promotion of employment in sectors with relatively higher wages (such as manufacturing and IT sectors).
366. Priority objectives of the macroeconomic framework of the ADS and public expenditures, particularly expenditures on social protection, allow for defining target indicators for poverty reduction in the medium and long-term perspectives. Based on the economic and social policies to be enacted, the Program plans to reduce the level of poverty in the country to around 24 percent by 2017 (compared to 32.4 percent in 2012), about 18 percent in 2021 and about 13 percent in 2025. For extreme poverty, the Program plans a reduction to 2.4 percent by 2017 (compared to 2.8 percent in 2012), 2.1 percent in 2021 and 1.8 in 2025, in effect resolving this problem altogether. The Program also plans to reduce inequality in the country as a whole, and between its regions.
367. The main factors reducing poverty will be the increase in employment incomes of the population, including accelerated increase in employment incomes of the poor, as well as increase in public expenditures on social insurance and social assistance and their better targeting.

**Table 29. Main target indicators of poverty reduction**

	Actual			Target indicators		
	2010	2011	2012	2017	2021	2025
Poverty level, % of population	35.8	35.0	32.4	23.7	18.1	13.0
Extreme poverty level, % of population	3.0	3.7	2.8	2.4	2.1	1.8
<i>Memorandum items</i>						
Upper poverty line, dram/month	33,517	36,158	37,044	43,218	48,642	54,747
Extreme (food) poverty line, dram/month	19,126	21,306	21,732	25,354	28,536	32,118

368. For the level of poverty in individual target groups of population, the Program aims to reduce poverty among children, pensioners, the employed, including those with waged employment and the self-employed. In particular, in order to ensure increased employment incomes among the poor, including those with employment, the Program envisages continuous increase in the ratio of the minimum wage to the upper general poverty line, as a result of which the minimum net wage in 2017 will amount to around 160 percent of the upper general poverty line (compared to 2010-2012, when it comprised 89-90 percent of the upper general poverty line), in 2021 it will amount to 190 percent and the same indicator for 2025 will be around 240 percent.
369. In order to reduce the level of poverty among pensioners (and their families), the Program envisages continuous increase in the level of average pensions, as a result of which the pension in 2017 will amount to around 125 percent of the upper general poverty line, in 2021 the same indicator will amount to around 155 percent and in 2025 it will be around 200 percent.

## VII. SOCIAL PROTECTION

### 17. CURRENT SITUATION AND TRENDS

370. Social protection is one of the priorities of the state policy of the Republic of Armenia. The objective of the state policy for social protection is to expand the capabilities of the population to face certain risks or meet certain needs. It is implemented through very concrete and targeted policies for social assistance, social security and insurance, which aim to reduce poverty, mitigate inequality, ensure decent old-age, expand the opportunities of vulnerable groups of population and provide certain social guarantees to them, as well as improve the demographic situation.
371. Currently an integrated social service system is implemented in the area of social protection. The delivery of integrated social services stems from assessed social needs of the applicant (citizen or family) with adequate social services offered by both public and non-public organizations (NGOs) under cooperation agreements, including public and local social programs. Local social programs are designed by community heads with the support of territorial centers for complex social services (TCCSS) based on assessment of the community social needs.
372. The TCCSS functions following the one stop shop principle. Eighteen TCCSS-s were opened within the framework of implementation of the integrated social service system. They are located in renovated buildings and are equipped with adequate information technologies and computer hardware (it is planned to have 56 such centers in the country). TCCSS-s host the territorial agency rendering social services, the territorial department of state social security service, the territorial public employment agency and the medical-social expertise department. Applications are collected at the common reception of the TCCSS, which has a unified paper flow system.
373. In order to achieve the mentioned objectives, the public expenditures on social protection increased nominally during 2010-2013. They comprised about 26 percent of state budget expenditures on social protection in 2010-2011 and in 2013, while in 2012 they comprised around one third - 29 percent. The major part of public expenditures on social protection, around 70% in 2010-2014 is being allocated age, predominantly pensions related expenditures.

**Table 30. The indicators of financing of the social protection system during 2010-2014**

	2010	2011	2012	2013	2014
Public expenditures allocated for social protection, bln. AMD	244.2	256.2	291.7	297.4	362.0
Public expenditures allocated for social protection, % of GDP	7.0	6.8	7.3	7.0	7.7
Public expenditures allocated for social protection, % of state budget expenditures,	25.6	26.0	29.0	26.0	29.0
Including per following articles, bln. AMD:					
Health problems and disability	1.4	1.2	1.2	1.2	1.3
Old age	178.5	188.4	199.0	200.0	254.7
Persons' having lost close relatives	0.1	0.1	4.8	4.8	5.1
Members of family or children	44.0	43.5	47.1	50.9	57.5
Unemployment	5.6	4.1	2.8	2.3	2.4
Provision on housing	1.0	0.7	4.8	2.6	0.5
Special social benefits (not included in other categories)	5.1	9.3	10.6	9.5	11.2
Social protection (not included in other categories)	8.5	8.7	21.4	26.0	29.5

Source: actual state budget expenditures of Armenia for 2010-2013 and planned expenditures per law on Budget for 2014.

## 18. OBJECTIVES

374. Social protection policy aimed at poverty reduction, mitigation of inequality, ensuring decent old-age, expanding the opportunities of vulnerable groups of population and improving the demographic situation in the country is one of the priorities of the ADS. The main objectives in this area are:

- 1) Targeted provision of social assistance, including monetary assistance, as well as comprehensive social services packages, to the vulnerable and targeted social groups of population (in medium term perspective insuring gradual transition to the predominant provision of comprehensive social services packages);
- 2) Ensuring decent old-age, including the operation of the mandatory funded pension system;
- 3) Social support for improving demographic situation.

375. Considering that social protection is one of the priority directions of state policy, as well as based on the priorities and the objectives, the ADS envisages a continuous increase in public spending on social protection in nominal terms. This means that all types of social benefits and pensions will increase continuously.

376. Social protection expenditures from the consolidated budget will be maintained around 8-9 percent of GDP and around 29-30 percent of consolidated budget expenditures. By nominal values, compared to 2013, they will increase in 2017 by 1.7 times and around for 2.5 times in 2021.

377. Major part of state expenditures on social protection will be channeled to pensions, which starting in 2014 will also include the expenditures on the funded pension system. The share of resources channeled to pensions in the overall social protection expenditures will amount to 75-80 percent in 2017-2025.

**Table 31. Main target indicators for financing of social protection system 2013-2025**

	Actual, preliminary	Plan	Target Indicators		
	2013	2014	2017	2021	2025
Consolidated budget expenditures allocated for social protection, bln. AMD	300.7	365.3	507.5	777.4	1,227.3
<i>As percent of consolidated budget expenditures, %</i>	25.7	28.4	30.5	29.3	29.9
<i>As percent of GDP, %</i>	7.0	7.7	8.0	8.2	8.7
Index, 2013=100	100.0	121.5	168.8	257.6	408.2
Of which: by main programs, in percents					
Pensions, including:	62.5*	64.9	73.8	77.6	81.2
Labor pensions	55.7	53.6	58.3	60.0	62.5
Other programs of social protection	37.5	35.1	26.2	22.4	18.8

\*Social pensions excluded

378. Developments of the social protection system are analyzed below in more detail, by its individual components.

## **19. SOCIAL ASSISTANCE SYSTEM**

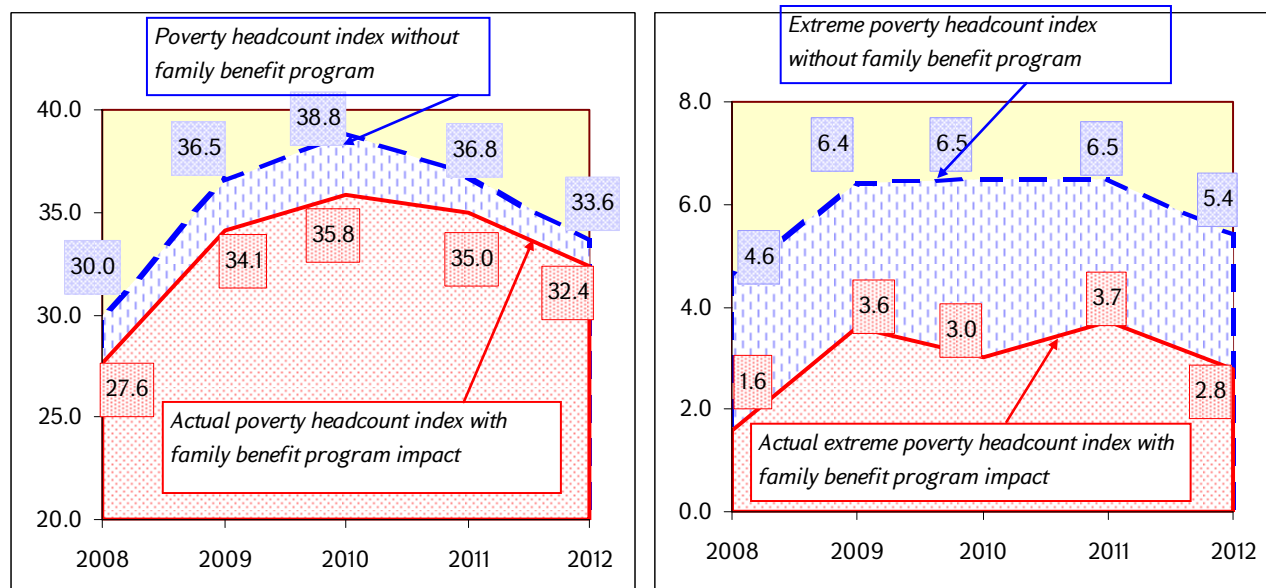
379. Based on the overall priorities of the social protection sector, the medium term priorities of ADS' social assistance sphere will remain the "Family living standards enhancement benefits" program.
380. At the same time, in the midterm perspective the existing model of provision of predominantly monetary assistance to poor and socially vulnerable groups of population will be gradually shifted to the model of provision of comprehensive social services packages, based of their needs. The main goal of the latter is the complex enlargement of capacities and opportunities of poor and socially vulnerable population mostly by provision of social services and by assistance in realization of their education, health, housing and other needs, as well as in their inclusion in the labor market. This will contribute to their welfare. The ideology of provision of comprehensive social services packages will give emphasis to the increase of motivation and opportunities for economic activity of the beneficiaries and their inclusion in the labor market.

### **19.1. FAMILY LIVING STANDARDS ENHANCEMENT BENEFITS**

#### **19.1.1 CURRENT SITUATION AND TRENDS**

381. Family living standards enhancement benefits (hereafter FLSEB) program is one of the largest social assistance programs implemented in Armenia. This program aimed at improving the living standards of beneficiaries is the successor of the Family Benefits Program that was effective until 1<sup>st</sup> January 2014. It encompasses family benefits for poor families with children and social benefits for poor families with no children. The number of families enrolled in both benefit components as well as the funds envisaged for 2014 is similar to those of the preceding Family Benefits Program. The overall objective of the FLSEB, as a successor of the Family Benefits Program, is supporting poverty reduction in the country. It provides public funds support to the most poor and economically passive families and population groups. Together with the pension system, the program has the largest share of public social transfers and has a key role in poverty reduction. In 2010, the provision of family benefits to the population allowed for reducing the representation of the poor in the country by 3 percentage points, or 1.1 times, and the representation of the extremely poor declined by 3.5 percentage points, or around two times. Thus, the FLSEB program has especially large impact on reducing the numbers of extremely poor individuals in the population. But in 2011-2012 the mentioned impact reduced: the provision of family benefits to the population in 2012 allowed for reducing the representation of the poor in the country by 1.2 percentage points, and the representation of the extremely poor declined by 2.6 percentage points.

**Figure 15. Impact of Family living standards enhancement benefits program on poverty and extreme poverty in 2008-2012**



Source: Social Snapshot and Poverty in Armenia RA NSS, 2010, 2011, 2012, 2013.

382. Based on the important role of the Family living standards enhancement benefits system in reducing poverty, the public expenditures on this program in nominal terms continuously increased during 2008-2013.

383. The mentioned circumstance accompanied by the reduction in the number of families registered in the system due to lower poverty levels, allowed for increasing the average amount of monthly benefits provided to beneficiary families to around 21,000 drams in 2008 and up to 29 thousand drams in 2013.

384. Since both the level of poverty and the number of poor families have increased between 2009 and 2010, the potential number of beneficiary families eligible for family benefits has went up correspondingly. Nonetheless the number of families applying to and enrolling with family benefits system shows a decline tendency.

**Table 32. Main indicators of the Family living standards enhancement benefits program 2008-2013**

	2008	2009	2010	2011	2012	2013
Public expenditures on FLSEB, mln. AMD, actual	28,838 <sup>1</sup>	29,146 <sup>1</sup>	30,878 <sup>1</sup>	35,516 <sup>1</sup>	33,100 <sup>1</sup>	37,125 <sup>2</sup>
Growth compared to the previous year, %	110.2	101.1	105.9	115.0	93.2	112.2
As percent of GDP, %	0.8	1.1	0.8	0.9	0.8	0.8
Number of families registered in the FBS	165,394	146,500	138,000	117,000	125,000	128,500
Family benefit recipient families	121,160	107,492	105,005	91,575	96,309	102,570
Average monthly allowance per family, AMD <sup>2</sup>	21,100	23,560	26,850	26,850	29,350	29,350
<i>Memorandum items</i>						
Number of poor families according to upper general poverty line	220.7	270.3	276.2	264.5	245.5	241,772
Family benefit recipient families to poor families, %	54.9	39.8	38.0	34.5	39.2	42.4

<sup>1</sup> Source: actual state budget expenditures of Armenia 2008-2012

<sup>2</sup> Source: reports of the Ministry of Labor and Social Issues

## 19.1.2 OBJECTIVES

385. Taking into consideration the envisaged gradual transition to more active forms of social support and the delivery of complex packages to poor and vulnerable population groups, in the long term perspective the Program aims to gradually decrease the number of potential beneficiaries of Family Living Standards Enhancement Benefit Programs and to ensure their conformity with the number of families below the lower poverty line and not the upper line. As of 2014 the ratio of beneficiary families to those below the poverty line is 75%. The Program targets at ensuring that the number of the beneficiary families under the FLSEB covers around 95% of the number of families below the lower poverty line in 2017 and reaches 100% from 2018. The Program policy is to maintain public expenditures for FLSEB program within the range of 0.6% of GDP in the long term perspective, provided there is continuous economic growth. This means that public allocations to FLSEB program in nominal terms will increase, maintaining their pre-program level in the mid-term perspective (in 2017) and increasing the 2013 level around 1.5 times in long-term perspective (in 2021).
386. Consequently, the average amount of benefits received by one beneficiary family will also stay on the pre-program level in the midterm perspective, while in the long term the nominal value will increase such that in 2021 it will overcome the 2013 level by around 1.7 times.

**Table 33. Main target indicators of the Family living standards enhancement benefits program**

	Actual	Planned	Target levels		
	2013	2014	2017	2021	2025
Family living standards enhancement benefits program expenditures from consolidated budget, mln. AMD	37,125	37,125	37,125	56,099	84,271
<i>Index, 2013=100</i>	100.0	100.0	100.0	151.1	227.0
<i>As percent of GDP</i>	0.8	0.8	0.6	0.6	0.6
Average monthly benefit per family, index 2013=100%	100.0	100.6	100.6	178.5	363.2
Number of beneficiary families	102,570	104,685	104,685	89,221	65,883
Ratio of beneficiary families number to number of families below lower poverty line, %	69.0	75.4	94.5	100.0	100.0

## 19.2. OTHER SOCIAL ASSISTANCE PROGRAMS,

### 19.2.1 CURRENT SITUATION AND OBJECTIVES

387. Taking into account the increase in poverty levels and the worsening demographic situation, the ADS gives a special importance also to the one-time childbirth benefits program and child care benefits for children up to two years of age.
388. Public expenditures allocated to one-off childbirth benefits slightly decreased in 2009-2013, but they allowed retaining of the average benefits at 50,000 AMD level for the 1<sup>st</sup> and 2<sup>nd</sup> child and at 430,000 AMD level for the 3<sup>rd</sup> and next children. Public expenditures allocated to childcare benefits for children up to two years of age increased in the same period by nearly

26 percent, but the monthly benefit remains the same: 18,000 AMD. The latter can be explained by higher birth rates in the last two years especially among working mothers.

**Table 34. Indicators for one time childbirth benefits and childcare benefits for children up to two years of age in 2008-2013**

	2008	2009	2010	2011	2012	2013
Public expenditures on One-off benefits for childbirth, mln. AMD	1,351 <sup>1</sup>	5,066 <sup>1</sup>	4,721 <sup>1</sup>	4,675 <sup>2</sup>	4,555 <sup>2</sup>	4,539
Average benefit for I and II child, AMD <sup>3</sup>	...	50,000	50,000	50,000	50,000	50,000
Average benefit for III and next children, AMD <sup>3</sup>	...	430,000	430,000	430,000	430,000	430,000
Memorandum Item						
Number of beneficiaries <sup>3</sup>	...	45,823	43,033	38,724	43,449	41,983
Public expenditures on Child Care Benefit for children under 2, mln. AMD	221.7 <sup>1</sup>	1,860 <sup>1</sup>	2,567 <sup>1</sup>	2,340 <sup>2</sup>	2,976 <sup>1</sup>	3,022
Average monthly benefit						
Average monthly benefit, AMD <sup>3</sup>	...	18,000	18,000	18,000	18,000	18,000
Memorandum Item						
Number of beneficiaries <sup>3</sup>	4,488	7,114	9,844	10,495	11,299	13,992

<sup>1</sup> Source: actual state budget expenditures of Armenia 2008-2012

<sup>2</sup> Source: law of the Republic of Armenia on state budget 2011

<sup>3</sup> Source: reports of the Ministry of Labor and Social Issues

389. Taking into consideration the poverty tendencies in the country, problems of young families, as well as demographic indicator trends and forecasts, due importance will continue to be attached to under 2 years old children care benefit and the one-off childbirth benefit programs. It is planned that the average benefit for under age of 2 child care and the one-off benefit for the first and second births, will stay on the pre-program level in a med-term perspective, whereas for average amount of one-off benefit for the third and fourth child it will increase reaching 1 million AMD, and for the fifth and subsequent births - 1.5 million AMD. Thus, already since 1st January 2014 the State Support Program for the third and subsequent childbirths was introduced with the purpose to boost birthrate in Armenia and improve living conditions of multi-children families, strengthen parents' confidence in their children's future, increase the amount and level of targeting of the financial support to the family for each third and subsequent child as a guarantee of family long-term development, reproduction and childbirth promotion. Within the framework of the Program, part of the one-off benefit for third and each subsequent birth in the family (from 1st January 2014 one million AMD for the 3rd and 4th birth and 1,5 million AMD for the 5th and subsequent births), namely 500 thousand AMD will be paid to the parents after the birth of the child and the remaining part will be transferred to the bank state support account thus forming a family capital (500 thousand AMD for the 3rd and 4th child and 1 million AMD for the 5th and subsequent child). The family capital will be possessed in non-cash manner by the parents for purposes defined by law until the child reaches age of 18. In addition, from the viewpoint of improving demographic situation it is important to stimulate formation of young families and childbirth. For this purpose it is appropriate to apply special mechanisms/projects for social assistance to such families. Such mechanisms must include such types of social assistance as provision of housing or provision of long term loans with low interest rates.

390. It is planned to revise the policy and approaches implemented in the field of disability through implementation of a new model based on comprehensive assessment of a person's needs and capacities, which takes into consideration all factors impacting relationships between a person and the environment. Mechanisms defining the disability status will be aimed at promotion of a person's rehabilitation potential and labor activity, delivery of social services adequate to his/her individual capacities and needs ensuring his/her full participation,



activities and social inclusion in the society. At the same time, the social support area will continue highlighting programs aimed at employment of disabled people and their integration in the society.

391. Programs aimed at social assistance to children in difficult living situations will continue to remain high on the agenda. In particular, targeted social programs on prevention of child inflow to institutions carrying out child care and protection and decreasing the number of children in such institutions will continue to have high importance. Alternative support services provided to children and their families will be expanded, taking into consideration specifics of child care, education, upbringing, physical and intellectual development, socio-physiological and medical rehabilitation as well as regional needs.

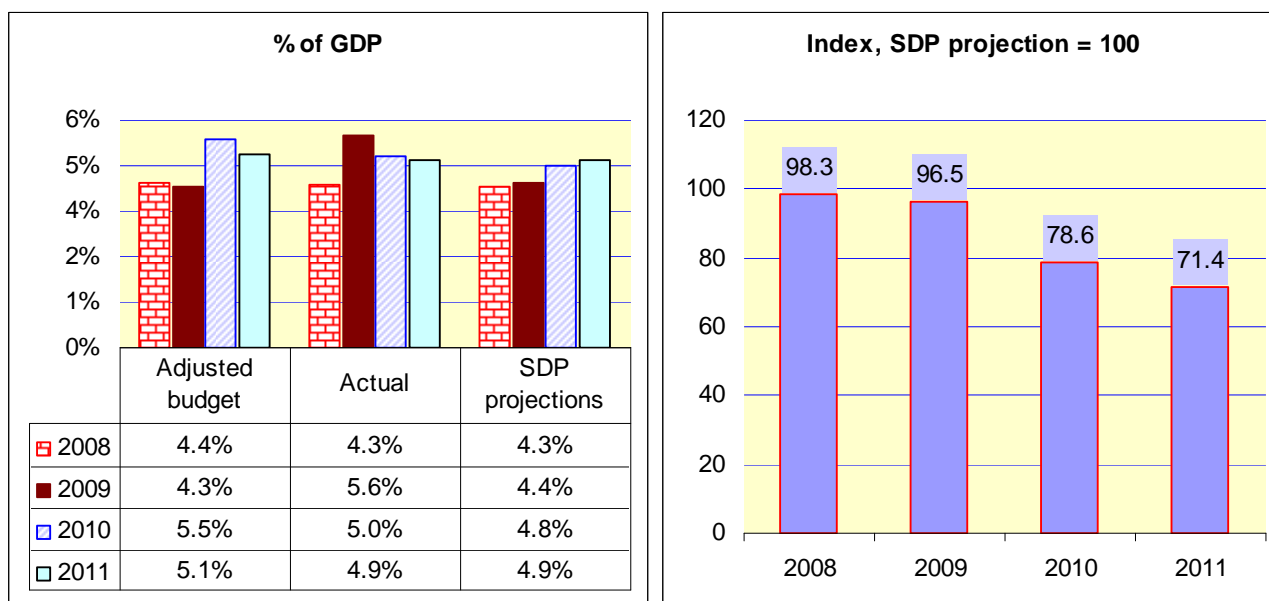
## 20. PENSION SYSTEM

### 20.1. SITUATION AND TRENDS

392. In 2009-2013 medium-term targets for continues increase of pensions were reflected in the annual and medium-term budget documents and serve as a milestone in the RA Government public expenditure policy (under which social protection, particularly pensions, is viewed as a priority).

393. In conditions of significant restriction of budget resource package, due to financial and economic crisis only targets for pension expenditure-to-GDP ratio set by SDP were possible to meet. Whereas, public expenditures on pensions, by their nominal value, were essentially lower than the levels provided for by the SDP (Figure 16). At the same time it should be noted that despite difficulties due to financial crisis, the planned budget expenditures on pensions were implemented in full without reductions.

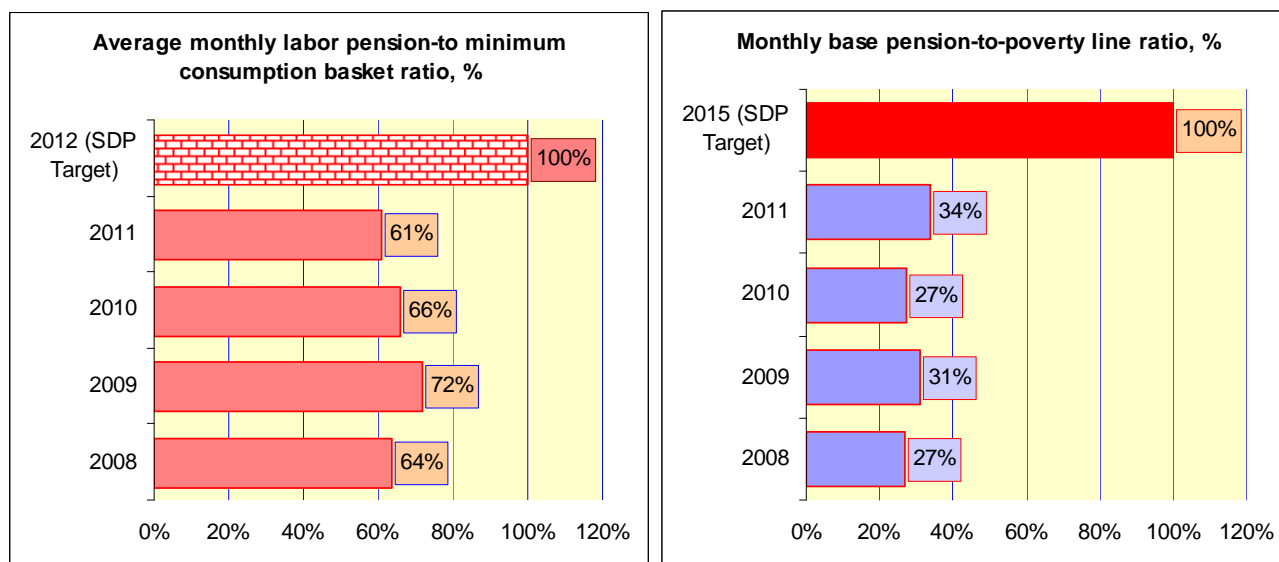
**Figure 16. Consolidated budget expenditure on pensions in 2008-2011**



Source: NSS, Ministry of Finance and SDP projections.

394. During 2009-2011 expenditures on pension, by their nominal value, have increased by around 22%. The increase of expenditure on pensions in 2009 and in the last months of 2010 was mostly attributable to increased size of monthly base pension (to 8,000 drams in 2009 and 10,500 drams starting November 2010 from 6,800 drams in 2008) and increased size of increment added to base pension per each worked year of a pensioner (to 450 drams in 2009-2011 from 395 drams in 2008). Nevertheless, with the said increases, SDP medium-term targets on average labor pension and base pension have become unreachable (Figure 17).

**Figure 17. Progress towards achieving SDP targets on labor and base pensions**



Notes:

1. For minimum consumption basket, indicators in Q3 prices (as published by NSS) have been used.
2. Poverty line refers to one published by NSS using methodology applied during ILCS for 2004-2008.
3. Consumption basket for 2011 estimated by applying 1.55 coefficient to food consumption basket in Q3 prices as published by NSS.

Source: Ministry of Finance, Ministry of Labor and Social Issues, National Statistical Service.

395. In addition, Armenian authorities have taken actions aimed at long-term reforms in the field. Particularly:

- In December 2010, the National Assembly of the Republic of Armenia approved a package of laws ensuring implementation of longer-term reforms in the pension sector.
- According to Law on State Pensions the length of work experience required to qualify for labor pension will be increased to 10 years in 2016 from 5 years applied up to 2011. The length of work experience required to qualify for labor disability pension is also has been revised.
- Actions were taken to improve management information systems in the field.

## 20.2. PRIORITIES AND OBJECTIVES

396. Funding of pension system will continue being viewed as public expenditure policy priority.

397. The prime goal of the policy in this sphere is the ongoing improvement of the social status of pensioners and ensuring long-term sustainability of the pension system.

398. Reforms in the sector will continue in two main directions:

- 1) Reform of parameters of the current distribution system and improvement of its

effectiveness;

- 2) Actions aimed at introduction of multi-pillar pension (particularly funded pillar) system.

399. Among the institutional reforms of the system, particular emphasis will be put on activities reducing contacts between pensioners and relevant authorized agencies, thus limiting risks of undesirable behavior.

400. To reduce poverty risks for pensioners the Government envisages implementing reforms aimed at below targets for average level of labor pensions:

	2017	2021	2025
Average labor pension-to-upper poverty line	125%	160%	200%
Average labor pension-to-minimum consumption basket <sup>47</sup>	100%	125%	150%

401. It is expected that achievement of defined targets will ensure that in 2017 the average labor pension in real terms will exceed around 1.5 times the level for 2012 and in 2025 the ratio will be 2.3 times.

402. Continuous increase of the basic pension will continue to be the primary tool for the increase of pensions, thus serving as the minimum livelihood safeguard for the pensioners.

403. The set goals were defined taking into consideration recent development trends and the planned general budgetary framework. Within the latter, it is planned that the level of pension expenditures will amount to 6.0% of GDP by 2017, 6.4% of GDP by 2021 and 7.1% of GDP by 2025 as opposed to 5% of GDP recorded in 2012.

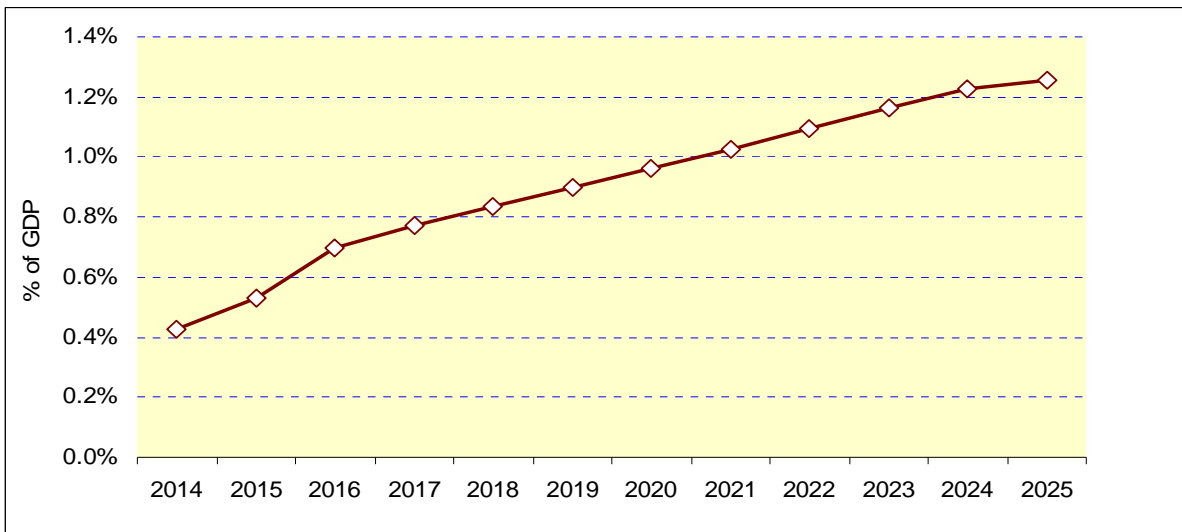
**Table 35. Consolidated budget expenditures on pensions, 2012-2025**

Indicators	2012	2014	2017	2021	2025
	Actual	Projections			
Total expenditure on pensions, billion drams	198	242	371	601	996
including					
<i>Labor pensions, billion drams</i>	169	196	296	464	767
Total expenditure on pensions, % of GDP	5.0%	5.1%	6.0%	6.4%	7.1%

404. Estimated public expenditures by year to be resulted from introduction of funded pension pillar are presented in figure below.

<sup>47</sup> The minimum consumption basket was estimated by adjusting the minimum food basket (2,412.1 ccal) value by 1.55 coefficient.

**Figure 18. Estimated public expenditure to be resulted from introduction of funded pension pillar (2014-2025), % of GDP**



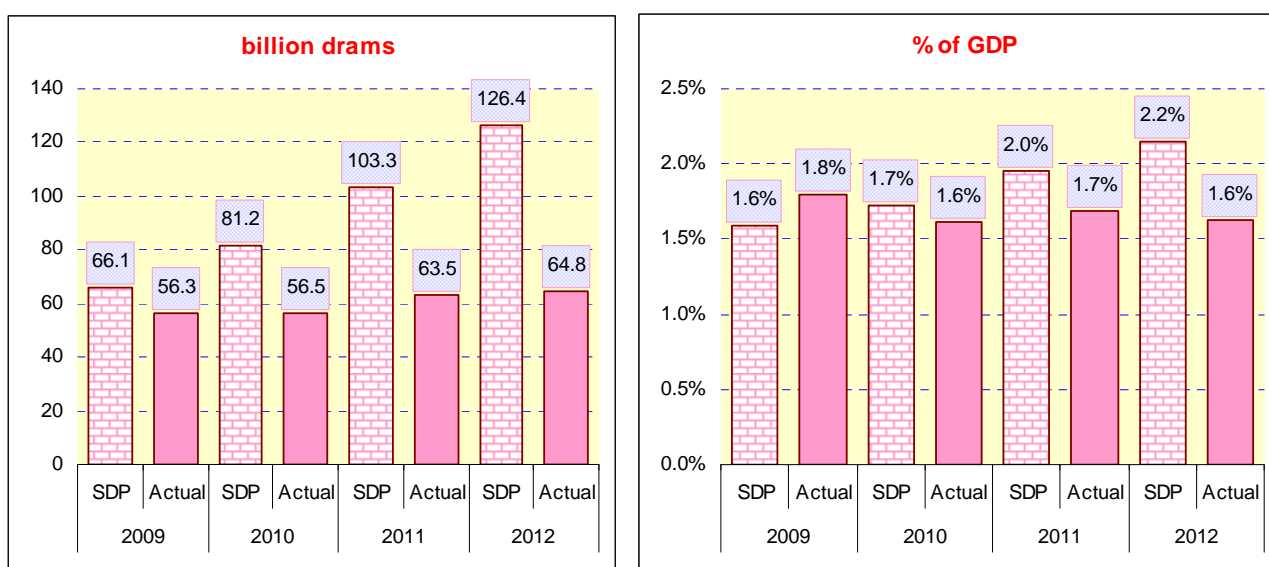
## VIII. HUMAN CAPITAL DEVELOPMENT

### 21. HEALTHCARE

#### 21.1. CURRENT SITUATION AND TRENDS

405. Decrease in budget resources and general narrowing of budget framework due to financial and economic crisis has had its impact also on the public expenditures in the healthcare sector. In 2010-2012, public expenditures on the healthcare sector has mainly stayed unchanged and discrepancies have been recorded from the respective midterm targets (Figure 19). Nevertheless, share of healthcare expenditures in the structure of consolidated budget expenditures has somewhat increased (6.2 percent in 2012 compared to 5.8 percent in 2009).

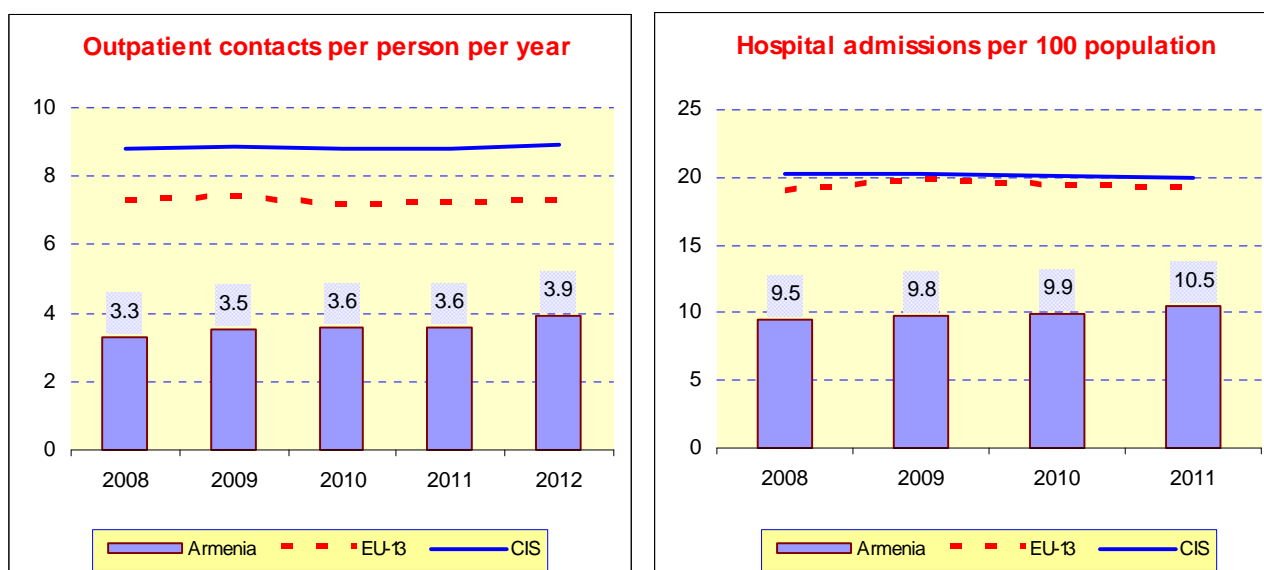
Figure 19. Consolidated budget expenditure in health sector in 2009-2012



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

406. During recent years some increase in indicators of inpatient and outpatient healthcare utilization were recorded (Figure 20), nonetheless, it can be stated that healthcare resources continue to remain underutilized. On the other hand, the indicators characterizing the use of outpatient and inpatient services in Armenia are 2-2.5 times lower than those of the CIS countries and new member states of the European Union.

**Figure 20. Utilization of outpatient and inpatient care in Armenia, EU new member states and CIS counties in 2008-2011**



Note: For EU and CIS countries hospital discharges are considered.

Source: Ministry of Health of the Republic of Armenia and Health for All Database, WHO/Europe, 2013.

407. The summarized results of the Integrated Survey of Living Conditions of households also revealed the generally low level of the use of healthcare services, although the same source indicates some positive changes as well. In particular, in 2008 25 percent of the population referred to medical consultations or treatment, while in 2012, results of the survey put the same indicator at around 33 percent. At the same time, although the deviations between the corresponding indicators for welfare groups of the population have relatively decreased, nonetheless, the difference is still remaining significant (Table 36).

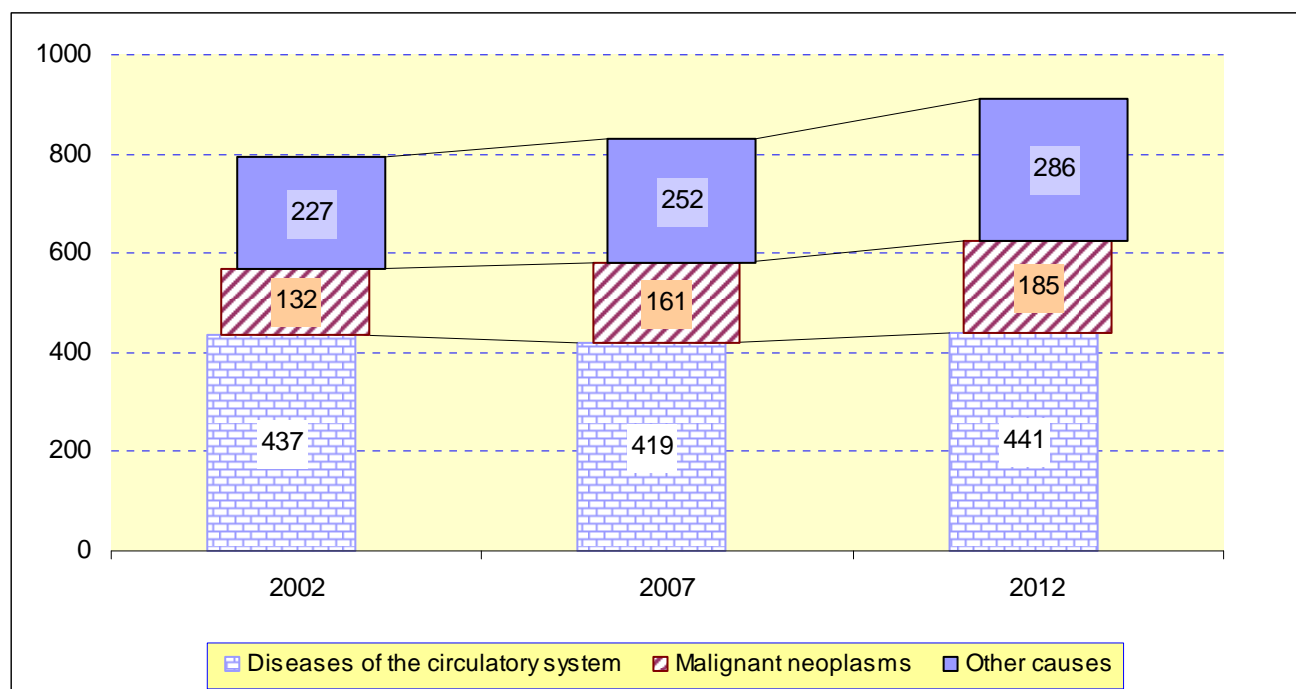
**Table 36. Share of population referring to medical consultation or treatment when sick, by place of residence and level of welfare, percentage**

	2008	2012
Total	25.2	32.7
Yerevan	31.6	38.9
Other urban communities	21.1	35.1
Rural communities	21.4	26.2
Non-poor	28.0	36.2
Poor	17.0	25.1
Extreme poor	9.0	20.7

Source: National Statistical Service of the Republic of Armenia (2008 and 2012 ISLC).

408. Rates of morbidity with non-contagious diseases (in particular diseases of the circulatory system, malignant neoplasms and diabetes mellitus) and the resulting higher levels of mortality continue to be of concern. During the last ten years the mortality rate from both cardiovascular deceases and malignant neoplasms has increased. In particular, mortality rate from malignant neoplasms has increased significantly (Figure 21).

**Figure 21. Mortality in Armenia by cause in 2002-2012, deaths per 100,000 population**



Source: National Statistical Service.

409. If summarizing, it can be stated that despite health sector reforms implemented in the past years there are still a number of unresolved systemic issues, and the activities to address them will determine future development of the sector.

## **21.2. PRIORITIES AND OBJECTIVES**

410. Considering the developments in recent years and the current situation, the government of Armenia will continue the reforms of the sector aiming to improve indicators for the health condition of the population, through better access to, as well as affordability and quality of healthcare services.

411. Continuing the adopted reforms, the government of Armenia will specially focus on measures for prevention of diseases, their early diagnosis and treatment, in particular aiming to reverse the negative trends formed with regard to morbidity with non-contagious diseases and the corresponding rates of mortality. In this regard, the interrelated development of outpatient and inpatient healthcare services will be considered as the main precondition for ensuring the proper continuity of medical care.

412. A key pre-condition to addressing the negative trends related to morbidity and mortality rates due to non-contagious diseases is in-depth analysis of risk factors based on comprehensive studies, and if needed, development and implementation of targeted programs.

413. In the medium-term, one of the main priorities for government intervention in the sector will be the further improvement and development of the primary healthcare level. This is explained, on the one hand, by the high level of accessibility, both physical and economic, of those services, and on the other hand, the importance of interventions at this level of medical care for identifying and preventing diseases. At the same time, in case of inpatient treatment, special emphasis will be put on the accessibility of key services (especially in regions), quality (in particular the availability of the corresponding specialists and material-technical

refurbishment), as well as, no less important, issues related to the institutional framework and relationships.

414. A special importance will be attached to development and implementation of quality standards for healthcare services. Development of disease management protocols and/or standards particularly for the most common conditions will be finalized. Evidence-based healthcare standards and patient database management protocols will be gradually introduced to address quality management issues in the sphere of delivery for healthcare services.
415. In the program period, again special attention will be paid to ensuring specialized inpatient medical care for individuals in the socially vulnerable and special groups of population. Nonetheless, the government of Armenia intends to further elaborate the approaches, aiming to improve the targeting and effectiveness of the corresponding programs.
416. Emergency cardiac surgery will be guaranteed for all citizens of the Republic of Armenia.
417. Recent reforms aimed at improving maternal and child healthcare will be continued and strengthened, while the identified gaps will be bridged. Special attention will be paid to child healthcare promotion and prevention of diseases, including immunization, better access to inpatient care and improved rehabilitation services. The latter will include expansion of rehabilitation service network. Efforts will be put to implement programs on improvement of child nutrition, early detection of children with special needs and initiation of early interventions. Programs aimed at improvement of access to and quality of maternity services and prenatal care will continue along with activities aimed at detection of pathologies in pregnant women, intrauterine diagnosis of congenital abnormalities and screening of newborns.
418. Activities will be implemented to establish a hematology hospital that meets European standards. It is also planned to found an oncology center that will enable applying modern scientific methods to detect, diagnose and adequately treat neoplasms.
419. During the projected period special importance will be attached to programs and activities geared at improvement of drugs' physical and economic accessibility. Priorities in this sphere will continue covering activities ensuring proper quality and safety of drugs.
420. The continuous increase of public expenditures on the sector is considered as one of the key leverages for implementing measures within the framework of the defined priorities. At the same time, the government, taking into account the international experience, will also emphasize the implementation of measures with relatively low cost, but high impact over the long run (for example measures for reducing risk factors related to cardiovascular diseases (fight against smoking, enhanced accessibility of key medicines, etc.)).
421. Improvement of the acting monitoring, evaluation, recording and reporting systems is an important precondition of successful implementation of future reforms in the sphere. On the one hand this will improve the system transparency and on the other hand will enhance commitment and efficiency of planned and implemented activities.

### **21.3. PROGRAMMING PUBLIC EXPENDITURES AND REFORMS OF FINANCING MECHANISMS**

422. The program plans to increase public expenditures on healthcare to 1.8 percent of the GDP by 2017 and around 2.7 percent of the GDP by 2025. To achieve the targets set, it is planned to increase the public expenditures/GDP ratio by 0.1-0.2 percentage points annually, as a result



of which the nominal value of public expenditures on the sector, compared to 2012, will increase in 2017 by 1.5 times and in 2025 by more than 3.5 times (Table 37).

423. In the program period, healthcare will be one of the priorities of public expenditures and allocations to the sector will increase more rapidly than the total expenditures of the consolidated budget. As a result, the share of public expenditures on healthcare is expected to constitute 6.7 percent of the total expenditures of the consolidated budget in 2017 and around 9.5 percent in 2025, compared to the actual 6.2 percent recorded in 2012.

**Table 37. Consolidated budget expenditures on healthcare 2012-2025**

Indicators	2012	2014	2017	2021	2025
	<i>Actual</i>	<i>Projections</i>			
Consolidated budget expenditure on healthcare, billion drams	64.8	80.6	112.0	209.2	381.7
% of GDP	1.6	1.7	1.8	2.2	2.7
% of consolidated budget total expenditure	6.2	6.3	6.7	7.9	9.3
Year-on-year percent change	2.1	24.9	22.2	17.0	15.9
Real consolidated budget expenditure on healthcare (Index, 2012=100)	100	116	144	230	358
Per capita real consolidated budget expenditure on healthcare (Index, 2012=100)	100	115	142	227	355

424. With respect to expenditures in the sector by main economic items, it is planned to channel 9-12 percent of state financial allocations to the sector to the financing of capital expenditures in the sector. Starting in 2018, the share of capital expenditures will slightly reduce, within the range of 7-10 percent of state allocations to the sector. Moreover, in capital expenditure priority will be given to investments in primary healthcare facilities both located in urban and rural communities.

425. In recent years, one of the achievements of public financing of the healthcare sector from the viewpoint of the effectiveness of distribution, was the ensuring of almost equal allocations to the primary healthcare and hospital services within the structure of the public financing of the healthcare sector. In the next 4-5 years, around 35-40 percent of state financing allocations to the sector will again be channeled to the financing of primary healthcare services. Thereafter, starting in 2017-2018, increases of overall state allocations to the financing of primary healthcare and hospital services will be distributed with the ratio of 65:35, with the larger share going to hospital services.

426. Considering low level of wages in the sector (both in hospitals and primary health care facilities), the government of Armenia intends to intervene with some leverages (regulate) in the wage policies implemented by facilities, aiming to, on the one hand, contribute to the proper level of remuneration of medical staff, and on the other hand increased the level of transparency and formalization of financial flows in the sector.

427. In the program period, the government of Armenia will continue to implement measures for improving the financing mechanisms of medical care. In particular, the system of copayment financing introduced in 2011 will be further developed and deepened. The agenda will also include, in particular, the improvement of the compensation mechanisms for hospital healthcare services, aiming to make a gradual transition to the mechanism for financing groups by diagnosis.

428. Increase of the efficiency of budget funds spending provided to the sector will be one of the issues on the agenda.

429. In order to ensure healthcare provision to socially vulnerable population groups and to improve effectiveness of relevant programs, the Government of Armenia, within the framework of social package and based on detailed study and analysis of the results of medical insurance program, intends to revise the state funding mechanisms for healthcare services delivered to socially vulnerable population, considering the possibility of expanding the medical insurance application frame as an alternative.

## 22. EDUCATION

### 22.1. CURRENT SITUATION AND TRENDS

430. The education sector in Armenia is considered to be important as one of the preconditions for sustainable development of the country, reproduction and development of the human capital. Thus, developments in this sector are one of the development priorities of the country. Increasing the quality and effectiveness of education at all levels of the educational system, increasing the relevance of different levels to international standards and ensuring affordable/accessible education for all groups of the population are priorities for the development of the sector. In order to achieve the mentioned goals, reforms are implemented at all levels of education.

431. Based on the requirements for successful implementation of reforms in the education sector, the SDP planned to continuously increase public expenditures in the education sector, both by their nominal value of and as a percentage of GDP – ensuring the 4 percent of GDP target indicator by 2015. The economic decline, shrinking of the GDP and the narrowing of the resource base of the budget, limited the possibilities for maintaining expenditures on education to the planned volumes.

**Table 38. The dynamics of the consolidated budget expenditures allocated to education sector in 2008-2013**

	2008	2009	2010	2011	2012	2013
<i>Consolidated budget expenditures on education, bln. AMD</i>						
Actual	113.6 <sup>1</sup>	121.1 <sup>1</sup>	111.9 <sup>1</sup>	122.4 <sup>1</sup>	121.5 <sup>1</sup>	122.1 <sup>2</sup>
Consolidated budget expenditures on education to GDP, %	3.2	3.9	3.2	3.2	3.0	2.9
Consolidated budget expenditures on education to total consolidated budget expenditures, %	13.6	12.8	11.5	12.1	11.7	10.4

<sup>1</sup> actual expenditures of Armenia's consolidated budget 2008-2012

<sup>2</sup> planned expenditures of consolidated budget

432. Analysis of the dynamics of public expenditures on the education sector reveals that consolidated budget public expenditures channeled to the education sector in 2008-2009, both by their nominal values and as a percentage of the GDP, had increased, but as a result of the crisis, they declined in 2010, and in 2011 returned to their nominal values of 2009. As a result, expenditures on education in 2013 amount to 2.9 percent of the GDP. The indicator for the share of expenditures on education as a percentage of GDP in Armenia in 2013 was 1.7 times lower than the average of the same indicator in 2010 for FSU and CCE countries (4.9 percent<sup>48</sup>) and around 2 times lower than the average for 2009 in 27 European Union countries (5.4 percent<sup>49</sup>). In Armenia in 2008-2012, on average 12.3 percent of public expenditures were

<sup>48</sup> Source: TransMonee Database, UNICEF, 2012

<sup>49</sup> Source: Eurostat Database

channeled to education. It must be noted that the average indicator in 2008 for OECD countries amounted to 12.9 percent.

**Table 39. Structure of expenditures of the consolidated budget on education 2011-2014, thousand AMD**

	2011	2012	2013 preliminary	2014
	Actual	Actual	Actual	Planned
<b>Total consolidated budget expenditures on education, of which:</b>	<b>122,436,067.9</b>	<b>121,474,278.1</b>	<b>122,110,757.3</b>	<b>147,525,224.8</b>
<b>Pre-school and elementary general education, including:</b>	35,542,034.9	34,078,933.4	36,670,337.2	40,163,422.8
Pre-school education	10,693,784.9	11,985,410.5	13,225,044.3	14,062,678.9
Elementary general education	24,848,249.9	22,093,522.9	23,445,292.9	26,100,744.0
<b>Secondary general education, including:</b>	45,244,532.5	49,102,343.1	48,257,319.2	51,591,468.3
Basic general education	30,530,199.1	30,530,829.0	30,563,746.7	32,786,277.4
Secondary (complete) general education	14,714,333.4	18,571,514.1	17,693,572.5	18,805,190.9
<b>Preliminary vocational (craftsmanship) and secondary vocational education, including:</b>	5,083,154.2	5,375,467.2	6,182,089.9	8,716,477.2
Preliminary vocational (craftsmanship) education	1,906,069.7	2,028,182.0	2,306,510.8	2,865,068.2
Secondary vocational education	3,177,084.6	3,347,285.1	3,875,579.1	5,851,409.1
<b>Higher education, including:</b>	7,884,836.4	7,780,550.8	8,055,380.1	9,922,395.2
Higher professional education	7,290,951.2	7,128,593.6	7,367,944.8	9,100,794.4
Post-graduate professional education	593,885.2	651,957.2	687,435.3	821,600.8
<b>Education, not classified by the levels, including:</b>	7,715,361.1	7,866,189.2	8,712,617.7	9,691,110.5
Extracurricular education	6,640,342.0	6,851,628.7	7,647,863.2	8,490,560.6
Additional education	1,075,019.1	1,014,560.5	1,064,754.5	1,200,549.9
<b>Supplementary services provided to education</b>	20,242,328.6	16,598,812.2	13,549,005.5	26,541,053.6
<b>Research and development activities in the sphere of education</b>	264.0	740.0	60.0	0.0
<b>Other Education (Not in the abovementioned items)</b>	723,556.2	671,242.2	683,947.8	899,297.1

Source: Ministry of Finance of Armenia

433. General education is a program priority in the education sector. The major part of expenditures in the education sector is channeled to the general education programs<sup>50</sup> (82-83 percent). The decrease in expenditures on education by their nominal value (and as a percentage of GDP) has not resulted in lower expenditures per one beneficiary, particularly also in the general education sector. In the 3 tiers of general education – elementary, basic/lower secondary and complete general/upper secondary schools, the nominal values of annual public expenditures per pupil have continuously increased in 2008-2010. Annual public expenditure per one pupil enrolled in the general education system in 2011 amounted to 15.1 percent of the GDP per capita, or around 181,000 Armenian drams. Annual public expenditures per pupil are differentiated by levels of general education. In elementary school in 2011, they amounted to 15 percent of the per capita GDP, or around 179,000 Armenian drams, in basic school - to 16.5 percent of the per capita GDP or around 198,000 drams and they were the lowest in complete general/upper secondary school - 13.1 percent of the per capita GDP or around 155,000 drams. Public expenditures per pupil in Armenia remain incomparably lower than the average for the European Union. In 2009, European Union countries annually spent on average around 22 percent of the per capita GDP per one pupil enrolled in elementary school and around 28 percent of the per capita GDP in general

<sup>50</sup> Formal basic education programs include elementary, basic and secondary (complete) general education (formal basic education, special education, etc.), as well as a number of programs envisaged within the framework of support to the implementation of general education programs.

secondary school, while the same indicators for Armenia in 2011 amounted to around 15 percent of the per capita GDP. Allocation of such small budgetary amounts to this sector hinders the entire process of reforms of the system and the ensuring of quality and accessible education for all groups of population.

434. There is a significant difference of public expenditures per pupil between preliminary and secondary vocational education and the upper secondary school<sup>51</sup>. At preliminary and secondary vocational education level, annual public expenditures in 2011 per one pupil in the public funded scheme was 2.2 times higher than the same expenditures per pupil in the upper secondary schools, amounting to around 31 percent of the per capita GDP, or 373,000 drams. At higher education level, annual public expenditures per student in the public funded scheme in 2011 amounted to 38 percent of the per capita GDP.
435. The most fundamental reform implemented in the general education sector is the formation of separately operating system of three-year upper secondary schools (grades 10 to 12) as the continuation of the general basic education. The purpose of establishing the system of the upper secondary schools is to improve the quality and effectiveness of education in this level, as well as give the possibility to their graduates to choose between further specialization and preliminary vocational education in accordance with their preferences. The establishment of upper secondary schools started in 2008. The number of high schools in Armenia during academic year 2011/12 was 104 and during 2012/13 – 108, which have 10th -12th grades. High schools are developed primarily in urban areas (their 95.5 are located in cities). 12-year education in rural areas is provided through secondary schools, which cover all levels of public education, including the high schools. During the 2012/13 academic year 812 secondary schools were functioning in the country, the overwhelming part of which, i.e. 86 % in rural areas. Those are mainly small schools (830 of currently functioning 1,364 schools have 300 pupils, 410 have less than 100 pupils), with around half (particularly high schools) failing to deliver both high-quality and effective education.
436. The 12-year education is provided through both high schools and (mostly) secondary schools. However, the secondary school network does not enable on the one hand ensuring financial, material and human resources centralization on the level of high schools, and on the other hand, implementing quality pre-professional/stream education and ensuring smooth transition to higher educational establishments. Hence, emerging of high schools and ensuring high-quality pre-professional education require gradual reorganization of secondary schools into basic and high schools and ensuring maximum accessibility of high schools throughout the country.
437. At the same time, Armenia has a system of preliminary and secondary vocational education. As of 2011, the system includes 5052 preliminary and 101 secondary<sup>53</sup> vocational educational institutions, which together with continuing the overall secondary education of their pupils also allow for obtaining specializations and qualifications. All preliminary and secondary vocational state educational institutions, in order to increase the accessibility of this educational programs, starting in the academic year of 2011-2012, admit students without entrance exams, only based on competition basis (with the exception of specializations in arts).

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<sup>51</sup> At preliminary and secondary vocational and higher education levels, calculations are based on free-of-charge or public-paid students, whose training is paid by public expenditures (public funded scheme).

<sup>52</sup> State institutions: 25 preliminary and 20 secondary vocational educational institutions, 4 colleges, 1 higher educational institution

<sup>53</sup> Including 80 state institutions: 6 higher educational institutions, 73 secondary vocational institutions and one college

They have not only the public funded scheme/free of charge students, but also students, paying for the tuition. However, annual public expenditures per pupil in the upper secondary school are considerably lower compared to the same expenditures in preliminary and secondary vocational educational institutions, which creates risks for proper establishment and operation of upper secondary schools and the formation of the demand for their services.

**Table 40. Annual public expenditures per pupil and per student in the public funded scheme in 2008-2011**

	2008		2009		2010		2011	
	AMD	To per capita GDP, %	AMD	To per capita GDP, %	AMD	To per capita GDP, %	AMD	To per capita GDP, %
Elementary and general secondary education, including:	144,063	13.0	182,145	18.6	186,309	16.8	181,381	15.1
Elementary education	138,458	12.5	166,218	16.9	159,617	14.4	179,449	15.0
General secondary education, of which:	146,202	13.2	188,910	19.3	201,893	18.3	182,460	15.2
Basic education: basic/lower secondary school	140,946	12.8	192,569	19.6	203,465	18.4	198,150	16.5
General (complete) secondary education: upper secondary school	159,013	14.4	180,327	18.4	198,290	17.9	156,714	13.1
<b>Preliminary vocational (craftsmanship) and secondary vocational education, including:</b>	304,335	27.5	347,422	35.4	343,595	31.1	373,103	31.1
Preliminary vocational (craftsmanship) education	347,919	31.5	344,242	35.1	310,035	28.0	366,059	30.6
Secondary vocational education	282,337	25.6	349,414	35.6	368,451	33.3	377,460	31.5
<b>Higher education</b>	354,930	32.1	398,301	40.6	401,896	36.3	455,271	38.0

Source: calculated based on the consolidated budget figures and NSS "Social panorama of Armenia" 2008-2011

438. Study of the number of pupils who continue their education at upper secondary education level after graduating from the basic school reveals some important trends related to the operations of the upper secondary schools system. The enrollment rate in upper secondary school is lower than in the other levels of general education system and demonstrates the downward trend. According to official statistics, in the academic year of 2010/2011, enrollment rate in upper secondary school amounted to 84.4 percent, compared to 96.8 percent in elementary school and 91.6 percent in basic school<sup>54</sup>. And the enrollment rate in the academic year of 2011/2012 in elementary school constituted 99 percent, in basic school it was 91.8 percent and in upper secondary school it amounted to 72.8 percent<sup>55</sup>. This means that the share of pupils continuing their education in upper secondary school among graduates of the basic school has declined. In academic year of 2011/2012, in the 1<sup>st</sup> level of the upper secondary school (or grade 10), were enrolled only 70 percent of graduates from the 9<sup>th</sup> grade of the basic school in 2010/2011 (this is the coefficient of the transition from basic/lower secondary school to upper secondary school. In the academic year of 2010/2011, from about 39,000 pupils in the 9<sup>th</sup> grade graduating class of the basic school, around 27,000 continued their education in the 10<sup>th</sup> grade of upper secondary school). While in academic year of

<sup>54</sup> Source: "Social Panorama of Armenia in 2010", NSS 2011

<sup>55</sup> Source: "Social Panorama of Armenia in 2011", NSS 2012

2006/2007, when the system of upper secondary schools was not yet introduced, the same indicator amounted to around 91 percent (it must be noted that the rate of transition from elementary school to basic school in 2008-2011 was 98-99 percent). Consequently, around 30 percent of graduates of the basic school, for one or another reason, have not used the educational services provided by upper secondary schools in 2011. At that, the reason behind this is not the difficult-to-access (physical-geographic) location of educational institutions delivering high school services, since as it was mentioned earlier, high school educational services are available in both urban and rural communities through secondary school system.

**Table 41. Graduates of the basic school in the academic year of 2010/2011 and their further enrollment at different levels of the educational system**

	Pupils	Percent in the total number of pupils enrolled in the last 9 <sup>th</sup> grade of the basic school in 2010/11 academic year	Percent in the number of pupils received graduation certificates from basic school in 2011
Total number of pupils enrolled in the last 9 <sup>th</sup> grade of the basic school in 2010/11 academic year	39,081	100.0	--
Of which:			
Received graduation certificates from basic school in 2011	37,756	96.6	100,0
Of which:			
<i>Admitted to the other educational institutions in 2011/12 academic year</i>	7,653	19.6	20.3
<i>Admitted to upper secondary educational institutions in 2011/12 academic year</i>	27,189	69.6	72.0
<i>Did not appear in any level/institution of the educational system in 2011/12 academic year</i>	2,914	7.4	7.7
Remained in the 9th grade	188	0.5	--
Studies are left unfinished	249	0.6	--
Emigrated	494	1.3	--
Other	394	1.0	--

Source: "Social Panorama of Armenia in 2011", NSS 2012

439. Of course, part of the graduates of the basic school prefers to continue their education in preliminary and secondary vocational educational institutions. In the academic year of 2010/2011, around 20 percent of pupils who received graduation certificates from basic school were admitted to other educational institutions. On the other hand, the number of pupils who leave the educational system at all after graduation from the basic school increases: part of the graduates of basic schools discontinued their education after graduating from the basic school. In the academic year of 2010/2011, 7.7 percent of basic school graduates did not continue their education at any other level in 2011/2012. Of course, part of them has seemingly emigrated, but there is a lack of information on that aspect. At the same time, the household living standard survey of 2010 reveals that it is basically the poorest segments of the population and the rural population that do not continue their education at upper secondary schools. In 2010, the rate of enrollment in upper secondary schools for the poorest decile of the population amounted to only 54 percent, and for the rural population it was around 53 percent<sup>56</sup>. This circumstance, in particular, creates poverty reproduction risks.

440. Although the number of population in the corresponding age group reduces because of the demographic trends, in 2007-2011 the preliminary and secondary vocational educational

<sup>56</sup> Source: "Republic of Armenia, Fiscal Consolidation and Recovery", WB, 2011

institutions had a steady rate of admitted students - on average 11-12 thousand students in the secondary vocational programs and 2-3 thousand students in the preliminary vocational programs. This is the evidence of the demand for services for those levels of the education system.

441. The aforementioned tendencies make the guaranteed free 12-year education of all population groups a serious challenge, if taken into consideration that part of vocational educational programs is implemented on paid basis. Hence, transition to universal 12-year education is a priority of public education. This means that the following are needed: a) ensure guaranteed free 12-year education (including vocational) in both high schools and vocational educational establishments for all basic education graduates, b) ensure correct planning of public expenditures in terms of the proportion of expenses related to high schools and vocational education.
442. In the general education system, increasing efficiency as a result of the reforms of the system is a priority. Thanks to the reforms of the general education sector, indicators characterizing the efficiency of the system showed positive trends in the beginning of 2000s, but they subsequently started to decline. In particular, the pupil/teacher ratio in 2006 amounted to 10.9. But in recent years, this indicator has started to decline again and amounted to 2 only 9.3 in 2012. Thus, the ratio of pupils/teachers is still far behind the international standard – in 2010, the average for the same indicator in the European Union countries was 12, and for OECD countries is amounted to 14.757. The same is true also for class density. It grew in the beginning of 2000s, and in 2005 amounted to 22 pupils in the class on average, compared to 20 in 2003, and reached the average for OECD countries in those years. But later, it started to decrease and in 2011 it amounted to 18.4. Of course this indicator is differentiated by different levels of the system. It was the highest in the elementary school in 2011 at 18.9, for the basic/lower secondary school it was 17.9 and the figure for upper secondary school was 18.2.
443. Regional distribution of these indicators reveals significant regional differences. The pupil/teacher ratio is the highest in Yerevan, Ararat and Kotayk regions (10.8, 10.1 and 10.0 respectively), and the lowest in Aragatsotn, Vayots Dzor, Syunik, Tavush and Lori regions (6.3, 6.6, 6.7 and 8.0 respectively). Class density indicator is also the highest in Yerevan, Kotayk, Ararat and Armavir regions (22.9, 20.4, 19.8 and 19.8 respectively) and the lowest in Aragatsotn, Syunik, Vayots Dzor regions (12.2, 12.7 and 13.0 respectively). There are also significant differences between urban and rural areas. In the academic year of 2011/2012, the pupil/teacher ratio for rural communities amounted to only 7.8, while it was 10.5 for urban communities. Consequently, the low level of average national indicators is explained by specific geographical characteristics, in particular the low level of this indicator of efficiency in rural schools. Taking into account the importance of protecting rural communities in general and remote, near border and small rural communities in particular, especially in conditions of the worsening demographic situation, the government will implement the policy for protection of schools in those communities and increasing the quality of educations to the extent possible. For such communities, other target values for the mentioned efficiency indicators should be defined, at the same time promoting high level of efficiency in rural schools. In this regard a special importance is attached to introduction of the practice of developing multi-set

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<sup>57</sup> Source: Eurostat and OECD databases. It is noteworthy that the international data estimation methodology is based on the number of full-time employed teachers, which is different from data for Armenia which are calculated based on the absolute number of teachers. Note that during 2011/2012 academic year about 44% of general education school teachers in Armenia were employed at 0,75 workload rate, about 34% at 0,76-1 workload rate and 22% at more than 1 workload rate.

classes in small rural community schools, which in its turn translates into the need of training multi-profile teachers at higher educational establishments especially for upper secondary school.

**Table 42. Pupil/teacher ratio and average density of classes in the general education institutions/schools in 2008-2011**

	2008/09	2009/10	2010/11	2011/12		
				Total	Urban	Rural
Number of pupils	414,781	392,946	370,892	386,439	233,837	152,602
Average number of pupils per class	17.8	17.1	18.4	18.4	...	...
Number of teachers	42,601	41,512	41,402	41,757	22,284	19,473
Number of pupils per teacher (pupil/teacher ratio)	9.7	9.5	9.0	9.3	10.5	7.8
Memorandum item						
Number of pupils per teacher (pupil/teacher ratio) in the preliminary vocational education system	7.3	7.2	6.8	5.3	...	...

Source: "Social Panorama of Armenia 2011", NSS 2012, "Regions and Yerevan in figures 2011", NSS 2011

444. Enhancing the qualifications of teachers through training courses, bringing their qualifications up to certain standards, and increasing their salaries on that basis, have crucial significance for the quality of general education. Since 2005, training courses are organized annually for around 20 percent of teachers. As a result, in the 5 years preceding 2011, 74 percent of teachers participated in training courses. At the same time, a new procedure for attestation of teachers was introduced in 2011, which will allow for differentiated financing and will create incentives for further improvement of qualifications. These measures will largely contribute to improving the quality of general education.
445. Correspondingly, salaries of teachers have been raised. In the beginning of 2000s, the average monthly remuneration for teachers grew continuously. In 2003-2006, it increased by around 3 times and amounted to about 58,000 drams in 2006 (for full time occupation). The ratio of the calculated annual average salary of one teacher to the GDP per capita in 2006 amounted to 0.85, compared to 0.43 in 2003. In 2009, the calculated average monthly salary of one teacher read the level of 116,300 drams - an increase of around 100 percent compared to 2006. Because of the decline in GDP and in order to maintain the level of salaries of teachers, the ratio of the calculated annual average salary of one teacher to the GDP per capita in 2009 amounted to 1.4. In 2011, the average calculated salary of one teacher increased to 117,500 drams, and the ratio of calculated annual salary of one teacher/GDP per capita constituted 1.3. All the mentioned indicators reveal that the efficiency of the general education needs significant further improvements. But the target values of the mentioned indicators of efficiency should be differentiated by type of settlement, in order to protect the low efficient schools of rural communities. At the same time, in order to promote the efficiency of rural schools, it is a priority to implement grant programs for enhancing the efficiency of those schools, which, in particular, will contribute to the normal process of integration of small rural schools.
446. Within the framework of the reforms of the formal basic education, special importance is attached to the issues of the management of the system, in particular the assets management, maintenance and operation. Considering that around 90 percent of expenditures on the educational sector are used for current expenditures, as well as taking into account the low level of efficiency indicators of schools, property and assets operations and maintenance become important issues. In particular, the planning of operation and maintenance costs of assets and the introduction of transparent mechanisms for their accountability become important issues.



447. With respect to enrollment indicators for other levels of the educational system, it must be noted that in preschool and specialization programs they are lower compared to the average of FSU and CCE countries, although an increase in the enrollment has been recorded in 2008-2011. In particular, in the academic year of 2010-2011, net enrollment in the preschool education amounted to 34 percent (in the age group of 3-6 years, the average for the same indicator in FSU and CCE countries is 59 percent<sup>58</sup>), compared to 29 percent in 2007-2008.
448. Although enrollment rates in specialization programs and higher educational institutions (tertiary education) show a tendency of increase, nevertheless they are much lower than the average for FSU and CCE countries and are highly polarized by living standard groups and by regions. According to the results of the Households Living Standards Survey conducted in 2010, the net enrollment rate of the poorest 10 percent of the population in tertiary education programs amounted to only 7.4 percent, and the same indicator for the richest 10 percent was 33.4 percent. In this regard, the issue is to enhance the accessibility of higher education for the poor groups of population and create equal opportunities for being admitted to higher educational institutions. To address this issue on 30 June 2011 the Government adopted the Strategy on Financing Higher Education in the Republic of Armenia. It defines reforms of higher education financing system, which provide for more targeted and effective state programs aimed at state financial support of students. For this purpose a number of student financial support programs will be introduced, including a) professional scholarship program, b) student financial support program, c) allowances for socially vulnerable and special group students, d) program on special scholarships for best progress students. At the same time, within the framework of the mentioned reforms, it is envisaged also to revise the relations of the state and higher educational institutions, especially as regards formation of tuition fees and student admission practices. In particular, it is envisaged to a) bring the amount of student scholarships and financial support in line with tuition fees, b) revise the current state policy of setting quotes of student admission and provide state quotes to professions of priority importance for the state.
449. At the same time, reforms of tertiary educational programs and additional training programs are underway and aim to improving the quality of preliminary and secondary vocational, as well as higher and continuing education, bringing these levels of education system in line with European standards, and increasing their competitiveness in international market.
450. Integration with the European higher education area assumes in-depth changes in the country's higher education system meeting requirements of Bologna process. The following components ensuring main requirements of Bologna process are already underway in higher educational establishments: a) introduction of the tri-level qualification system, b) introduction of the system of accumulation and transfer of academic credits at higher educational establishments in line with the European credit transfer system, c) establishment of the national system for professional education quality assessment and assurance in line with European standards, e) adoption of the national framework of education qualifications of the Republic of Armenia in line with European qualification framework, f) creation and implementation of the mobility organization system for students, academic and graduates, g) introduction of the system for cross-recognition of qualifications, diplomas and learning outcomes, h) expansion of students' participation in academic and management processes of higher educational establishments.

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<sup>58</sup> Source: TransMonee Database, UNICEF, 2012

451. The integration to European common educational area includes also the preliminary and secondary vocational educational systems guided by Turin process. The preliminary and secondary vocational educational system reforms in Armenia are geared at updating the educational content, increasing of management effectiveness and strengthening of logistics in line with corresponding European trends. According to the requirements of the Turin process, state educational standards for 100 specialties and qualifications of vocational and secondary education were developed with the following revision of curricula. Over 1000 teachers and officers of production processes of vocational schools and colleges were trained annually. Also directors and vice-directors of vocational schools and colleges have undergone corresponding trainings. Efforts were put to promote social partnership in the field of primary and secondary vocational education and to strengthen links between vocational education system and employers.
452. One of the key directions of the European cooperation, Bologna and Turin processes is the additional and lifelong education, where comparatively recently the Ministry of Education and Science started putting efforts. In 2010 the Additional and Lifelong Education Division was established in the apparatus of the Ministry of Education and Science with a mandate to coordinate the field, address challenges, and implement activities ensuring ongoing development of the sector.
453. However, the sector of tertiary education continues facing challenges as per both the quality and efficiency of education. With this in view the Government plans to implement the Program on Expansion of the Process of Integration of Vocational Educational System of the Republic of Armenia into the European Higher Education Area, the purpose of which is to ensure further development of Armenia's secondary and higher technical and vocational system in line with goals of the new phase 2010-2020 of the European higher education area.

## **22.2. OBJECTIVES**

454. Public education continues being a priority issue in the sphere of education. The public education program aims include:
- 1) Improvement of the quality of the general secondary education, its matching with internal standards and ensuring smooth transition to higher educational.
  - 2) Implementation of functional, modern forms and methods (including electronic) of supervision of the quality of education and assessment of knowledge, as well as stage by stage implementation of their unified system.
  - 3) Ensure equal access to high-quality guaranteed free 12-year secondary education for all population groups, transition from guaranteed minimum 9-year education to universal free 12-year education (including vocational).
  - 4) Separation of the high and basic school systems, gradual reorganization of secondary schools system into basic and high schools, with the exception of those rural communities of marzes, where the geography conditions the need to preserve secondary schools.
  - 5) Increase enrollment in upper secondary school, especially for poorer segments of the population;
  - 6) Continuously improve the efficiency of the system and introduce and fully establish an effective system of management, including assets management.

455. The priorities for achieving the mentioned objectives are: continuous training of teachers, increase in their salaries through introduction of a differentiated system for their salaries depending on the results of the qualification exams and the category obtained.
456. In order to ensure the enhanced quality of general education and the implementation of the mission of upper secondary schools, it is necessary as a priority; to refurbish schools (and specially high schools) with day needed material-technical and educational-methodological basis (laboratory equipment, computers, Internet, quality textbooks and teachers manuals, electronic educational resources, etc.). The mentioned objectives require a significant increase in annual public expenditures per pupil.
457. For the proper establishment of upper secondary schools, it is necessary, as a priority, to develop the corresponding programs for the schools and ensure smooth transition to the higher levels, to introduce the system of the corresponding standards, to ensure diversity of specializations and to expand the possibilities for preliminary specialization, to organize qualification training courses for teachers. At this level of general education, annual public expenditures per pupil should significantly increase, and the difference in this indicator compared to preliminary and secondary vocational educational institutions should diminish.
458. From the viewpoint of creating equal initial opportunities for the senior group of children of 5- 6 years of age, in preschool institutions, who are getting prepared to enter the general education system, it is a priority to improve the quality and accessibility of preschool educational services.
459. From the viewpoint of creating equal opportunities for children in vulnerable groups of population who need special conditions for studying in general education institutions, it is a priority to develop the inclusive education system in the general education and in the vocational education too, which will allow the children to at least receive quality basic education and to have a specialization.
460. Given the extreme importance of human resources for the country's long-term socioeconomic development, professional education should be the next priority during the program implementation. In terms of professional education the program envisages to:
- 1) Improve access to secondary and higher professional education for all population groups.
  - 2) Improve the quality of professional education and bring it in line with demands of the labor market, promote employment of graduates.
  - 3) Improve effectiveness of higher educational system, including structural changes, network review and improvement of the management system.
  - 4) Balance public regulation and financing systems of higher educational establishments, expand autonomy and academic freedom of higher educational establishments, expand state higher educational establishments' organizational and legal status and ensure diversity.
  - 5) Academic development of higher educational establishments, strengthening the research component in higher educational establishments, implementation of modern academic financing methods of higher educational establishments.
  - 6) Continue reforms aimed at streamlining professional education in line with the country's strategic educational and scientific development goals, provisions of Bologna and Turin Agreements. Particularly a) promotion of mutual cognition and mobility, b) improvement of the system of accumulation and transfer of academic credits, c) integration of higher education and research activities, d) implementation of internal systems to improve the

quality of professional education and institutional and program accreditation of public and non-public higher educational establishments, e) development of vocational and continuing educational systems . At the same time, improvement of the quality of higher education dwells on the following priorities: a) strengthening conditions for licensing of higher educational establishments in accordance with European standards and procedures, b) strengthening of the list of professions and granted qualifications and their harmonization with UNESCO and Eurostat classification, c) continuing internationalization of the higher education system through promotion of joint educational programs with European universities and joint granting of qualifications, which will definitely result in greater mobility of students and the faculty.

- 7) Higher education financing reform, including diversification of financing sources and mechanisms for higher educational establishments, improvement of targeting and effectiveness of state programs on student support, expansion of the volumes and forms of financial support of students, increase of state funding of higher education, promotion of higher education and business community cooperation, promotion of private investments, financing of innovative programs aimed at development of higher educational establishments and modernization of higher education.

461. In order to increase the efficiency and quality of the education, it is crucial to fight the corruption at all levels of education system.

462. Given the importance of the sector and the progress of reforms there is a need of increasing state support of the system by increasing public expenditures in the sector of education. Moreover, demographic trends should be taken into account, which apparently demonstrate tangible decrease in the number of educational system's beneficiaries. With this regard, expenditures on education from the consolidated budget, should increase by such an amount that taking into account economic growth that at least by 2017 they amount to around 2.8% of GDP, 3.3% by 2021 and 3.7% by 2025. At the same time, to meet the targets set out for the sector, the structure of public expenditures in education per sub-sectors needs adjustment in terms of the proportion of expenditures in upper secondary schools, preliminary and secondary vocational education, as well as higher education.

## **23. SCIENCE**

### **23.1. SITUATION AND TRENDS**

463. Creation of country's economy competitive advantages based on the science and high technologies is the primary precondition for the development. Development of the industries based on sciences and high tech can result in qualitatively new factors of economic growth. Competitive advantage in modern economy is mostly achieved by differentiation relying on knowledge-based goods.

464. A number of steps were taken during the recent years aimed at ensuring advanced development of science, including improvement of the legislative framework regulating scientific and technical activities, as well as implementation of competition and program financing system of scientific programs and themes funded from the state budget. During 2008-2009 an independent scientific expertise system was created, which currently involves about 1,500 academicians both from the country and abroad.

465. Numerous internationally recognized profound works have been published by Armenian scientists or with their co-authorship in prestigious scientific journals. According to the SCOPUS

classification of countries, Armenia is highly ranked especially as regards publications in the sphere of natural sciences, such as mathematics, physics and astronomy, biology and chemistry. In 2011 Armenia ranked 41st among 140 countries in the fields of physics and astronomy and the 63rd in overall ranking.<sup>59</sup>

466. There are active international scientific organizations, laboratories and groups in Armenia. Particularly, local scientific organizations participate in broad-scale international scientific experiments aimed at regulation of essential scientific problems in international research centers or within the framework of scientific cooperation with LHC, HESS, JLab, DESY, JINR, etc. Programs implemented jointly with other countries or international organizations enable integrating the country's scientific human resources into the international scientific and educational community and create favorable conditions for participation in grant programs, thus essentially expanding financial resources provided by international organizations to Armenia. During 2012-2013 four scientific organizations of Armenia act as coordinators of the European Community's Seventh Framework Program (FP7/2007-2013) (total budget EURO 2 million). During the recent years international scientific cooperation has considerably developed. In particular, agreements have been signed and joint projects are being implemented with France, Belarus, Russian Federation and Germany. Apart from that, agreements have been signed for Armenia's participation in international organizations, as well as for founding branches of those organizations in Armenia.
467. Though in 2009 state funding of scientific and technical programs has increased more than 3 times in nominal terms compared with the 2001, the relative funding still lags keeping Armenia behind a number of developed and developing countries. Between 2008 and 2010 the state budget allocations to scientific and technical activities totaled 0.19%, 0.27% and 0.24% of GDP correspondingly. For comparison, in 2009 28 EU countries (including Croatia) spent on average 0.68 % of GDP<sup>60</sup>. It is noteworthy that in EU countries, on average 1/3 of gross expenditure on research and developments (R&D) is covered by the state and the rest is funded from private sources. Though there is no clear statistics on the share of private sector in research activities in Armenia, according to estimations, the difference between private funding of R&D costs in Armenia and the average EU figures is eminent. In this regard, one of the key steps towards expansion of funding in this sphere is the promotion of private sector participation in funding of research and development initiatives. The first steps are already in the place, namely biannual co-funding programs started in 2011 aimed at achievement of scientific results with the support of private sector. In 2011, at least 15% of funding of each program came from off-budget sources and in 2013 the figure reached 25%. For the future the private sector share is planned to reach 50%.
468. According to data provided by the Ministry of Education and Science, today around 80% of public allocations to the science are targeted at fundamental studies and only 20% at developments of applied nature. Whereas in US 16% of the funds are earmarked for fundamental studies, 26-28% for applied studies and 56-58% is spent on experimental and engineering works and technological developments.
469. In addition to the financial problem, among factors hampering development of knowledge-based economy is the lack of relevant environment favoring acquisition and dissemination of know-how, application of outdated technologies in a number of branches of industry, absence

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<sup>59</sup> Source: SCImago Lab, [www.schimagojr.com](http://www.schimagojr.com), indicators are taken from SCOPUS database. The classification is based on H index, which shows the number (h) of publications of the country that received at least (h) citations.

<sup>60</sup> Source: OECD database

of stimulus to be involved in research and absence demand for high scientific qualification, as well as existence of economic monopolies.

470. Another key problem is about the human resources in science. After the collapse of the Soviet Union the country faced an overall aging of academic staff and in some areas elimination of the entire academic school. The absence of a targeted policy promoting effective reproduction of the country's scientific potential leads to insufficient turnover of generations of scientific and academic resources. There is significant drain of young specialists from science, which can create serious difficulties for development of science. To ensure effective changing of generations in science, the State Committee of Science of the Ministry of Education and Science has developed a program to attract young people in the sphere of science by aiming creation of relevant employment and socioeconomic conditions in order to use effectively the creative potential of young specialists, as well as to implement activities aimed at increasing attractiveness of science.
471. Lastly, the nowadays scientific and technical logistical basis and infrastructures limit opportunities to conduct researches meeting contemporary requirements and standards and do not contribute to effective utilization of available academic potential. Absolute majority of equipment is obsolete, which does not enable high-quality research activities, particularly of applied nature. At the same time, in 2013 the State Committee of Science of the Ministry of Education and Science has already initiated the annual program on modernization of the logistical basis and infrastructures in the sphere of science. Starting from 2013 tender-based financial support is provided aimed at the establishment of joint-use scientific hardware or laboratories.
472. The abovementioned challenges are reflected in the amount of innovations implemented in the economy. Though high technologies are considered a priority sphere and are aimed at promoting competitiveness throughout the entire economy, and certain progress is reported in different international reports during the past years, Armenia has not documented significant progress yet. Particularly, the 2012-2013 Global Competitiveness Report ranked Armenia 105th among 144 countries in terms of innovation (in the GCR 2011-2012 Armenia held 112<sup>nd</sup> position out of 142 countries).
473. In some cases the created applied scientific products are not competitive in the global innovations' market. This stems from objective and subjective reasons. The fact of not having developed infrastructures for academic studies leads to decline of competitiveness of applied scientific products.
474. Armenia has very few industrial large corporations which can act as a platform for the development of scientific and industrial unions thus boosting improvement of the industry process and increasing the share of private sector in funding of science. Besides, there is a need of creating scientific production associations through consolidation of mostly applied research organizations. The pioneer in this field is the "Haykensatechnologia" scientific production center created in 2010 in the sphere of biotechnology, which is comprised of the Biotechnology Institute, Microbiology Institute and the Microbial Depository Center. At the same time, the export policy of Armenia lacks in the component of creation and export of science-based value added, and there are no financial structures for commercialization of scientific products. Their creation is envisaged by the year 2020 which is a long period given today's dynamic changes.
475. In this regard, a significant step forward was the President's recommendation to prioritize technological innovations and the guarantee of granting privileges to companies creating innovative goods and services that will prove to be competitive in both domestic and external

markets. The government promises solid tax advantages for innovative and high tech-based programs (3-4 years exemption of profit tax, VAT deferral, etc.).

## **23.2. VISION**

476. The development vision for science implies developing Republic of Armenia into a knowledge-based economy, which is competitive in the European scientific and technical community in terms of its fundamental and applied scientific research and development. Implementation of this vision requires:

- 1) Development of a system for sustainable development of science and advanced technologies,
- 2) Upgrading material and infrastructure base of scientific activities,
- 3) Ensure stable growth of highly qualified workforce in scientific and technical fields,
- 4) Attract young specialists to science and implement manageable and smooth change of academic generation,
- 5) Ensure effective state sponsorship of fundamental academic studies and advanced development,
- 6) Promote implementation of researches providing know-how applied in economy, as well as increase of the number of innovations and patents in scientific organizations,
- 7) Develop harmonious system for development of science, technologies and innovation-based knowledge, promoting participation of private business in scientific events, ensure targeted application of gained knowledge in education and different spheres of economy, and
- 8) Considerably expand international cooperation in the field of science and technologies.

## **23.3. OBJECTIVES**

### **23.3.1 STRUCTURAL AND TERRITORIAL OBJECTIVES**

477. Development of science requires institutional reforms of the system. There is a need of optimization and structural reforms of scientific and technological activities, by uniting state organizations of similar scientific direction regardless of their legal subordination. According to the NSS data, in 2011 about 35 scientific research institutes functioned within the structure of various ministries. To improve their performance effectiveness, at least some of them can be moved under the Armenian Universities or relevant scientific organizations. On the one hand, this will promote close cooperation with research institutes, and on the other hand the research findings will be transformed into the policies of the ministries.

478. There is a tendency of reducing the number of research institutes. In 2011 only 72 out of 102 institutes functioning in 2005 were left, of which 9 were closed up between 2010 and 2011. This tendency is dictated both by optimization of scientific organizations and financial allocations to scientific and research establishments, their human resources and labor productivity. Their centralized management is more reasonable.

479. There is a need of establishing modern systems of organization and management of activities at scientific organizations, clearly outlining responsibilities and rights of directors and

academic boards, as well as limiting their term of office. Another important aspect is development and implementation of modern mechanisms for the evaluation of effectiveness of scientific organizations' activities, thus ensuring direct dependence of state funding of scientific organizations from achieved products and introducing performance-based incentives for scientific organizations demonstrating remarkable effectiveness. Implementation of such mechanisms should be coupled by individual incentive programs for scientists who have good performance (the first such competition was launched in 2013 by the State Committee of Science of the Ministry of Education and Science). This will not only improve social justice in the sector, but will also build confidence among young employees about their career development.

480. Another science - related problem is the almost absence of geographic distribution or it is very unequal. As of 2011 only 11 out of 72 scientific and technical organizations were located in regions. Three organizations function in each of Kotayk and Aragatsotn marzes, two organizations in Shirak, one in Ararat, one in Armavir and one in Syunik marzes.
481. The remaining regions do not have research institutes. The state policy should be targeted at boosting science in regions, since equal territorial development implies equal geographic development of science as well. Also, it should be considered that development of science in marzes of Armenia should not be an end in itself, but rather be based on economy specifics of the region. Later on, on the basis of these research centers, a program of establishing a technopark in each region can be implemented, thus creating innovation-based development opportunities for the region.

### **23.3.2 RESOURCES AND INFRASTRUCTURE**

482. Development of science should be based on integration of science and identification of its development priorities. Armenia's scientific and technical development priorities between 2010 and 2014 are defined in the RA Government Decree 640-N of 27 May, 2010. They include the following: Armenology, humanities and socioeconomic studies, life sciences, renewable energy, new energy sources, leading technologies, information technologies, space studies, earth studies, environmental studies, fundamental sciences promoting essential applied studies. It is envisaged that these priorities will be reviewed every five years. In addition, development of science implies demand for managers with managerial skills in this field, which will be a serious leverage for attraction of financial resources and funding of most competitive research teams.
483. Increase of financial allocations is one of the main priorities in science development. Particularly, science program is geared at increasing financial allocations to science and bringing scientists' wages to the level of average salary in the economy. The share of knowledge- and high technologies-based industries and services in the total GDP of the country should become dominating in some 10 to 15 years, as opposed to the current 2%.
484. Human resources are the basic factor of scientific development, hence there is a need of developing and implementing a program to attract and embed young specialists in science. Among key elements of these programs are improvement of working and socioeconomic conditions of young scientists, increasing scientists' career attractiveness, as well as individual and corporate incentives (for scientists and organizations) for those who effectively educate and train scientific human resources. In addition, annual grant programs supporting research activities by PhD students and biannual grant programs for young academic workers are implemented from 2011. It should be noted that improvement of career attractiveness of academic workers is extremely important. For that purpose the individual incentive



mechanisms for scientists were adopted. A clear-cut scientist's professional career mechanism should be developed in the nearest future, envisaging transition from PhD to permanent employment, according to the model used in developed countries.

485. At the same time, the state order mechanism for education and training of human resources in the sphere of science should be reformed. Activities should be implemented in order to reform and streamline the content of PhD training and to improve the academic level of theses submitted. There is a need for transition to 4-year PhD programs and introduction of a modern system of granting academic degrees compatible with European scientific and educational standards. Creation of research universities in Armenia should be the first step towards implementation of modern methods of education of science and educational personnel. International experience suggests that research universities enable much more effective combination of educational and scientific components. The active scientific environment contributes to education of highly qualified specialists who meet modern requirements of science. It is more appropriate for our research universities to implement post-graduate /post-diploma/ higher education based on Master's degree and Bachelor-based (first degree) post-graduate, researcher programs. As analysis of Armenia science and higher education show, in the nearest future it is possible to open a technological research university on the basis of natural sciences. Secondly, there is a need of developing mechanisms for organization of targeted post-graduate education and post-doctoral courses at international lead scientific and educational centers.
486. One of the primary areas contributing to the development of science in Armenia is creation of developed infrastructures necessary for scientific activities, i.e. modern research laboratories, innovation centers, techno parks, which can not only implement various programs, but also serve as a solid platform for attracting reputable specialists and implementing joint projects.
487. Two approaches are considered for the development of consortium programs jointly with leading scientific and research organizations. First, relevant centers specialized in such programs should be opened, staffed with specialists experienced and skilled in implementation of such programs, preparation of applications and international cooperation. This task can be achieved by full use of the potential of Armenian Diaspora and scientists. The first step in this direction is the program on mobilization of the academic potential of the country by the State Science Committee of the Ministry of Education and Science.
488. Effective development of modern science and technologies requires better access to academic publications and information sources for scientists and all interested parties. Joint utilization and dissemination of knowledge and information is critical when speaking of modern science and technologies. Each university should have its information system to maintain data on academic projects implemented by the faculty. Such databases should include information reflecting products of academic and research activities conducted in a given field. At the same time, systems of library organizations enable preserving information on certain articles, persons, thematic catalogues, etc. There should be automated data collection from various sources which interprets into integration of information systems of academic researches. Relevant information systems are already available at some universities of Armenia (e.g. Yerevan State University), corresponding Agreements are concluded envisaging free access to international scientific and technical systems (Thomson Reuters, Springer), and a Virtual Science Library is created.

### 23.3.3 SCIENCE-ECONOMY RELATIONSHIP

489. Existing gaps between the science and industry should be bridged and restored. Innovations and achievement of new development levels should be the primary goal of any industrial enterprise activity. In this regard an important aspect is registration of new trademarks, new products, as well as granting patents for scientific discoveries, as well as implementation of their commercialization policy.
490. Creation of favorable economic environment and expansion of business opportunities is critical for scientific organizations.
491. Commercialization of science requires state support in implementation of applied studies. Addressing this type of scientific and technical issues should dwell on public-private cooperation mechanism by implementing co-funding programs jointly with the private sector. Such co-funding programs are already being implemented with 15% share of private sector in 2011 and 25% in 2013. In the future state budget allocations should be expanded and the share of off-budget resources should reach 50%. Besides, there is a need of public targeted programs geared at addressing specific problems of an economic sphere. These programs should be developed jointly by the responsible public agency and research institution responsible for scientific research and development of the concerned direction.
492. Implementation of an effective innovation system is critical for development of knowledge-based economy in the country. Research and developments require involvement of venture capital, creation of scientific and industrial centers, as well as establishment of business incubators and techno parks at universities.
493. Organization of modern industries in Armenia is important, as it will improve competitiveness of created academic products. Another important aspect is development of centers for commercialization of academic products. These centers should be specialized in two directions: (i) clearly define what producers' needs are (ii) present the standards/criteria to the academicians. At the end they should perform as mediators and ensure commercialization of the created products.
494. Innovative activities of SMEs should be encouraged actively. Importance is attached to diversification policy of locomotive and priority branches of industry (clusters), i.e. establishing clusters on the scientific platform with good academic potential, thus boosting development of the branch. On the other hand, industrial activities of SMEs should be promoted, since trade in Armenia's GDP has reached 12%, which proves largely commercial nature of SMEs.
495. Coordinated reforms in the sphere of management of intellectual property will be targeted at protecting products of intellectual activities and ensuring their marketing in Armenia and other countries. Among priority objectives are improvement of the legislative framework, training and education of national human resources, regular study of innovative activities according to economy branches, creation of a computerized information system on intellectual property and development of adequate infrastructures.
496. Tax policy should become one of the pillars preserving the country's intellectual and educational potential. Tax incentives should serve as an effective mean of maintaining and strengthening the country's intellectual potential.

## 24. CULTURE

### 24.1. PROTECTION OF TANGIBLE AND INTANGIBLE CULTURAL HERITAGE

497. During the recent years the government has implemented a number of activities in the sphere of culture aimed at protection of tangible and intangible cultural values, increase in the quality of human resources and their social conditions, as well as assurance of access to cultural heritage. Implemented and current activities include also renovation of buildings and structures of cultural organizations in order to develop modern art infrastructures, as well as strengthen logistical basis.
498. The Fine Art Education Concept Paper was adopted following the protocol decree No 47 issued 18 November 2004 by the Government of Armenia. For the implementation of the program envisaged by the Concept Paper, from 2007 state orders are placed at musical and art schools for socially vulnerable children with reimbursement of tuition fee for folk musical instruments. In 2009 state order was issued also for string and wind instruments. To ensure access to cultural education 33 basic schools were opened in regions of Armenia with methodology centers, which enabled providing in-depth professional fine art education, ensuring good quality, and easy geographic access. Among priority activities envisaged by the aforementioned Concept Paper are furnishing logistical bases of schools implementing fine art educational programs, purchasing new instruments and materials, renovating buildings and structures.
499. With the help of cultural programs aimed at development of individuals quality and affordability of cultural education is ensured. In particular:
- 1) RA Government on November 15 of 2012 has approved “Children’s and young’s arts education 2013-2015 program”, which ensures continuity of trainings for teachers working in arts’ and music schools , provision of necessary materials and modernization of equipment, development of curriculum, teaching methodology and educational process, as well as provides for unified state policy in the sphere of arts’ education.
  - 2) With aim of developing creative capacities the “Foundation of assistance to cultural education” set up in 2008 will continue to operate through its branches in Yerevan and ten marzes. Each year 9000 students and 1950 teachers of arts’, fine arts and music schools will receive methodological and practical assistance from the Foundation.
  - 3) For around 700 students and 500 teachers of Armenian music schools, fine arts and arts schools will participate in master classes in RA and Nagorno-Karabakh conducted by leading specialists of the Republic.
  - 4) In 33 reference schools set up in 2008 in RA (3 schools in each marz) will continue organization of regional stages of number of republican contests, festivals and exhibitions, as well as concerts and concerts-lectures with the aim of providing methodological support and ensuring affordability of fine arts education and increase in its quality.
  - 5) “Teaching of national, string and wind instruments in music and arts schools” project initiated in 2007 will continue. In the frames of this project each year around 2400 students in 140 music and arts schools in marzes and capital of Armenia will receive reimbursements of tuition fees.

- 6) “Pupil’s philharmonics” will continue its operations, organizing lecture-concerts for kids and young people in capital and marzes.
- 7) Works of arts of Armenian composers and scientific-educational literature (26 names annually) will continue to be published with the state’s support.
- 8) Participation of talented children and young in prestigious contests and festivals for youth, as well as in master classes will continue to be sponsored (90 participants per year).
- 9) Support to debuting and innovative programs will continue thus helping to replenish the sphere with new creative resources and ensuring smooth alternation of generations.

500. Processes of purchase of musical, art and theater works and placement of social and creative orders are currently implemented with an aim of improving social conditions of culture persons and creation of favorable conditions for creative activities. These activities follow primarily two purposes: first, to enrich the repertory of theater and concert organizations with works of modern authors and the second, to improve social conditions of the workers.

501. Among key achievements in the human resources policy in the sphere of culture are approval of complex training and requalification programs, which are aimed at creation of effective human resource allocation schemes in regions of Armenia based on studies and analysis and the improvement of state orders mechanism for human resource education and trainings in the field of culture.

502. Main goal of programs on protection of tangible cultural heritage is renovation and maintenance of immovable historical and cultural monuments, museums and libraries, which will not only promote the hand-over of Armenian cultural heritage to future generations but is also a key factor for tourism development.

503. Museum programs are aimed at inventory of current cultural values and collections (inclusion into collections, classification), academic studies (information/data collection, description, preparation of specifications), completion, maintenance and protection (restoration and reinforcement of museum items) as well as guaranteeing public access to those values.

504. Programs on preservation of monuments are aimed at the study of historical and cultural monuments, their inventory and recording, preservation, restoration and use of most endangered monuments, promotion of target activities contributing to cultural tourism.

505. Inclusion of historical and cultural monuments in tourism routes and organization of various activities/events, and establishments of craftsmanship centers are among main objectives. Particularly, monitoring of 1000-1500 monuments and archeological sites is planned during 2014-2025, which will help to define monument restoration priorities and clear descriptions/specifications of the form and order of their use. According to preliminary estimates, it is expected to restore 10 to 15 monuments annually (reinforcement, renovation), as well as to include 15 to 20 monuments and archeological sites in tourist routes annually.

506. Publicity of cultural heritage is an important aspect of development strategy, and following steps are envisaged for that purpose:

- 1) Ensure availability of museums, library and archive materials in printed and electronic formats.

- 2) Ensure access to cultural heritage for the population and the tourists through publications of museums' road maps and guides.
- 3) Dispersion of Armenian cultural trends in local and foreign markets with the purpose of increasing Armenian's recognition abroad and forming positive attitude.
- 4) 3-5 documentaries and TV programs will be created on Armenian monuments each year, as well as 2-5 books and directories will be published.

507. Local community inhabitants' participation in archeological excavations for the works not requiring professional skills will promote creation of job places.

508. With the purpose of preserving and further developing the museums it is planned to implement the complex program "Museums and Libraries of Armenia". In the frames of the program will be designed and acquired systems necessary to ensure the preservation of collections of cultural values and archive funds. As well as there will be installed special observation system for the preservation of the RA museums and library collections and this system will be evaluated and developed.

509. Programs in the field of libraries are aimed at maintenance and stocking of electronic catalogs of current library collections and national bibliographic data, expansion of information services, automated systems, development of Armenia public library network, academic studies, ongoing stocking of funds and easy access to and full use by public. In order to improve service delivery at community/local libraries it is envisaged to merge them with libraries of cultural establishments of other types in that area (excluding those having status of public libraries). Possibilities of delivery of professional publications and periodicals enabling acquisition of agricultural information should be considered when developing rural library stocking processes.

510. Programs in the area of intangible cultural heritage are aimed at ensuring ownership of intangible cultural heritage by the public, various population groups, sustainability and protection of domestic traditions, customs, habits, ceremonies, beliefs, knowledge and skills. Activities planned to address these issues include:

- 1) Support in creation of folk art and crafts pieces,
- 2) Establishment of small folk art and craftwork shops in regions, preparation and publication of training and consulting manuals on folk craftwork skills.
- 3) Organization of folk dance and song excellence classes and organization of intangible cultural heritage-related ceremonies and celebrations, shooting of films.
- 4) Development of an assistance program for the organizations dealing with collection and study of intangible cultural heritage, as well as those involved in related publications and public awareness.

## **24.2. DEVELOPMENT AND MANAGEMENT OF CULTURAL INFRASTRUCTURES**

511. To promote development of modern art infrastructures it is planned to continue renovation of buildings and structures of cultural organizations and to replenish their logistical basis, including:

- 1) Development of a program on renovation of buildings and structures of cultural organizations and replenishment of the logistical basis;

- 2) Assessment of the assets, buildings and structures, as well as premises/facilities of cultural organizations and their classification according to small, medium-size and large communities;
- 3) Implementation of a complex program on replenishment of cultural organizations with modern equipment.

512. Restoration of regional cultural organizations, i.e. houses of culture, is one of the primary objectives of the sphere given the multiple functions vested on them in rural communities: they host the libraries, amusement center, folk groups, craftsmanship centers, and in general all cultural and public events. The need of restoration is especially urgent in houses of culture of border villages. This will enable addressing a number of problems such as creation of jobs, mitigation of migration, promotion and advocacy of national traditional cultural values among youngsters, etc. Besides, the above-said is critical also in addressing national security issues.

513. To ensure access to cultural heritage new information and communication technologies and electronic management systems were introduced in the sphere of culture. Museums, libraries and archives received internet connection. Development of a unified portal for their websites is underway. The following activities are envisaged during the program implementation:

- 1) Creation of multimedia programs for library and archive collections, as well as virtual museums and audio guides;
- 2) Creation of a unified information bank of libraries, museums and archives of Armenia;
- 3) Development of an electronic management system and electronic intranet across cultural organizations.

514. Development of culture sphere managers' institute will be an ongoing process throughout 2014-2025, which aims at organization of local and overseas trainings (20 specialists per year abroad) and upgrading of managers in the field of culture. Among planned activities is regulation of human resources management definition or professional and service requirements for human resources. A special attention will be paid to professional staffing of culture centers located in remote, border and high mountainous villages.

515. Strategic direction of cultural policy is the approach to human resources policy in cultural education and general culture spheres. The main aim of such policy is to found grounds for further development of educational-cultural and fine arts institutions through implementation of a unified state human resources policy, to ensure adherence of those institutions to modern standards, to enable modernization of material and equipment base, and finally to create a situation when the demand for specialists in the culture sphere will be met.

516. Main objectives in the field of development of modern art and promotion of cultural processes include:

- 1) Implementation of state grant programs in the field of culture (music, theatre, application art, visual arts, dances, cinematography, circus, literature, etc.)
- 2) Regulation of market relations, including copyright protection;
- 3) Endowing cultural organizations with broader possibilities of performing business activities;
- 4) Ensuring wider possibilities of publicizing art works including via mass media and internet channels.

### **24.3. EXTENSION OF INTERNATIONAL CULTURAL RELATIONS**

517. International cooperation in the sphere of culture is based on the bilateral and multilateral agreements signed by the Republic of Armenia, on the memorandums and projects, as well as ratified international conventions. This cooperation aims at developing cultural dialogue and diverse relationships with other states, international organizations and structures, to carry out directed promotion of Armenian culture (cultural heritage, contemporary Armenian art) abroad, to make international culture accessible to wider Armenian population and to increase the number of joint and co-financed international projects.

518. Directions for developing international cooperation during 2014-2015 are:

- 1) Multilateral cooperation:
  - a) Cooperation with UNESCO
  - b) Cooperation with European Union
  - c) Cooperation with Council of Europe
  - d) Cooperation with CIS
  - e) Cooperation with other international structures (Francophone countries, Black sea economic cooperation area)
- 2) Bilateral cooperation.

519. For worldwide advocacy of Armenian culture cooperation geography and cooperation formats will be continuously expanded. Number of joint and co-financed projects will grow year over year.

520. An important role is assigned to involvement of Diaspora in Armenia's cultural activities. For that purpose it is planned to develop, approve and implement a state program on preservation of the national identity during the observed period, which will include development of the "Culture of Armenia" website, development and implementation of a targeted Armenian culture advocacy program for international audience, as well as advocacy of Armenian culture via satellite TV.

### **24.4. PUBLIC TELEVISION**

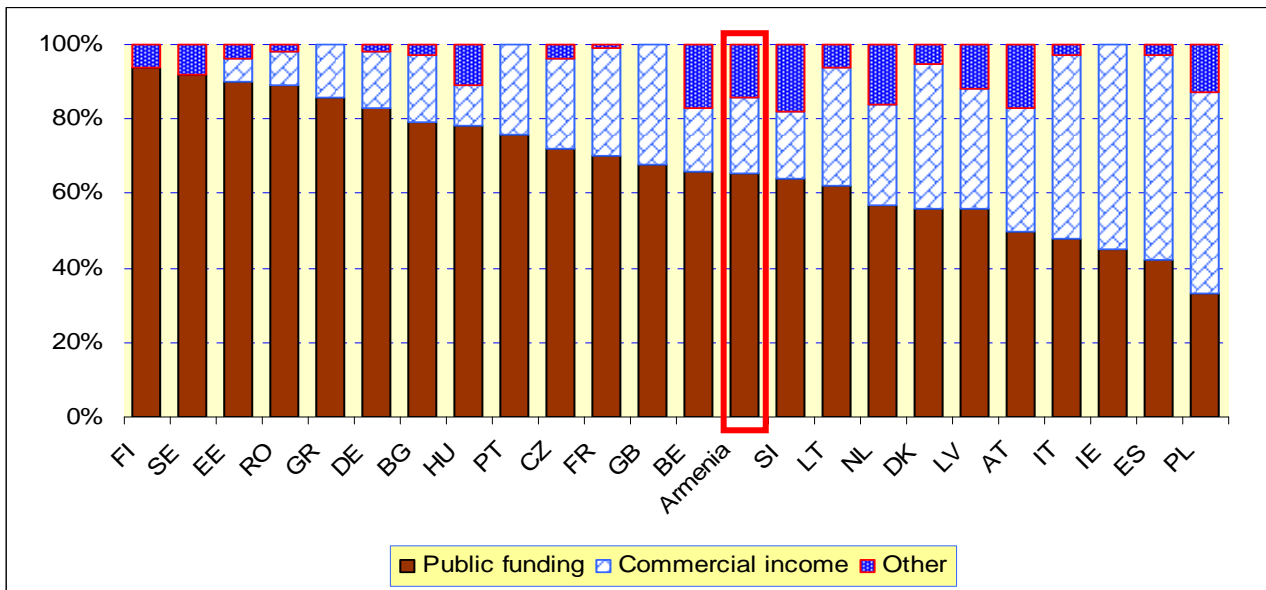
521. Public television is the key instrument of cultural policy implementation and unlike other mass media is accessible for almost the entire population of the country. Increase of the share of aired cultural and educational programs is one of the fundamental ways of increasing access to culture. In this regard, the public TV policy should refrain from increasing share of amusement and other similar programs (hence from the increase of commercial income) at the expense of reduction of cultural, educational programs<sup>61</sup>.

522. At the same time it should be highlighted that the structure of the Armenian radiotelevision company revenues by sources is close to the average European level, hence further need in increase of the commercialization level is not observed (Figure 22).

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<sup>61</sup> According to the Communications presented to the RA National assembly by the RA Public Radio-television Council in 2010 and 2011 the share of cultural, scientific and educational content programs in the total broadcasting duration has decreased from 55% in 2010 to 42% in 2011.

**Figure 22. Composition of public broadcaster companies revenue in EU countries (2006) and Armenia (2011)**



Source: European Audiovisual Observatory and Armenia Public TV and Radio Company Board.



## IX. ENVIRONMENTAL PROTECTION

523. The cornerstone of the environmental component of sustainable development is the protection of the balanced environment through conducting a resource efficient economy.
524. In 2009-2011, developments in the environmental sector of the Republic of Armenia were mainly implemented within the framework of the priorities of sustainable development and in accordance with the 2<sup>nd</sup> National Environmental Action Plan approved by the government of Armenia.
525. In 2009-2011, positive changes were recorded in a number of directions.
526. More than 15 laws regulating the environmental sector were adopted and the following strategic programs are approved or endorsed by the government of Armenia:
- 1) Timetable of activities developed in accordance by the 2009 Action Plan of the Commission for Sevan Lake Issues at the office of the RA President and submitted by the Commission (RA Government decree number 876-N dated on 24.06.2010).
  - 2) Since 2001 each year RA Government approves an annual program on “Measures aimed ad recovery, preservation, reproduction and utilization of Lake Sevan ecosystems”.
  - 3) On November 15, 2012 by Decree number 1441-N the Government of RA has approved “Program on establishing new forest area around Lake Sevan for 2014-2023 period”.
  - 4) Program of actions in 2011-2015 stemming from the concept paper for creating a comprehensive and unified national system for environmental education, edification and awareness;
  - 5) “Clean Motherland” national program.
527. In the last 12 years, the volumes of collected environmental and nature use charges have increased more than 15 times – from 608 million drams in 1998 to 12,171.4 million drams in 2011. State financing of the sphere grows rapidly, in 2011 the state budget allocated 6.63 billion drams to environmental protection, which is around 35.3 percent more than in 2010.
528. The public awareness process has improved and the public has become more active in decision-making processes.
529. **Biodiversity protection** and specially protected areas have developed significantly. Decisions of the government of Armenia have expanded the specially protected natural areas, including new reserves of Arpi Lake and Arevik National Park, Jermuk Hydrological, Hankavan Hydrological, Zangezur and Zikatar. As a result, the surface of specially protected areas amounts to about 380 thousand hectares, which is around 12.8% of the territory of the country and is close to standards adopted internationally. As a result of revision and additions to the list of natural monuments in Lori and Tavush marzes, currently the total list of natural monuments of Armenia counts 232 units. Government decree 31-N dated on 02.08.2012 envisages revision of this list also in other marzes and Yerevan during 2015-2017 period. In 2010, the Redbook of fauna and flora in the Republic of Armenia was revised and republished. Volumes of funding by international assistance programs have increased. Forest restoration and protection measures were implemented on 32,065 ha of forest land. Replenishment of fish reserves in Lake Sevan has continued. During 2010-2013 , more than 1,290 thousand summer trout and Gegharkunik fries were released into the lake. According to data from the

Hydrology and Ichthyology Institute of the National Academy of Sciences the growth rate of fries and their density indicators are satisfactory. For more effective use of the Lake Sevan recreative resources, 6 public beaches were created on the shores of Lake Sevan.

530. **Atmosphere protection**, in particular, the framework for servicing the electronic system for normalizing emissions has been expanded, from the 203 projects of permissible emissions' limits presented in 2011, 135 (or 66.5%, compared to 42.8% in 2010) have been submitted in electronic version. Changes and amendments were made to the law on "Protection of Atmospheric Air", which has clarified the powers of competent and regional governance bodies and has created conditions for introducing the principle of "best available technologies" used in the European Union. Programs are implemented under the Clean Development Mechanism of Kyoto protocol, the number of which is growing continually, in particular Nubarashen and Lusakert projects are examples of private public partnership for reducing the impact of hazardous waste.
531. **National Water Program**, within the framework of the program, the norms for ensuring water quality and volumes of environmental withdrawals have been developed for all River basins, taking into account the requirements of the European Union water framework directive (2000/60/EC). The stable increase of the level of Lake Sevan has continued (55 cm in 2007, 6 cm in 2008, 30 cm in 2009, 47 cm in 2010, 23 cm in 2011). The water level of the lake, as at 31 December 2011, constituted 1900.15 m. In general, since 2001, the water level in Lake Sevan has increased by more than 3.6 m, reaching 1900.1 meters as of January 2012. Cleaning work in water covered areas continues. In 2007-2011, more than 1,231 ha of water covered forest areas were cleaned. At the same time, measures for ensuring the quality of water are implemented: Treatment plants are being constructed in Gavar, Martuni and Vardenis cities. Construction work started in 2010 and is planned to be completed in 2013 with the financing of the European Bank for Reconstruction and Development. For effective use of ground waters in Ararat Valley, 283 water meters were installed and sealed.
532. The government of Armenia, with its Decree No. 1192-N dated 18 August 2011, approved the "Methodology for monitoring man-made pollution of soil on the territory of the Republic of Armenia". The legal framework for waste management has been established. The protocol decision No. 49 of the government of Armenia dated 15 December 2011 endorsed the concept paper of "Clean Production", which will contribute to the safe management of chemical substances and wastes, the introduction of ecologically clean production and the comprehensive solution for protecting the environment from pollution.
533. According to the law of the Republic of Armenia on "Targeted use of environmental fees paid by companies" (2001), environmental fees paid by large mining companies are allocated to the financing of environmental and healthcare measures in communities, which are directly impacted by the negative consequences of environmental pollution as a result of the mining operations of the company. The total amount of subventions allocated to 26 communities and Yerevan city for implementation of environmental programs amounted to 733.7 million drams in 2007-2011. Large environmental projects implemented are as follows:
- 1) Tree planting projects in Erebuni and Kentron administrative districts of Yerevan (2011) and Akhtala community (2010-2011)
  - 2) Construction of solid waste landfill for Alaverdi city (2011)
  - 3) Improvement of the internal gas supply network of Haghpat village (2009-2011)
  - 4) In Odzun community, restoration of forest areas and maintenance work, cleaning of flood drainage channels, construction and repair of sewerage pipeline in Jaghats district, local heating system installation in kindergartens (2010-2011);

- 5) Improvement of sanitary conditions in Metsamor city (2011)
- 6) Installation of energy-saving solar water boilers in Kajaran community kindergarten (2010)

## **25. ENVIRONMENTAL PROBLEMS AND PLANNED MEASURES**

534. Regardless of the recorded progress, environmental problems still persist and should be among the priority issues for the government.
535. In the forthcoming years, it is especially important that parallel to the government's efforts for improving the rates of economic growth, measures should be taken to reduce as much as possible the associated environmental risks. In particular:
- 1) environmental risks associated with the expansion of the mining industry as a result of higher prices for metals in international markets;
  - 2) illegal forest logging resulting from higher gas prices;
  - 3) overexploitation of water resources due to rapid development of subsectors using underground water resources and as a result of climate change;
  - 4) increased desertification risk.
536. Priorities of the environmental sphere will be based on the following key provisions:
- 1) In the coming years, the environmental strategy should aim to improve legislative and normative frameworks of the environmental policy. "RA Law on Environment protection policy" will be developed and adopted.
  - 2) The environmental impact assessment and monitoring system should be revised in order to adopt a differentiated approach towards businesses, based on the level of environmental impact of their operations. That will reduce the need for administrative measures with regard to businesses with limited impact on environment, will promote the introduction of environmental friendly and resource saving technologies, and will later ensure the phase-out of old technologies with hazardous emissions. Conditions should be created for ensuring public supervision.
  - 3) It is necessary to simplify, clarify and introduce e-governance in order to reduce corruption risks in the environmental management sector. Parallel to improving administration, it is necessary to develop incentive mechanisms for environmentally friendly operations, energy and resource preserving incentives, including also the introduction of the principles of public-private partnership and mechanisms for environmental rating, labeling and self-monitoring in companies.
  - 4) Compensations received from the current level of nature use and environmental payments are 32-40 times lower than the actual damage caused. In particular, the future application of zero or low tariff privileges defined for environmental fees and nature use fees in some sectors for economic development purposes is very risky. In this regard, the economic mechanisms of the environmental policy should be revised in the following main directions:
    - a) Draft and include the methodology for assessing the component of environmental pollution and overuse of natural resources in the main macroeconomic forecasts (indicators).

- b) Gradual increase of environmental protection and nature use fees, which on the one hand will enable improving effective use of natural resources and on the other hand will bring additional revenues to the state budget, thus directly increasing budget financing of environmental protection activities.
  - c) Revision of nature use charges' rates enacted within the current system of taxes and permits (limitations) to create incentives (especially in nature use organizations) for transition to "green economy" with the purpose of making the cyclical use of resources (material) economically beneficial. Creation of economic incentives due to targeted use of tax and financial leverages in order to transit to close type interior use and prevention of tailings.
  - d) Adapt the requirements of current standards and technical regulations to the introduction of energy efficient and resource saving technologies, to ensure production and(or) purchase of ecologically clean and high quality products.
- 5) Relevant economic and supervision mechanisms will be developed and introduced for maintaining the targeted use of lands, preventing the current negative trends in the change of land status and its degradation. Those mechanisms, in particular, without hindering businesses from receiving a reasonable profit level will contribute to the reduction of waste disposal from mining, production and domestic sectors, and will ensure the formation of the necessary financial means for sustainable management of tailings sites and landfills. Also, criteria for evaluating ecosystem services will be developed.
- a) A monitoring network for studying the pollution of lands in Armenia will be created, in order to establish a comprehensive database on soil conditions of all land areas in the country and, specially, land areas related to the mining industry.
  - b) A differentiated taxation system will be developed, which will contribute to the targeted and sustainable use of arable land and pastures and will protect their organic layers.
  - c) The government will develop and use financial and institutional mechanisms for re-cultivation of degraded lands. For this purpose, especially international cooperation will be activated, including cooperation with the newly formed global financial assistance mechanisms formed under the UN convention on climate change (Green Climate Fund, Redd +, Adaptation Fund).
- 6) Continue improvements of the management system of specially protected natural areas, which assumes improvement of legislative framework, expansion of the system, creation of biosphere preserves on the basis of Shikahogh preserve, development of a bio resources monitoring and registration system, ensuring sustainable management, and development of community participation mechanisms. Provide for special studies to detect new branching of Vayk kast caves (Mozrov and Arj), ensure their preservation and use for tourism purposes.
- 7) Forest national program will be developed and implemented with the aim of forest plantation and restoration in the forests and forests' lands in the republic, as well as improvement of quality indicators of the existing forests and founding new forests. Improvement of control mechanisms against illegal forest logging will be carried out in parallel with forest plantation and recovery activities.
- 8) Continue the implementation of measures according to the 2009 work plan of the committee on Lake Sevan Issues.

- 9) Develop basin plans for comprehensive management of water resources and decentralization of management functions.
  - a) Strategic reserves of water resources will be increased, in particular through the regulation of river flows and reduction of water losses, monitoring of the use of ground waters and improvement of the control system.
  - b) The government will take measures in order to reduce the pollution of water resources, through improving economic mechanisms as well as restoration of infrastructures with the active use of international cooperation mechanisms.
- 10) Improvement of environmental monitoring system in order to ensure application of unified monitoring approaches and standards, collection of reliable information on ecological situation as well as statistical data from other sources.
- 11) Improvement of ecological situation in settlements, specially the capital city, including:
  - a) Proper application and implementation of the set of tools for spatial and landscape planning;
  - b) Application of modern methods for solid waste removal and processing;
  - c) Development and implementation of measures for reducing emissions from means of transportation which are the main source of atmospheric air pollution in Yerevan city, including through the development of public electric transportation means providing energy efficient and low emission (green) transportation.
- 12) Economic and legal mechanisms for promoting the introduction of “green” innovations in line with decisions on sustainable development of “Rio+20” general assembly will be developed, including through the support of government and international community.
- 13) The government of Armenia will continue to provide comprehensive support to the development and implementation of environmental plans by local self-governing bodies.
- 14) “Ecocity” pilot project will be implemented.
- 15) Activities for implementing comprehensive measures for ecological education, public awareness and public participation will become more intensive.

## **X. ESTABLISHING AND STRENGTHENING A MODERN SYSTEM OF PUBLIC ADMINISTRATION**

537. Improved quality of public administration, strengthening of the principles of its transparency, accountability, publicity and controllability, results in further democratization of governance, and has a key role in the social and economic development of any country. The development of the justice system also plays a key role and aims to ensure a judicial power which is fair, efficient and accountable to the public, protects civil, economic and social rights of the public and the safety of people.
538. Based on the importance of this sector, the development issues of the public administration system have been reflected, first of all, in all comprehensive long-term social-economic development programs of Armenia, particularly the poverty reduction strategy paper and the sustainable development program.
539. The governance system development consists of development programs and reforms for a number of interrelated important components which characterize the multiple aspects of the system. Those include: structural and functional reforms of public administration, development of the public service system, development of local self-governing institutions and reforms of the public finance management.
540. Current chapter starts with the analysis of the trends in previous years related to the relevant indicators for comprehensive assessment of the public administration system, followed by the presentation of target values up to 2025. Thereafter, the strategic priorities for development of the main subsectors of the public administration system are presented, which will ensure the achievement of the target values of result indicators within the timeframe of the program. The functional reforms of the public administration system focuses mainly on two quite important directions – introduction of electronic management systems and optimization of the inspection system. Thereafter, the priorities for development of the local self-governing system and the strategic directions for reforms of public finance management are presented. Improvement of the quality of services delivered in the sphere of public administration is a key determinant of public administration system development (development of public services) along with implementation and improvement of a unified and fair remuneration of public officers, based on the employee's performance and labor productivity.
541. At the end of this chapter, the key directions of justice reforms in the judiciary system, as well as prosecutor's office and maintenance of public order and safety subsectors, are presented. As an important precondition for the development of the public administration system and as a very relevant problem, this chapter ends with the presentation of priority directions of the anticorruption strategy.

### **26. PUBLIC ADMINISTRATION SYSTEM DYNAMIC'S INDICATORS OF ARMENIA 2008-2010 AND THEIR TARGET VALUES UP TO 2025**

542. The sustainable development program planned to implement reforms of the public administration system of Armenia, as a result of which, indicators characterizing the system should have exceeded by 2012 the 2006 levels of those in Eastern Europe and the Baltic states. But the global financial-economic crisis and the measures implemented by the government to eliminate its negative consequences, did not provide adequate possibilities and means for full and complete implementation of the main points of public administration reforms envisaged in

the sustainable development program. This is the reason why the indicators characterizing the public administration system of Armenia have not yet reached their target values (Table 43).

**Table 43. Public administration system dynamic's indicators of Armenia 2008-2010**

Governance indicators	Year	Percentile rank (actual, 0-100)	Percentile rank (SDP, 0-100)
Voice and accountability (Civil society's participation in government formation process, freedom of speech and press)	2010	26,1	50,0
	2009	23,2	
	2008	25,0	
Political stability	2010	47,2	51,2
	2009	52,1	
	2008	43,8	
Government effectiveness	2010	49,8	58,1
	2009	55,5	
	2008	50,0	
Regulatory quality	2010	58,4	67,8
	2009	60,3	
	2008	60,2	
Rule of law	2010	39,8	45,1
	2009	40,3	
	2008	45,7	
Control of corruption	2010	30,6	47,1
	2009	32,1	
	2008	32,5	

543. The values of some indicators have even declined, in particular, indicators characterizing the rule of law and corruption control<sup>62</sup>. And the values of indicators characterizing the public administration system in 2010 differ from their values envisaged by the SDP by 1.1 to 1.9 times. The largest difference is in the first indicator, which characterizes the level of civil liberties in the country, the difference is also large with regard to the indicator for corruption control.

544. Another important indicator characterizing corruption is the Corruption Perception Index calculated by the Transparency International, which has also declined in recent years, down to 2.6 in 2011.

545. Another key indicator characterizing public administration is the tax to GDP ratio. Despite the decrease in this indicator which is mainly explained by global financial-economic crisis, the government, and its long-term strategic development program plans to raise the value of the indicator in forthcoming years by 0.3-0.4 percentage points annually, ensuring the target levels of taxes/GDP ratio of 24.3% by 2017, 25.9% by 2021 and 27.4% by 2025.

546. The development and improved efficiency of the public administration system and significant reduction of corruption are very important preconditions for sustainable and comprehensive long-term development of the country.

547. Accordingly, despite the inadequate progress of the reforms of the public administration system in 2008-2011, the government of Armenia sees serious challenges in this sector and

<sup>62</sup> Table 43 presents the cluster of six types of indicators for assessing public administration developed by the World Bank and widely used for international comparisons, which was used for the first time in the SDP.

defines more ambitious objectives and targets for the medium-term and long-term strategic development programs.

548. As in the case of the sustainable development program, the indicators of the European Union, especially Eastern European and Baltic states, serve as important guidelines for indicators characterizing the public administration system. With this regard, modernization of public administration system will have a continuous nature taking as a guiding benchmark European and international best experience.

549. Table 44 presents the medium-term and long-term target values of public administration indicators.

**Table 44. Public administration main target indicators, 2017, 2021 and 2025.**

Governance indicators	Year	Percentile rank (Program indicators, 0-100)
Voice and accountability (Civil society's participation in government formation process, freedom of speech and press)	2025	90
	2021	75
	2017	64
Political stability	2025	80
	2021	70
	2017	57
Government effectiveness	2025	90
	2021	75
	2017	62
Regulatory quality	2025	92
	2021	85
	2017	75
Rule of law	2025	80
	2021	70
	2017	60
Control of corruption	2025	80
	2021	70
	2017	58

550. Within the logic of public administration reforms in Armenia, target values for public administration system indicators in 2017 are fixed at 2010 average level of Eastern European and Baltic states, which are given in last column of Table 44. These indicators are normalized on scale from 0 to 100, where 100 is the score achieved by the best country in the overall list and 0 corresponds to the achievement of the worst country.

551. The corresponding indicators in developed countries (OECD) for 2010 are defined as long-term target values for indicators characterizing the public administration system in Armenia. The only exceptions here are the indicators characterizing the rule of law and control of corruption, the target values of which are 10 percentage points lower than the similar indicators in OECD countries. The issue here is the existing wider gap, as well as the need for a certain period of time to establish the rule of law in the society.

552. Following the same methodology, the government of Armenia aims to increase the corruption perception index (Transparency International) reaching indicators of 4.5 in 2017, 5.5 in 2021 and 6.5 in 2025.



553. Thus, even by 2025, ensuring the 2010 indicators of developed countries in Armenia is a quite ambitious goal, as the values of those indicators, already in 2010, were basically higher than 90 percent (in the range of 0-100 percent). Regardless of the mentioned fact, these indicators are realistically achievable in the next 10-15 years, as the Armenian authorities will demonstrate the corresponding adequate political will, tenacity and commitment. Achievement of the target values of these indicators largely depends on the intensity and effectiveness of reforms planned in the public administration and justice systems, as well as the full implementation of the anticorruption strategy.

## **27. FUNCTIONAL REFORMS OF THE PUBLIC ADMINISTRATION SYSTEM**

554. As a result of the structural and functional reforms implemented in the public administration system in recent years, significant progress was recorded in improved transparency, accountability and efficiency of public administration.

555. Thanks to those reforms, ministries currently perform their functions of developing, monitoring and implementing policies in their relevant sectors, while the powers for provision of services, regulation and supervision and inspection functions were basically transferred to agencies and inspections created as independent units of ministries. Those changes resulted in the elimination of a certain part of duplicated functions.

556. In addition, some structures were reorganized into state non-commercial organizations, as a result of which structures performing administrative functions were separated from structures performing governance functions<sup>63</sup>.

557. As a result of the reforms of the public administration system, also charters of ministries were clarified and the structures of their administrations were unified – departments, secretariats and sections were created.

558. Considerable success was recorded especially in the area of electronic administration, the necessity and priority of which was presented in detail already in the SDP.

### **27.1. DEVELOPMENT ELECTRONIC ADMINISTRATION SYSTEM**

559. The creation of possibilities for electronic administration, particularly electronic document circulation and exchange, significantly decreases the paperwork load and saves working hours, optimizes the number of public servants and enhances their qualifications.

560. In addition, the introduction of an electronic system for services provided by the state, on the one hand, improves the openness, accountability and transparency of the operations of the public administration system, and on the other hand, reduces corruption risks through significant reduction of direct and personal contacts between public servants and the private sector.

561. As a result, administration operations become more controllable by citizens, as it creates the opportunity for citizens to participate in the administration process.

562. The following important programs were implemented in recent years in the electronic administration sector:

- 1) issue of electronic visas,

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<sup>63</sup>Medium-term expenditure framework of the Republic of Armenia 2013-2015, Yerevan, 2012.

- 2) introduction of ARCA electronic payment system,
- 3) transition to Mulberry electronic document management system,
- 4) electronic signature,
- 5) possibility for businesses and citizens to follow documents and applications electronically,
- 6) electronic system for submitting tax declarations,
- 7) electronic permits and licenses,
- 8) electronic procurement,
- 9) electronic registration of businesses,
- 10) ID cards and biometric passports,
- 11) system for submitting electronic applications to the intellectual property agency,
- 12) information search system of the intellectual property agency,
- 13) electronic auction system for auctions of the Compulsory Enforcement Service,
- 14) electronic system of Armenian legal information,
- 15) electronic system of the real estate Cadastre,
- 16) web-site for official public announcements,
- 17) electronic system for court related data and information.

563. Despite the significant progress recorded in the sphere of electronic administration, Armenia is still far behind the European Union countries with respect to public electronic services. A lot still needs to be done in this direction.

564. Based on the need for enhancing the efficiency of public administration and its further democratization, as well as the successful implementation of the objectives of anticorruption strategy, the following policy actions will be implemented in the electronic administration sphere in the forthcoming years:

- 1) **Mapping of databases.** In order to resolve the problems of the electronic administration sphere in Armenia, it would be necessary to map all public databases – identifying their contents, to know where they are located, what their use is and how they are managed. Joint use of different electronic databases by different owners and implementation of an automated cross-check system is one of the main goals in this sphere. As a result, it is expected that one registry of all databases will be created and continually updated.
- 2) **Creation of electronic registry.** One basic electronic ID register (e-ID) will be created, which will allow the specific user to establish a link with publicly owned information.
- 3) **“Official directory of the Republic of Armenia”** will be published electronically.
- 4) **Exchange of information between databases of the police-civil status registration.** Based on the former two actions, links will be created between the population state registry section of the corresponding department of the police (passport and visa department) and civil status registry of the Ministry of Justice. This link will be used for

the e-Registry system. As a result, the corresponding department of the police can directly enter the civil status registry.

- 5) **Study of national digitization.** The draft of the national digitalization strategy will be developed. It will open the road for an action plan and allocation of resources for digitalization of data.
- 6) **“Mail Armenia”.** The pilot phase of the electronic mail system for users will start and will ensure contacts with the government (and vice versa) through email.
- 7) **Police electronic network.** With the support of the Road Traffic Police Department, a network system will be prepared and installed, which will allow users:
  - a) fill out applications for driving licenses electronically. Users should just take their driving licenses immediately after their legal issuance.
  - b) electronically pay road traffic police fines.
  - c) electronically fill out applications for registering vehicles. Users should just take their documents related to the registration and the vehicle license plate.
- 8) **Digitalization of civil status acts.** The process for digitalization of civil status acts will be initiated. It will ensure the adequate quality of the results of digitization.
- 9) **Development of Electronic system for emergency risks management.**
- 10) **Electronic entry of citizens into their personal data used by the government.** E-cabinet will be initiated, where the user will be able to follow his/her personal data at the disposal of the government, as well as notify in case of any contradiction or mistake.
- 11) **Electronic statistics.** With the support of the National Statistical Service of Armenia a network system will be introduced, which will allow companies to provide the required data electronically.
- 12) **Establishment of an electronic training center for electronic administration.** An electronic training center for electronic administration will be established, new personnel will be trained in the process of developing and implementation of operational processes of the center will be supported.
- 13) **Creation of a unified social security database (social bank) of individual data of citizens and persons residing in RA.** The system will enable receiving electronic data necessary to exercise applicant's social rights, performing data cross-matching, thus improving the effectiveness (both economic and time-wise) and targeting of the process and reducing corruption risks.

## **27.2. INSPECTION SYSTEM REFORMS AND OPTIMIZATION PROGRAM**

565. Inspection reforms, first of all, aim to facilitate business activity in the economy, in particular to excluding duplicate inspections by various bodies, regulate the process of those inspections, etc. The process of reforms was made more intensive by the approval of the concept paper for inspection reforms in Armenia by the Government of RA in 2009.
566. Within the framework of the legislative reforms of the inspection system, amendments and changes to the law on “Organization and conduct of inspections in the Republic of Armenia” was drafted and passed by the parliament on 23rd June 2011. It includes:
- 1) the requirement for introducing the risk-based inspection system by inspection bodies,
  - 2) definition of the mechanism for planning inspections, based on the risk level of the company,
  - 3) requirement for introducing checklists,
  - 4) description of the new system for summarizing the results of inspection and enhancing the level of accountability.
567. The optimization program for the inspection system aims to optimize the inspection system and the inspections conducted in Armenia, within the framework of the institutional reforms of the inspection system. The program does not include the improvement of bodies conducting inspection which are in charge of inspecting state revenues, i.e. the tax and customs sectors. Moreover, activities for institutional improvements have already been conducted in the mentioned sectors. The objective of the program is to enhance the efficiency of the operations of all bodies conducting inspections, which will improve the quality of services provided to the public and will ensure the effective use of state resources.
568. The objective of bodies conducting inspections is to protect the public from hazardous foodstuff, contagious diseases, hazardous products and other similar threats, which are currently part of the functions of the ministries and are implemented by 16 inspection bodies. Joining of inspection bodies by sectors and the separation of the function of ensuring safety from the policy of the ministries is the current best practice worldwide. According to the same approach, the level of safety can be enhanced not by continually increasing the number of inspections, but rather the effective management of state resources and targeting of inspections. The approach assumes small number of inspectors working in the system composed of a small number of inspection bodies, but at the same time ensuring safety and higher productivity as efficiently as possible.
569. Thus, the efficiency and productivity will increase by:
- 1) the application of risk-based inspections,
  - 2) the involvement of highly qualified inspectors,
  - 3) ensuring the necessary studies, analyses and training,
  - 4) reducing the cases of bribery in the inspection system,
  - 5) the involvement of a small number , but qualified specialists,
  - 6) unification of administrative services,
  - 7) reducing corruption as the business cost.
570. The main changes are as follows:
- 1) Optimal grouping of the 16 bodies implementing inspections, ensuring their coordination and providing support at national and local levels,

- 2) Establish a new legal status for inspectors, with higher qualifications and higher salaries compared to the current situation,
- 3) Move entirely to the application of risk-based inspections throughout the inspection system,
- 4) Develop a new effective system for combating corruption.

## **28. DEVELOPMENT OF LOCAL SELF-GOVERNANCE SYSTEM AND REFORM PRIORITIES**

571. With respect to local self-governance in Armenia, also due to the corresponding constitutional changes, huge efforts have been made for developing and strengthening the fundamental principles of local self-governance in cooperation with international donors, especially the Council of Europe. Among the policy measures implemented in the above-mentioned directions in 2008-2012, the following can be noted as the most important ones:

- 1) The law on local self governance of Yerevan city and other relevant laws, as well as the package of bylaws were adopted according to which Yerevan has received the status of a community. On 31<sup>st</sup> of May 2009, the first elections of Yerevan Council took place, which were held, for the first time in Armenia at the local self governance level, based on the proportionality principle,
- 2) In 2009-2010, the process of transferring the ownership of state owned land areas outside the administrative boundaries of communities to the communities was implemented, as a result of which the economic and resource capacities of communities increased,
- 3) On December 8<sup>th</sup>, 2011 Parliament of RA has approved a law “On amendments and additions to the RA Law on Local governance”, which clarifies organizational and legal structure for the administrations of urban and rural municipalities halls. According to these provisions the administration obtains status of municipal administrative institution.
- 4) The revenue base of local self-governing bodies has been expanded: a new local tax has been set up – hotel tax, as well as new duty type for cars’ parking lots. The administration related to all types of local taxes are defined as the mandatory authority of local self-governing bodies,
- 5) The classification of community service positions, ranks granted to community servants, procedures for conducting competitions for vacant community service positions, as well as organizing and conducting attestations for community servants, have been clarified in order to make them more transparent and open,
- 6) On February 26th, 2013 RA Parliament ratified an addition to European Charter on Local Governance – “Right to the participation in local governance”. To implement the requirements arising from that document amendments has been made to RA Law on Local governance, which are aimed at strengthening citizens’ participation to local governance, increase the transparency and publicity of local authorities. This law has been approved by RA Parliament on 19th of June, 2013.
- 7) A joint program of action for further development of local self-governance has been elaborated and adopted jointly with the Council of Europe.

572. In general, in the last decade, a large volume of work has been done for development of local self-governance.
573. At the same time, for example, according to the annual reports “Nations in transit” published by the Freedom House, Armenia’s local self-governing system in 2005-2010 was consistently assessed at 5.50 points, while in 2011 the assessment was 5.75 points, which means that Armenia’s local self-governing system is still in transition from authoritarian to democratic governance system<sup>64</sup>.
574. Further developments of local self-governance system in Armenia directly depend on further deepening of decentralization and democratization processes. Reforms in the local self-governance system should be implemented by systemic and comprehensive approaches.
575. In this context enlargement of communities is also highlighted since existence of numerous small and weak communities continues being a structural problem. These local administrations deliver limited services, thus creating imbalance between local governments and the limited municipal service delivery capacities..
576. For the development of RA local self-governance system and in order to ensure the effective and coordinated implementation of the policy for power decentralization, the government of RA, in the forthcoming years, will continue to:
- 1) Accordingly apply the international experience in local self-governance, including the European charter of local self-governance of the Council of Europe, as well as the best international practice for decentralization of power, through the analyses, adaptation and introduction of those practices.
  - 2) Equally resolve the priority issues of the development of local self governance system and the policy of power decentralization - administrative and fiscal decentralization, strengthening of local self-governing bodies and development of local democracy, through improvement of legislation, apart from other actions applying institutional reforms and consistent application of legal norms.
  - 3) Significantly increase the transparency and accountability of the operations of local self-governing bodies, clarification of internal and external control procedures in communities, and implementation of the mandatory legislative requirement for reporting of the head of community on the implementation of community four-year development program, its submission to the community council for approval and making the report publicly available.
  - 4) To implement measures promoting participation of citizens in decision-making and public administration at local level. In order to increase the level of openness of the operations of local self-governing bodies, mechanisms for awareness of community residents and community civil society, consultations with the latter and feedback will be introduced, and the institute of public supervision will be fully established.
  - 5) Increase the level of financial independence and self-sufficiency of communities, ensuring the sustainability and diversity of their budget revenues.
  - 6) Ensure the availability of the corresponding financial means necessary for implementing mandatory and state delegated functions of local self-governing bodies.
  - 7) Implement a new financial equalization system, defining most effective mechanisms for allocation of RA state budget subsidies to communities in order to better target subsidies<sup>65</sup>.

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<sup>64</sup> <http://www.freedomhouse.org/template.cfm>

<sup>65</sup> RA Government Program, May, 2013

- 8) Increase the lawfulness, efficiency, transparency, openness and accountability of financial management in communities.
- 9) Development and implementation of pilot programs for the provision of competition-based utilities to the population and improvement of their quality.
- 10) Gradually introduce the proportional election system as a result of community amalgamation.
- 11) Build local self-governing bodies capacities for introduction of information technologies, formation of information society in communities, promotion of “electronic participation”, legislative, normative and methodological regulations for introduction of ICT in communities, ensuring that technical infrastructures, introduction of management information systems in local self-governing bodies.
- 12) Improve the procurement procedures in municipalities and facilitate control process,
- 13) Ensure efficient control mechanisms with respect to the decisions and actions taken by the head of municipality.
- 14) Continue cooperation between the Council of Europe and the Republic of Armenia within the framework of action program on further strengthening of local self-government, implementation of which will be largely supported by the Program on Support to Consolidation of Local Democracy in Armenia funded by Government of Denmark.
- 15) In line with imperatives for current times, prepare a package of changes in order to revise Chapter VII of the RA Constitution pertaining to local self-government.
- 16) Initiate signing of the provisions of the European Charter of Local Self-Government that are not signed by the Republic of Armenia so far.
- 17) Initiate actions to ensure more effective exercising of the principle of subsidiarity and to transfer the powers for regulation and management of a significant part of public problems to local administrations within the scope of their competences and for the benefit of the population.
- 18) Expand capacities of local councils (in legal and practical areas) in all issues within the scope their competences in order to develop effective administrative capacities of communities and to strengthen their role and significance in relationships with executive bodies.
- 19) Clarify the nature of issues and functions within the scope of local self-governance (particularly mandatory or state-delegated) and strengthen the position of local governments by empowering them to address key local issues.
- 20) Develop official advisory mechanisms with national and local authorities, as well as national associations of local governments.
- 21) In order to increase municipal autonomy, improve mechanisms for definition of local taxes by local self-government bodies.

## **29. PUBLIC FINANCE MANAGEMENT**

577. In this sector, mainly due to reforms implemented by the Ministry of Finance, significant progress was recorded in 2008-2012.
578. One of the important measures envisaged already in SDP – the comprehensive public finance management strategy, was developed and approved by the government of Armenia in 2010<sup>66</sup>.

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<sup>66</sup>See Public Finance Management Reform Strategy. 2010

579. The Ministry of Finance, with the support of international financial organizations, prepared and published the first assessment report on the system of public finance management in 2008<sup>67</sup>.

580. At the same time, in cooperation with the Ministry of Finance, the World Bank and International Monetary Fund published valuable papers devoted to the reforms of public finance management<sup>68</sup>. Thus, in 2008-2011, the issue of public finance management was at the center of attention of both the government and international financial institutions, based on the necessity for more effective implementation of government programs, on the one hand, and for a rapid response to the global financial crisis, on the other hand.

581. Reforms conducted in this area include the following subsectors and issues:

### **29.1. ENHANCING THE QUALITY OF MACROECONOMIC ANALYSIS AND FORECASTS AND THEIR CLOSER INTEGRATION WITH MTEF AND BUDGETARY PROCESSES**

582. This issue became more urgent during the process for overcoming the negative consequences of the global financial crisis. Despite a number of measures for enhancing the quality of macroeconomic forecasts by the Ministry of Finance and the Central Bank, nonetheless their operative links with fiscal and monetary policies are still weak.

583. The evidence, in particular, is the fact that the macroeconomic scenario of the sustainable development program elaborated based on the pre-crisis forecasts is being revised already two years after the financial-economic crisis, parallel to the revision of this long-term strategic program.

584. Acknowledging the importance of this issue, the Ministry of Finance and the Central Bank will create a joint technical committee on macroeconomic issues, which will be chaired jointly by the Deputy Minister of Finance and the Deputy Chair of the Central Bank. The committee, bringing together the available limited capacities in this field, will discuss all technical issues related to the development of macroeconomic programs and forecasts or their revision, will submit proposals to the Minister of Finance and Chair of the Central Bank on the macroeconomic situation, which will allow for the necessary coordinated adjustments to be made in the fiscal and monetary policies both in short-term and long-term perspectives.

585. In this regard, the corresponding changes will be made also in the agenda of the permanent working group in charge of coordinating the MTEF, with the inclusion of discussions on macroeconomic programs and objectives. It will also allow for taking into account the impact of public expenditure programs on the macroeconomic program.

### **29.2. SIGNIFICANT IMPROVEMENT IN IDENTIFICATION AND ANALYSIS OF FISCAL RISKS**

586. A large volume of work has been conducted in recent years for assessment and analysis of fiscal risks. According to the public finance management reform strategy adopted in 2010, the

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<sup>67</sup>See assessment report on public finance management system. Ministry of Finance of the Republic of Armenia 2008

<sup>68</sup>See for example Priorities of Public Finance Management Reforms. World Bank. 2012



analysis of fiscal risks is included in the MTEF, and a description of those risks and the updated information on the probability of their occurrence are included in each year's budget package.

587. Identification, classification and analysis of macro fiscal risks is one of the priorities of public finance management, particularly taking into account the negative impact of the global financial and economic crisis on the economy of Armenia. Currently, the recording and analysis of fiscal risks is not complete. For example, almost no analysis of the sensitivity of significant risks is made (with the exception of two factors related to public debt).
588. With this regard the government plans to improve the analysis of fiscal risks in the near future in accordance with international best practices<sup>69</sup>. One of the priorities in this sphere is the preparation of the consolidated report on fiscal risks, which will include, first of all, risk analyses of the following concepts: (a) changes to the main forecast assumptions; (b) debt and financial assets; (c) conditional expenditures of the central government; (d) items not included in the budget; (e) state enterprises; and (f) local self-governing bodies.

### **29.3. PROGRAM BUDGET**

589. In recent years, measures are taken for the introduction and further strengthening of the set of tools envisaged in the program budgeting (PB) methodology in order to introduce program budgeting. In particular, monitoring of non-financial indicators of programs is conducted and agencies submit quarterly reports to the Ministry of Finance, program classification of public expenditures is introduced, program classification has been integrated with systems based on other classifications, the development of "program passports" is due to start, as an important tool for presenting the link between sector policy and the budget<sup>70</sup>.
590. In general, it must be noted that 2009-2011 were years for further strengthening of PB reforms and introduction and application of budget planning, monitoring and accountability tools.
591. In the processes of introducing PB in Armenia, the main emphasis was put on developing the methodology, planning, implementation and accountability mechanisms for the system being reformed and adapting it to the specific aspects of the country, as well as on the efforts for their testing and gradual introduction. As of 2012, all the budgetary authorities in Armenia plan their budgets in PB format (including the non-financial indicators describing the results) and present monitoring reports.
592. Some state organizations have also improved the annual analytical reports on budget execution. Efforts have been made for building the capacity of the corresponding staffs. But nonetheless, the mentioned activities are more of a "complementary nature" and are not the main source of budget planning, decision-making on sectoral allocations and analyses. This significantly reduces the effectiveness of the BP mechanism.
593. The planned reform measures will address the above-mentioned problem. The main objective will be the full transition to the BP format in the medium-term.

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<sup>69</sup> IMF, Manual on Fiscal Transparency (2007)

<sup>70</sup> For more details, see progress report on the implementation of the sustainable development program (2009-2010), 2011

594. First, it is planned to develop the relevant legal framework, stipulating program budgeting as the primary basis for budget planning, execution and accountability. In order to properly prepare for the full transition to BP, the legislation will define a transitional period of 2-3 years for full transition to BP.
595. The next target of the reforms will be to improve the quality of the programs' content (sector programs, which would be the basis for the budget). The program classification of the budget has already been developed, but further work is required in order to fine-tune their content.
596. It is often the case, where even staffs of sector agencies do not have a full understanding of the objectives of programs, the relevance of the methods and a number of other issues related to the effectiveness of programs. Larger efforts will be needed in this direction, as it is necessary to fill the academic knowledge gap emerged in the post-Soviet period.
597. The selection of measures for implementing budgetary programs and founding their budgetary allocations on causal links will require long and consistent efforts, which will be implemented in the medium-term, resulting in significant adjustments in budget programs and the list of measures for their implementation, as well as financial allocations to those measures.
598. In parallel to the above mentioned, efforts will be made for human resources capacity building. One of the cornerstones of BP reforms is that the budget will not be seen only as a financial document for financiers, but rather a sector policy document for sector specialists of budgetary agencies. In this regard, the primary role belongs to the capacity building efforts.
599. Last but not least aspect of the reforms will have impact on the relationships with the institutions acting on the "demand" side of the reforms. Those institutions include not only the National Assembly, as the direct beneficiary of the budget plan and its execution report, but also the Chamber of Control, mass media representatives, analytical centers, etc. Continuous efforts for improving the transparency and openness of the budget will be measures aimed at enhancing the performance of their roles by the mentioned bodies, including not only the prepared materials, but also reforms of the decision-making process also taking into account the international best practices.

#### **29.4. INTERNAL PUBLIC FINANCE SUPERVISION AND AUDIT**

600. The role of internal public finance supervision and audit becomes more important due to the introduction of program budgeting, as, in this case, in parallel to the decentralization of financial management, the independence of budgetary program managers and their responsibility for its effective implementation are significantly expanded. Consequently, internal public finance supervision and internal audit are necessary conditions for ensuring the targeting and effectiveness of budgetary expenditures.
601. One of the medium-term priorities of the RA Government is the full introduction of internal public finance supervision, which will verify the compliance of the transactions with proper financial management, transparency, expenditure and targeting effectiveness, savings and the requirements of the relevant legislation<sup>71</sup>. The full establishment of internal public finance supervision and audit is also one of the key preconditions of the EU- Armenia ENP action plan.

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<sup>71</sup>See Public Finance Management Reform Strategy. 2010

In this regard, it is important to adopt and apply the laws on “Financial Management and Supervision” and “Financial Inspection”.

602. Unlike the internal financial supervision, the legislative and regulatory legal basis for internal audit has already been created. In this subsector, in the forthcoming years, the introduction of internal audit in all state organizations and local self-governing bodies will be completed, and also a unified electronic information system will be created, which will allow for the implementation of all phases of internal audit with the use of the relevant computer software – from documentation and programming phase, ending with the preparation of the reports.
603. Amendments to the RA Constitution and adoption of the Law on Control Chamber resulted in greater autonomy of the Control Chamber. Today the Control Chamber is the only supreme audit body in the field of public finance. Further reform in supreme audit is aimed at implementation of international best practices and international standards of supreme audit institutions, with the most important ones being financial, operational and organizational independence, legality, impartiality and transparency.

## **29.5. ACCOUNTING AND FINANCIAL REPORTS**

604. Unlike the private or corporate sector, the introduction of standards in line with international standards for accounting in the public sector has not yet been implemented. Currently, accounting in governance bodies is mainly done with the chart of accounts and instructions for their application approved in the Soviet Union. Accounting in state non-commercial organizations is basically conducted by the legislation regulating accounting in organizations of the private sector. Unlike organizations in the public sector, accounting in private sector organizations is conducted and financial reports are prepared based on international financial reporting standards (IFRS).
605. In order to increase significantly the usefulness of the public sector financial reports for decision-making purposes, the Republic of Armenia intends to make the transition to the use of accrual accounting standards<sup>72</sup>. Currently in the RA have been translated and professionally edited International public sector accounting standards (IPSAS) based on accrual accounting available as of January 1<sup>st</sup>, 2008. In line with the mentioned standards, the draft law on “Public sector accounting” and other drafts of legal acts regulating accounting has been developed.
606. The results of pilot introductions of IPSAS revealed that the full introduction of IPSAS will require huge material and human resources, which, taking into account the country’s current level of development is not reasonable yet. At the same time, the comparison of the government finance statistics manual (GFSM) and IPSAS revealed that there are significant differences between the two systems.
607. Considering the above mentioned, new Armenian public sector accounting standards (APSAS) will be developed for the public sector of the Republic of Armenia, which will be based on accrual accounting principle. The basis for developing APSAS will be IPSAS, the entire package of IFRS and the IFRS for small and medium-sized enterprises. In cases, when IPSAS and IFRS have different approaches regarding one specific issue, one of them will be selected.

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<sup>72</sup> At the global level, IPSAS standards for accounting in public sector organizations (preparation of financial reports) are developed by the International Federation of Accountants.

608. The newly developed APSAS, as well as the chart of accounts elaborated for its applications, should be in line with the GFSM based accounting classifications adopted for the budgetary and public sector of the Republic of Armenia. This approach will allow for receiving from the accounting system the reports required both by the budgetary legislation and financial reports required by APSAS.
609. Based on APSAS, the draft law on “Public Sector Accounting” and other drafts of legal acts regulating accounting will be further elaborated. It is planned that the new system of accounting will be introduced into the public sector in 6-7 years.
610. After the implementation of the above-mentioned phase (6-7 years later), new studies will be conducted in order to determine the necessity and possibility for full transition to IPSAS. If the studies showed that it is necessary and possible to immediately make the full transition to the IPSAS, then the corresponding program will be developed for implementing the necessary actions. Otherwise, yet another intermediary phase will be implemented for further harmonization with IPSAS.

## **29.6. IMPROVING PUBLIC INVESTMENTS AND NON-CURRENT ASSETS MANAGEMENT SYSTEM**

611. Public investments play a significant role in increasing the overall potential for development of the country and improving the quality, efficiency and accessibility of public services. In the last decade, the annual average level of public investments amounted to 4.1% of the GDP, which is a low level for a developing country. Nonetheless, taking into account the capacities of production and social infrastructures in Armenia, demographic forecasts, as well as the relatively low level of overall public expenditures, it is not plan to increase public investments in the medium-term and long-term, throughout the time period of the program, it is planned to maintain public investments at the level of 4% of the GDP.
612. Thus, from the viewpoint of ensuring an adequate level of public investments, it is of primary importance to have an effective management system for the entire public investment management cycle and to improve it continuously - sectoral priorities, selection of programs within the framework of those priorities, assessment, implementation and supervision functions.
613. The main priority in this sector will be the introduction of a formalized and integrated assessment system for public investments.
614. Together with ensuring an adequate level of public investments, it is also important to introduce a new accounting and effective management system based on APSAS for public non-current assets.
615. The primary issues in the management of non-current assets would be the introduction of a unified register for public non-current assets and introduction of non-current assets management plans in all organizations of the public sector.

## **30. CIVIL SERVICE DEVELOPMENT**

616. In recent years, due to the reforms of the sphere, civil servants have been distinguished from persons holding political, discretionary positions and from employees involved in technical services. During that period the general description of each group of civil service

positions, limits of the responsibility of persons holding civil service positions and the system of remuneration of civil servants have been elaborated.

617. In accordance with the 2009-2012 SDP implementation action plan, the following key subprograms have been implemented in the civil service sector:

- 1) Electronic document circulation, in order to create the possibility for a unified database and exchange of information, the Civil Service Council Internet website was opened;
- 2) In order to ensure social guarantees for civil servants, the system of mandatory medical insurance for civil servants has been introduced;
- 3) For improving the ethics rule of conduct for civil servants, the “Code of Conduct for Civil Servants” was drafted and discussed with stakeholders;
- 4) For revision of the attestation process for civil servants, a performance assessment system was introduced;
- 5) In order to improve the recruitment into the civil service system and the processes of replenishment of the system, a unified certification system for candidates of junior positions and a candidate assessment system based on awarding of points for the interview phase of the competition for recruitment in vacant positions were introduced;
- 6) In order to create legislative basis for other types of service, harmonization of services, ensuring unified principles, the law on “Public Service” was adopted.

618. Taking into account the priorities of the civil service system further development, a policy paper on reforms of the civil service system (Policy Paper) has been drafted jointly with EU SIGMA program, which will be supplemented with the development and approval of list of measures to be implemented: The document has put primarily focus on the following aspects:

- 1) Improvement of the management of the civil service system;
- 2) improvement of the system of the lists of civil service positions and their ranks;
- 3) filling of civil service positions (selection and recruitment);
- 4) mobility (possibility for promotion), assessment and training system;
- 5) the complete system of rights and obligations, including disciplinary procedures;
- 6) forming and dissolving of the bodies of the civil service system, terminating working relationships and social guarantees.

### **30.1. POLICY FOR INCREASING PUBLIC SERVANTS’ SALARIES**

619. The government of Armenia considers the increase in salaries of the employees of public administration and justice systems as the most important precondition for increasing the effectiveness of the reforms in those sectors and implementation of the anticorruption policy. In 2009-2012, salaries of public servants increased on average by 3.4% per year, instead of the 12% planned by the sustainable development program. This actual 3.5 times, slower than planned, increase in the nominal salary was ensured mainly due to the significant increase in the salaries of judges, prosecutors and investigators, as well as increase in the salaries natural growth and issuing of new ranks and other titles.

620. Considering that in the crisis and post-crisis years, it was not possible to ensure significant increase of the salaries of employees in the public administration and all other budgetary sectors, efforts in this direction in 2014-2017 will be of higher priority, as the most important precondition for the effectiveness of the reforms and programs implemented in those sectors.

621. The salary policy for employees of the public administration and justice systems were based on the following provisions and principles.
622. The government of Armenia will ensure the continuity of its policy for increasing salaries. Thus, already since July 1<sup>st</sup> of an unified system of salaries for persons occupying positions in the public sphere will be implemented, which will be accompanied by tangible increase in salaries of those workers. In each year after 2014 the government will ensure at least 10% increase in the salaries of the employees of the public administration and justice systems, which will be in line with the average rate of increase in salaries in the economy.
623. Parallel to the increase in salaries, the necessary measures will be taken in order to ensure implementation of internal and external fairness of public servants' salaries. Salaries of equivalent specialists working in the public and private sectors. would be comparable.
624. The government will make proposals for strengthening the principle of unified scale of salaries for different sectors of public service, as well as defining the optimal ratio of salaries of different levels of public service and high-level officials.
625. The policy for increasing the salaries of public servants will also ensure the ratio of the average annual salary of public servants to the GDP per capita at the level of 0.6-0.8, which is currently characteristic of many European Union countries.
626. Increase in the salaries of employees of public administration and budgetary sectors are a necessary, but not yet sufficient condition for the successful implementation of government's programs. Sufficient conditions would be the implementation of programs ensuring targeted and diverse development, as well as the unavoidable responsibility of public administration and budgetary sectors employees, envisaged by the legislation, in case of incomplete implementation of those program, and generally shortcomings in their performance.
627. In 2012 the RA Government introduced the Social Package Program, financial resources of which were spent primarily on health insurance by the beneficiaries. Provision of the social package, as a social-employment guarantee of public sector employees, will be consistently expanded to the extent possible, including the scope of beneficiaries. In addition, the addressness and effectiveness of the program will be improved.
628. An important element of social protection for those employed in public sector is the old age pensions system. The primary direction here is that, parallel to the increase in the years of working experience, the pension of the public servant will also increase and will amount to up to 70% of his salary in the last years. This approach is already being applied for 12 years for military service personnel, the police and National Security Service employees. In order to provide public servants with such pension insurance, an additional maximum of 300 million drams of allocations would be required from the state budget each year. Provision of such a pension will be a strong incentive for recruiting more knowledgeable and experienced experts in the public service system.

### **31. JUSTICE SYSTEM**

629. In the last two decades, significant reforms were implemented in the legal system of Armenia, Judiciary power and the prosecution system, as a result of which some progress was recorded in bringing the justice sector of the Republic of Armenia in line with the modern requirements of a state ruled by law.

630. With 27 November 2005 changes to the Constitution of the Republic of Armenia, the second phase of justice reforms in the Republic of Armenia were initiated.
631. Thus, on 1<sup>st</sup> June, 2006 the new law of the Republic of Armenia on the Constitutional Court was adopted, and created legal guarantees for individuals to exercise their right to constitutional justice, introduced the institution of individual's constitutional complaint, significantly improved constitutional procedural processes.
632. In February 2007, the Judicial Code of the Republic of Armenia was adopted, which for the first time systemically regulated the relationships linked with the organization of the judiciary power and its operations, which formerly was done by separate laws, additional guarantees for independence of judges were stipulated, the role and significance of the Court of Cassation was changed substantially, according to which one of the main functions of the Court of Cassation is to ensure the unified application of the law, a specialized court – the Administrative Court of Armenia, for effective supervision of the executive power was established, the Administrative Court of Appeal was established, self-governing bodies of the judiciary power were established – the General Assemble of Judges of the Republic of Armenia and the Court Chairmen's Council, a school for training candidate judges was established (Judiciary School), which aims to provide quality specialists to work as judges<sup>73</sup>.
633. Serious steps were taken for ensuring the material and social independence of judges; in particular, the salaries of judges were increased significantly.
634. In order to ensure the continuity of justice reforms, the Order of the president of the Republic of Armenia on “Approving the strategic action plan of justice reforms 2009- 2011 and the corresponding action plan, as well as establishing a working group” was issued on 21 April 2009, the priority objectives of which were to ensure independent, accountable, transparent and accessible justice, to reduce corruption risks, to improve the strategy and legislation of the judiciary system.
635. Despite the progress recorded as a result of the implemented reforms, they cannot be considered sufficient or comprehensive enough, since numerous issues have not yet been resolved. In particular, the most important of the existing issues was not resolved, i.e. ensuring a fair and effective justice system. Some manifestations of that issue are still persistent at the legislative, as well as the practical levels. It must be noted that the limitations of independence are the consequences of both external and internal interventions, and the causes are of functional and structural nature. Based also on circumstance and generally the necessity for systemic implementation of justice reforms, the president of the Republic of Armenia by the Order dated June 2012 approved the strategic program for legal and judicial reforms in Armenia in 2012-2016 and the corresponding action plan.
636. The main objective of the program is to ensure a legal system and judiciary power in Armenia in line with the modern standards of a state with rule of law, which assumes, in particular:
- 1) fair, efficient and accountable judiciary power,
  - 2) increased effectiveness of the system of criminal justice and criminal punishment,
  - 3) increased effectiveness of administrative justice and administrative procedural processes,
  - 4) increased effectiveness of civilian justice and further improvement of civilian legislation,

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<sup>73</sup> Strategic Program for Legal and Justice Reforms 2012-2016, Yerevan, 2012.



- 5) increased effectiveness of court procedural functions,
- 6) ensuring reforms of the defense lawyer system,
- 7) increased effectiveness of the operations of the prosecutor's office,
- 8) increased effectiveness of arbitration, notary and public register management systems,
- 9) rehabilitation of legal awareness building and legal edification system

637. Within this context, the targeted and effective solution of the following problems becomes important:

### **31.1. ACCESS TO JUSTICE**

638. One of the main factors for ensuring access to justice is the provision of free of charge legal aid. The Law on Advocacy of Armenia envisages free of charge legal aid in criminal cases, as well as, from 1 January 2013, for certain categories of people, in civil and administrative cases, including legal consultations, preparation of documents, etc. In order to have a successful process of provision of services by the public defender, it is necessary to provide the corresponding technical assistance, and particularly enhance the human resources and institutional capacities. In particular, it is necessary to increase the number of public defender job positions, support the public defender's office in establishing offices for regional public defenders, and help those offices with refurbishment, provision with information technologies (computers, printers, etc.).

### **31.2. PUBLIC SERVICES**

639. One of the priorities of the government of the Republic of Armenia is the creation of the necessary preconditions for provision of quality services to the population. This measure includes, first of all, the reduction of the time necessary for provision of services and also a reduction in the number of governmental bodies involved, reduction of contacts between citizens and public servant, ensuring lower costs and excluding the risk of corruption. Based on the above-mentioned, it is appropriate to introduce a unified "one stop window" for registration of civil status acts, state registration of legal persons, provision of passport and visa, which assumes the provision of the whole package of the mentioned services to the client through one window.

### **31.3. NOTARY SERVICES**

640. Introduction of an electronic management system for the notary sector allows the notary to receive a number of documents or information online to carry out his functions, thus freeing the applicant from the obligation to obtain additional documents from other bodies. In addition, the introduction of an electronic management system in the notary public sector, would allow for the provision of certain types of public services, introducing "one stop window" also in the notary public sector, in particular, in case of availability of computers and an online link between the notary and the relevant governmental bodies, and the notary, in addition to the necessary notary functions, can also perform other functions and thus significantly reduce the time needed for provision of public services.

### **31.4. CRIMINAL JUSTICE**

641. Currently, Armenia has a problem with overcrowded prisons. The amnesty decision of the National Assembly of the Republic of Armenia on 5 May 2011 freed around 420 prisoners. But



the problem should be, nonetheless, solved through institutional reforms. In order to reduce the number of prisoners, it is necessary to promote application of punishments not connected with imprisonment. At the same time, the Criminal Justice Department of the Ministry of Justice of the Republic of Armenia does not have the adequate technical capacity, which would allow for application of alternative punishments, such as house arrest, as well as the proper supervision of punishments other than imprisonment. For this purpose, it is necessary to acquire the corresponding technical means for application of alternative punishments (surveillance devices, technical refurbishment and improvements of the buildings of the territorial units in charge of implementing alternative punishments). To create a probation service in the structure of the RA criminal and executive system in order to improve effectiveness of the punitive and enforcement policy implementation<sup>74</sup>.

642. Another issue in this area is the need of bringing Armenian prisons in conformity with European standards. Despite the reconstruction of a number of prisons, most of them do not meet penitentiary requirements. Hence in order to bring conditions for prisoners in line with international standards and ensure adequate respect for human rights in places of imprisonment, it is planned to build new criminal executive establishments equipped with modern technical systems.

## **32. PROSECUTOR'S OFFICE**

643. In 2008-2012, significant organizational-legal reforms were conducted in the prosecution system of Armenia. Since 2008, the Law on Prosecutor's Office is fully enacted and, in accordance with the requirements of the Constitution of Armenia, has created the radically new legal regulatory framework for the status of prosecutor's office and prosecutors, powers of prosecution, work of prosecutors and the rules and conditions for service provided by public servants in the administration of the prosecutor's office.

644. Rules for appointing and dismissing prosecutors, as well as appointment of public servants in the administration of the prosecutor's office have changed significantly.

645. The prosecutor's office, in compliance with the requirements of international treaties, has been given the power to develop and implement the state policy on crimes in the Republic of Armenia. Within the mentioned framework, first of all, organizational-legal and structural changes have been made in the prosecution system. The organization and powers of the entire operations of the prosecution are implemented mainly by object specializations, and also partially by specializations of bodies and subjects. Accordingly, the Chief Prosecutor has approved the structures of the Chief Prosecutor's Office and Central Military Prosecution, defining the framework of powers of their structural units.

646. By the order of the Chief Prosecutor of Armenia, the list of corruption crimes has been prepared, which being a part of the state policy on crimes developed and implemented by the prosecutor's office, has become mandatory for pre-trial and criminal investigation bodies.

647. One of the most important reforms implemented in this sector, and still continues, is the development and introduction of electronic management systems (software) for managing statistics and archives at the prosecutor's office.

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<sup>74</sup> RA Government Program, May, 2013

648. Significant reforms of organizational-legal nature have been implemented regarding the admission of applications-complaints made by citizens, their registration, recording, processing, sending of justified and reasoned responses and organizing audiences, regulating their various legal regimes, time frames, and issues related to the justifications and reasoning of responses.
649. In order to ensure the openness and transparency of the operations of the prosecutor's office, numerous press releases, daily news items, articles, speeches, publications, clarifications, responses to notifications, etc. have been prepared, and were disseminated by television stations, as well as the Internet.
650. Conferences, seminars, discussions, national as well as with retreats including individual regions, have been conducted with mass media representatives, non-governmental organizations and international organizations in order to communicate the organization and enactment of powers during the operations of the prosecutor's office. The webpage of the prosecutor's office also allowed for the public to assess the operations of individual units of the prosecutor's office.
651. Armenia's prosecution system faces a number of challenges related to accountability, full independence, increase in the effectiveness of the fight against corruption, etc. Based on the above-mentioned circumstances, priority directions of the reforms of the prosecution system in Armenia are as follows<sup>75</sup>:
- 1) ensure the full independence of the prosecution and its accountability, implementation of the principle of non-intervention in the operations of the prosecution,
  - 2) as the guarantee for ensuring the independence of prosecutors, revise the rules for appointing prosecutors, defining clear criteria for eliminating candidates from the list of candidate prosecutors, as well as revise the rules and conditions for promotion of prosecutors with the inclusion of clear criteria for promotion,
  - 3) reform the system for disciplinary sanctions against prosecutors, clarifying the basis for disciplinary sanctions,
  - 4) study the international experience in the supervision function of the prosecutor's office over the legality of application of sanctions and use of force and other means, and as necessary to plan measures for enhancing its effectiveness,
  - 5) establish separate legal regulation for public servants in the administration of the prosecutor's office,
  - 6) improve the capacities of the prosecutor's office in the areas of information and communication technologies, in particular through ensuring the introduction of an electronic management system (software) in the prosecution system for managing document circulation.

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<sup>75</sup>Strategic Program for Legal and Justice Reforms 2012-2016, Yerevan, 2012.

### **33. ENHANCING THE EFFECTIVENESS OF THE PROTECTION OF PUBLIC ORDER, ENSURING PUBLIC SAFETY AND FIGHT AGAINST CRIMES**

652. The implementation of the current demand of the society and the state for having a police force corresponding to the standards formed in democratic societies, in both the short-term and long-term perspective will be the main objective directing the development of the operations of the police force in Armenia.
653. As a result of legislative and administrative reforms, a number of important preconditions for modernization and further development of the unified system of the police have already been ensured. Nonetheless, for further improvement of the capacities of the police and its relevance to the demand of the society, it is planned to further expand and deepen the systemic reforms in the coming years, by initiating both additional legislative and administrative changes, as well as introduction of new tools and methods into practice.
654. The implemented and planned systemic reforms, in effect, include the following main areas of police operations.
655. The patrol service has been fundamentally reorganized in order to protect law and order in public places, ensure the safety and rights of citizens, and provide proper services for preempting and preventing crimes and violations of law. As a result, the number of patrol stations in the capital city, placement and numbers in pedestrian walkways and auto-routes has increased. A notable example is yet the small number of new patrol service stations established currently only in Yerevan, the main objective of which is to enhance the level of trust of the public in the police by making the transition to a qualitatively new form and method of providing the service.
656. For further improvement of the protection of public order and ensuring public safety, it is important to make the transition from mandatory military service personnel to the contractual service in the police army unit. This has provided the opportunity for more effective organization of the training of the personnel, including military-technical knowledge and methodological skills.
657. As a result of large-scale legislative work for protecting the rights and freedoms of citizens, the legal framework regulating the protection of public order and the ensuring of public safety has improved significantly, in particular with regard to the application of physical force and use of special means and arms. Based on the comprehensive study of the international experience, for the first time in the history of the police, the armament of the police, including firearms, ammunition, special means and means of personal protection for police officers was listed in a non-confidential normative act. Thus, the public has been given the opportunity to scrutinize police armaments. Characteristically, the list of armaments can only include the special means which have the corresponding permits from the Ministry of Health.
658. Based on the international experience, a number of guidelines and regulations were developed and are applied to the operations of police officers involved in the protection of public order, including conducting negotiations, physical force, application of special means and arms, rights and obligations of police officers during arrests or apprehension.
659. The current and long-term objective of reforms in the given area of police operations is the re-organization of the content of the external service of the police, which directly and positively will reflect on the members of the society and for the citizens to feel safer and have more trust in the police.

660. Proper implementation of that objective will be possible by ensuring the introduction of more effective methods and forms for protection of public order and strengthening of public safety, improving the management system, improving the protection of safety of the staff and objects of special significance, consistent enhancing of the theoretical knowledge of police officers involved in the given area and their practical capacities.
661. For further strengthening of police-public relationships and cooperation, special importance is attached to the introduction of the model of community police. Community police was organized in Yerevan city and started operations on 1 July 2012.
662. The next step is the piloting of community oriented police, where all the external service forces of the police will be involved. The main objective of the community police is to ensure safety of the citizens and protect public order, as well as provide support to natural and legal persons in the protection of their rights and legal interests.
663. It is envisaged to introduce the community police operations' assessment system corresponding to modern standards, where a considerable importance will be attached to the opinion of community residents.
664. A most important step for enhancing the effectiveness of the fight against crime was the introduction of the territorial branch service model for implementing the new principle for organizing the criminal intelligence operations.
665. As a result of further consistent work, it is planned to:
- 1) improve the current level of coordination of entities involved in crime prevention and their informational provisions. In this regard, it is important to create a unified automated information system together with law enforcement bodies and other stakeholder agencies.
  - 2) improve the mechanisms for operations of crime prevention and the implementation of the principle of responsibility and unavoidable punishment for committing crimes,
  - 3) reduce the overall level of crimes, as well as the level of public threats caused by those crimes,
  - 4) enhance the effectiveness of the fight particularly against trafficking and illegal drugs, organized crime, corruption, money laundering, cyber crimes,
  - 5) ensure the active participation of citizens in preempting, preventing and identifying crimes,
  - 6) as a priority, improve the level of technical provisions of intelligence, investigation, as well as forensic services.
666. One of the priority directions for modernization of the police is the reforms of the professional education system, as the society and the state today need educated police officers trained by modern relevant programs and methods. For this purpose, the education system of the police has been fundamentally reorganized.
667. In the coming years, the priority of educational reforms will be the training of personnel through the wider use of information technologies, introduction of an innovative system for enhancing training and qualification, and for that purpose, the integration of the police educational academy into the international police training system.
668. The quality and accessibility of more than fifty different types of services provided by the police to citizens has improved significantly.

669. The legislation on traffic safety has improved and brought in line with international standards. The procedures for registering vehicles and issuing of driving licenses have been simplified to the extent possible. The requirement for submitting certain certificates, which used to be mandatory, has been eliminated. Data bases registering road traffic accidents, administrative violations, and automatic registration of vehicles and driving licenses have started to operate.
670. By a number of legislative amendments and changes, procedures for obtaining Armenian citizenship, renouncing Armenian citizenship, issuing of passports and visas have improved. In order to improve procedures for obtaining (renouncing) citizenship, entry and exit of foreign citizens, the “one hall” principle for providing services to citizens has been introduced.
671. Short timeframes, to the extent possible, have been set for passport related procedures. The requirement for presenting a number of documents (certificates), which used to be mandatory, for example the requirement for extending the validity period of the passport in person, have been eliminated. An information portal in Armenian, Russian and English languages has been created in the Passport and Visa Department of the Police and there is an operational hotline (090007007).
672. The work for operation of the electronic system for provision of information on the process of applications on citizenship and civil status is underway, and it will allow for the citizens to enter the “www.passportvisa.am” website with the serial number of the application and receive comprehensive real-time information on the processing of the application.
673. On 1 June 2012, the system for provision of new passports with biometric data has started to operate.
674. The persistent improvement of the quality of services provided by the police in the long-term perspective will continue to be one of the priorities of the police.
675. Consistence will also be demonstrated in the improvement of the organizational structure of the police. The Transport Department of the police has already been dissolved. The functions of the mentioned department have been transferred to territorial units of the police and Head Department for State Protection, at the same time reducing the number of job positions with one-third. In the headquarters of the police, structures with similar functions have been dissolved and duplication of functions has been excluded. The number of job positions at the headquarters has shrunk by around 13%. Those job positions are transferred to the territorial units of the police, and these units receive more autonomy in their operations, that’s enhancing the effectiveness of the performing of functions by the police and at the same time enhancing the level of their responsibility.
676. The introduction of the special civil service in the system is an important measure for implementing citizen supervision of the police and further enhancing the transparency of police operations. 441 serviceman holding positions in the police in different units have already been transferred to the special civil service. This process will be finalized during the next year.
677. The continuous and full information provision to the public on the operations of the police has been considered as one of the most important measures for strengthening the trust of the public in the police, and it is planned to:
- 1) continually inform the population on issues faced by the police related to the protection of public order, prevention and identification of crimes, the addressing of those issues through more active press conferences, the official website, “02” TV program, weekly journal and other possible means,

- 2) enhance the level of trust and awareness of the public with regard to the state policy enacted in the law enforcement sector.

678. In line with the reforms of the budgetary policy of the government of Armenia, the financial planning sphere is also being reformed. The objective is to significantly enhance the targeting of police financing from the state budget, efficiency and transparency of the use of public funds, and from 2010 the principles of program budgeting were introduced in the police.

679. In the near future, the transition to program budgeting will allow increasing significantly the supervision of the public with regard to police operations, as all the programs and policy measures (services) will have the corresponding quantitative and qualitative result indicator for specific time periods.

680. The progress with regard to the technical refurbishment of the police is also notable. Examples are as follows:

- 1) Rapid Response Center in Yerevan city department,
- 2) CCTV systems in popular places of Yerevan,
- 3) Speed cameras in streets and automatic violation surveillance cameras at crossroads,
- 4) Development and introduction of GPS location service for vehicles of traffic police response center for violations of traffic rules, as well as traffic police, is underway.

681. The gradual expansion of the mentioned and similar systems is important for the effective management of the limited police force and provisions for the protection of public order, ensuring public safety and fight against crimes, preventing the possible deviations and violations of the accepted norms and rules, and in case of violations, the unwavering application of the principle of unavoidable responsibility, and reducing the contacts between drivers and police officers to a minimum.

682. Nonetheless, in general, the level of refurbishment with the main assets characterizing the capacity of the police is still low. Around one-third of the vehicles used for various purposes in the system (rapid response, patrol, logistics, etc.) are in operation for 10 years or more, and 23% of those vehicles are depreciated to the extent that they need to be written off the balance. The situation is particularly inadequate in territorial units with regard to devices for forensic services, equipment, as well as means of communication and computers. Around half of the radio communication devices, and one-third of computers in Yerevan police department and regional departments, as well as their structural units, should be replaced, since they are physically and functionally depreciated. In the mentioned units, every sixth police officer has one mobile radio communication device, and every 11th officer has one computer. According to the annual balance of the police in 2011, as of 1st January 2012 the level of depreciation of the basic means in general constituted 78.1%.

683. As a result, one of the priority issues to be resolved in the coming years is the improvement of the material-technical provisions of the police, including the updating of information technologies, as well as technical refurbishment of police units.

684. Improving social security of police staff, including the existing remuneration system, is an important factor for further improving the effectiveness of police operations and the successful implementation of the anticorruption strategy in the system in the long-term.

685. Significant progress was made in improving social protection and providing social guarantees in 2012, as a result of the provision of services included in the social package of the

Government of Armenia, which are also extended to the police and persons holding special civil service positions.

686. The government plans to increase the salaries of police officers and police staff in the coming year, since the salaries are still lower than those of the justice system and prosecution bodies. They are also lower than the monthly salaries of police officers in a number of CIS countries.
687. It is planned that the implementation of the program will significantly contribute to further strengthening of lawfulness and legal order in the country, protection of the constitutional rights and freedoms of citizens from criminal violations, ensuring public order and safety, as well as improving the quality and accessibility of services provided to the population, reduction of corruption risks in the system, increased effectiveness of the fight against crimes. As a result of the implementation of the program, the main indicators characterizing the efficiency of police operations will be improved.
688. Thus, although the level of crime will somewhat increase in the coming years (mostly due to better recording of crimes), nonetheless, one of the main performance indicators – number of crimes per 100,000 of population, will have a clear declining trend in the long run.

## **34. ANTICORRUPTION POLICY**

689. The fight against corruption in the Republic of Armenia has acquired a systemic nature since 2003. The first anticorruption policy paper was adopted in 2003 – the anticorruption strategy and action plan for 2003-2007. As a result of the implementation of the mentioned documents, legislative reforms were conducted aimed at reducing corruption risks and further strengthening of the fight against corruption. The new anticorruption strategy adopted in 2009, and the corresponding action plan for 2009-2012, is a comprehensive policy paper which includes 240 activities in a number of sectors, including activities related to the prevention, criminalization of corruption, as well as public awareness and education activities.
690. In order to ensure the proper implementation of the mentioned documents, the Anticorruption Council headed by the Prime Minister, and the Anticorruption Monitoring Committee chaired by the Assistant to the President of the Republic were established by the decree of the President of the Republic on 1 June 2004.
691. The fight against corruption in the Republic of Armenia is implemented in the following main directions – prevention of corruption, criminalization of corruption and the participation of the civil society in the fight against corruption.
692. The Republic of Armenia also participates in the following international structures for the fight against corruption: GRECO group of the Council of Europe, anticorruption network of the Organization for Economic Cooperation and Development and the monitoring body of the anticorruption convention of the United Nations. Armenia has already been subjected to monitoring within the framework of the first two organizations and has received the corresponding recommendations, which formed the basis for the subsequent policies on the fight against corruption.
693. The main achievements in the above mentioned directions are as follows:

### **34.1. CORRUPTION PREVENTION**

694. Reforms for preventing corruption have been implemented in recent years, especially focusing on the contacts between the state and citizens, as well as conflict of interests among state officials, approving the code of conduct for the latter, the public procurement system, as well as other sectors.
695. Reforms were implemented in the state registry system for legal persons. With the introduction of an electronic system for registration of legal persons the time needed for registration has been reduced significantly.
696. In June 2011, the Law on Public Service was adopted, based on which the Ethics Committee for high-level officials was established in January 2012. Functions of the committee include the management of the registry for property, incomes of high-level officials and their relatives and declarations of relatives, their analysis and publication, in order to ensure the transparency of the activities of high-level officials. The committee also identifies conflicts of interests and violations of the rules of ethics by high-level officials, in accordance with the law, and submits recommendations for their eradication and prevention, initiates procedures, etc. The Ethics Committee for high-level officials has approved its working procedures, the registry of high-level officials has been prepared and guidelines for preparation and submission of declarations on property, incomes of high-level officials and their relatives have been developed.
697. Priority issues for the Ethics Committee of high-level officials are enhancing the role of the committee and its institutional development, as well as improving the relevant legislation and ensuring mechanisms for application of the legislation. In order to increase the efficiency of the committee's operations, it cooperates with the World Bank, OSCE, EU structures and other international organizations. For institutional development and full establishment of the ethics system, the committee is studying the best international practices in the spheres of codes of conduct and their application, declaration of conflict of interests, systems for identifying cases of conflict of interests, as well as in defining sanctions in the ethics system with the purpose of their introduction in Armenia.
698. With the support of the World Bank, work is being done for making the transition from hardcopy declarations of the property and incomes of high-level officials and their relatives to an electronic system of declarations. At the same time, in order to improve the analysis of declarations, an electronic system for declaration analysis will be developed, which will include a component for assessing risks related to individual indicators.
699. The new forms for declaration of the property and incomes of high-level officials were approved by the Government of Armenia in 2011. Implementation of these two measures will significantly reduce the corresponding corruption risks.
700. Practical steps will be taken to differentiate business from politics and separate the public administration apparatus from business.<sup>76</sup>
701. In accordance with the Anticorruption Convention of the United Nations regular reports on corruption risks will be published.
702. The reform of the procurement system - adoption of the new law, introduction of an electronic system of procurement, was a very important step. Since 2012, all procurements of state bodies are implemented through the electronic procurement system, which will significantly reduce the risk of corruption in procurement.

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<sup>76</sup> RA Government Program, May, 2013



703. Anticorruption measures implemented in financial supervision and financial audit sectors are also significant.
704. The Legal and Judicial Strategic Program for 2012-2016 approved by the order of the President of the Republic of Armenia on 30 June 2012 will ensure significant progress in the fight against corruption. According to expert assessment, the majority of activities stemming from the program have a clear anticorruption direction.
705. In order to ensure a comprehensive and all-inclusive reflection of corruption events in Armenia new indicators will be estimated and published, such as global corruption barometer, the bribe payers index, etc.
706. A key role in prevention of corruption is attached to the following basic provisions reflected in the RA Government program:
- 1) Elimination of factors contributing to corruption in state structures and society, increase of transparency of anticorruption activities with a special emphasis on the priority nature of preventive measures to combat corruption;
  - 2) Gain trust of each member of society towards public institutions through better accountability, transparency and responsibility.<sup>77</sup>

## **34.2. CRIMINALIZATION**

707. The main intention was to bring the corruption crimes envisaged by the Criminal Code of Armenia in line with the requirements of international treaties.
708. As a result of legislative changes, the provisions of the Criminal Code of Armenia fully reflect corruption related crimes stipulated in the relevant international documents.
709. The fight against money laundering and terrorism financing has made significant progress. In particular, in 2008 Armenia adopted the Law on Fight against Money Laundering and Financing Terrorism, based on which the relevant effective institutional mechanisms were established and developed.
710. In recent years, anticorruption measures mainly aim at eliminating corruption in contacts between the state and citizens. This direction remains to be a priority.

## **34.3. EXISTING ISSUES AND FUTURE STEPS**

711. Measures for enhancing the efficiency and transparency of administrative procedures will be consistently implemented.
712. Reforms of the Notary Public and the system for registering civil status acts are underway. Radical measures for fighting corruption in the state governance and a number of other sectors of public life will be implemented.
713. Reforms of the judicial system are not of less importance and will also aim at fighting corruption in the system. This sector remains to be in the center of attention of the state and it is planned to continue the reforms.

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<sup>77</sup> RA Government Program, May, 2013

714. Additional activities will be implemented to introduce international anticorruption principles and standards in the RA legislation, particularly:
- Illicit enrichment will be criminalized as a corruption criminal offence,
  - Criminal liability will be imposed also on legal persons for corruption-related offences.
715. It is also necessary to study and research the causes of corruption, which will be done periodically in order to better adjust the corresponding policy.
716. The government attaches importance to improving the coordination mechanism for implementation of anticorruption strategy and action plan and enhancing its efficiency, as well as more active participation of the civil society in the coordination and implementation of the fight against corruption.
717. In the nearest future the RA will summarize outcomes of implementation of activities provided for by the 2009-2012 anticorruption program and will correspondingly adopt the new anticorruption strategy, which will have more detailed reflection on approached and activities aimed at prevention of political corruption and particularly election bribes. A special attention will be paid to the transparency and publicity of the financing of political parties.

## XI. BUDGET FRAMEWORK

718. One of the key missions of the strategy is, to the extent possible, match the strategy priorities with budget expenditure priorities within the envisaged resource package.

719. The budget framework designed within ADS will serve as a basis for definition of sector budget ceilings for MTEFs to be developed during the implementation of the program. This will enable on the one hand lay a foundation for ensuring continuation of the policy, and on the other hand, direct medium-term policy towards long-term development goals.

## 35. RESOURCE FRAMEWORK OF CONSOLIDATED BUDGET

720. The main source for expansion of the resource framework during the implementation of the strategy will include tax revenues, which, as a result of implemented activities, will increase in average 0.3-0.4 percentage point of GDP annually, whereas the other revenue items will show relatively stable behavior. At the same time, taking into consideration macroeconomic stability (in particular stability of public debt), it is envisaged to limit borrowings from external and internal sources to the possible extent. In particular, it is envisaged to limit the borrowings by 1.8% of GDP by 2017 and after that period steadily decrease the borrowings down to 1.3% of GDP in 2025.

**Table 45. 2013-2025 consolidated budget resource framework**

	Indicators	2014	2017	2021	2025
		<i>billion drams</i>			
A	Revenues	1,170	1,559	2,477	3,920
A1	Tax revenues	1,120	1,512	2,419	3,845
A2	Official transfers	20	17	15	15
A3	Other revenues	30	30	43	61
B	Borrowings	116	113	164	189
<b>C</b>	<b>Total resource available</b>	<b>1,286</b>	<b>1,672</b>	<b>2,641</b>	<b>4,109</b>
		<i>% of GDP</i>			
A	Revenues	24.9%	25.0%	26.5%	27.9%
A1	Tax revenues	23.8%	24.3%	25.9%	27.4%
A2	Official transfers	0.4%	0.3%	0.2%	0.1%
A3	Other revenues	0.6%	0.5%	0.5%	0.4%
B	Borrowings	2.5%	1.8%	1.8%	1.3%
<b>C</b>	<b>Total resource available</b>	<b>27.4%</b>	<b>26.8%</b>	<b>28.2%</b>	<b>29.3%</b>

721. Given the above said developments the total available resources of the consolidated budget will show continuous growth trend, reaching 29% of GDP at the end of the projected period, which is about 3.5 percentage point higher than the actual rate recorded in 2012.

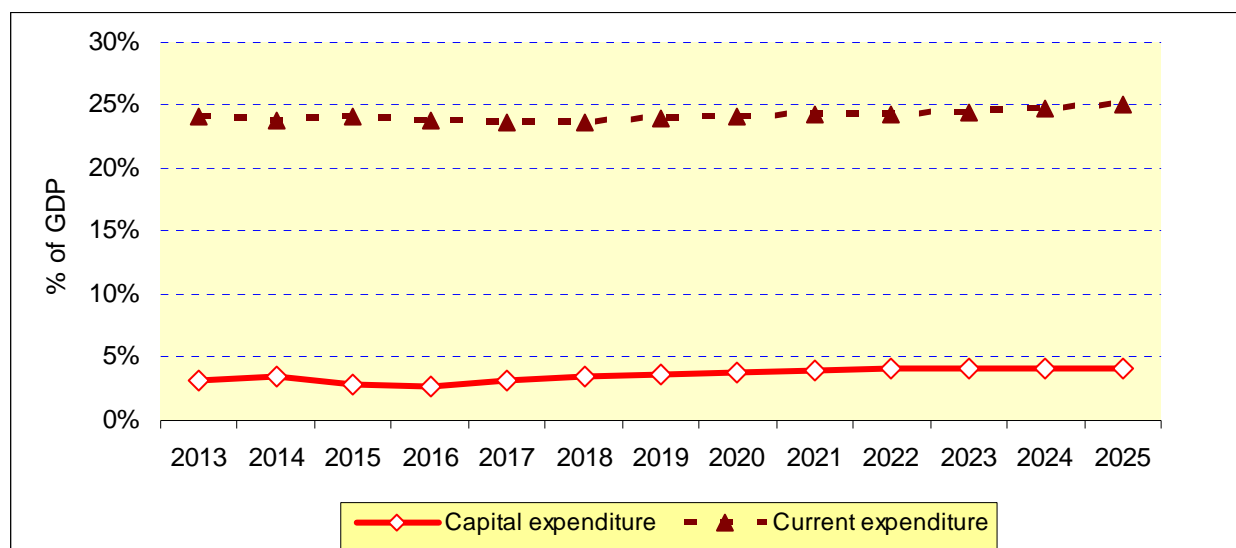
## 36. CONSOLIDATED BUDGET EXPENDITURE FRAMEWORK

722. Public expenditure policy within the forecasted resource package will be aimed at ensuring the priorities and goals defined by the strategy with direct or solicited impact mechanisms.

723. An accelerated growth of consolidated budget expenditure in GDP is planned for 2014-2025<sup>78</sup>, which will result in increase of the consolidated budget expenditure-to-GDP ratio by around 2.5 percentage points, totaling 29.3% in 2025.

724. The share of capital expenditure in total expenditure during the whole programming period will be 12-14% and will be relatively high (around 3-4.2% of GDP). It will be directed mainly at the following 3 priority directions: infrastructures (including drinking water and irrigation systems and road network), defense and social services (including health and education).

**Figure 23. Consolidated budget expenditure by main economic item (2013-2025), % of GDP**



725. Table below presents breakdown of consolidated budget expenditure by aggregated groups of expenditure in functional classification.

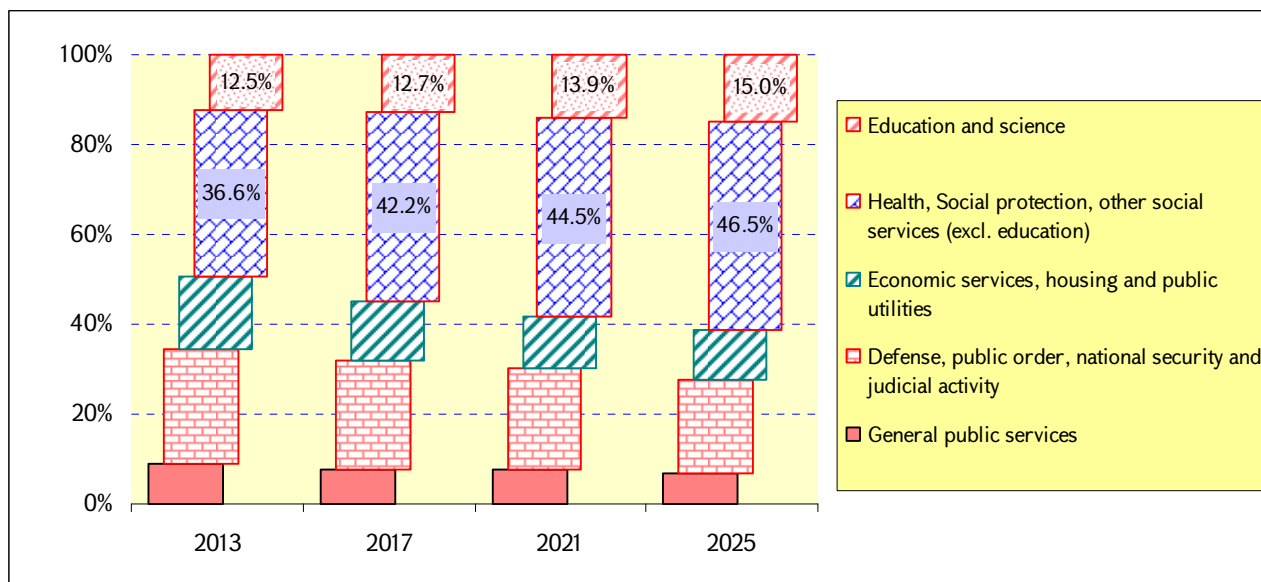
**Table 46. 2014-2025 consolidated budget expenditure by main function**

	Expenditure directions	2014	2017	2021	2025
	<i>% of GDP</i>				
	<b>Total expenditures</b>	27.4%	26.8%	28.2%	29.3%
<b>A</b>	<b>General public services</b>	4.2%	3.9%	4.0%	4.0%
	<i>Including: public debt service</i>	1.3%	1.3%	1.4%	1.5%
<b>B</b>	<b>Defense, public order, national security judicial activity</b>	5.9%	5.9%	5.7%	5.5%
<b>C</b>	<b>Economic service</b>	2.6%	2.7%	2.4%	2.4%
	Agriculture, forestry, fishing and hunting, environmental protection	0.9%	0.9%	0.8%	0.8%
	Transport and communications	1.8%	1.5%	1.4%	1.4%
	Other economic services	0.2%	0.3%	0.3%	0.3%
<b>D</b>	<b>Housing and public utilities</b>	0.7%	0.5%	0.5%	0.5%
<b>E</b>	<b>Social services</b>	13.2%	13.1%	14.6%	15.9%
	Social protection	7.8%	8.0%	8.3%	8.7%
	Health	1.7%	1.8%	2.2%	2.7%
	Education	3.1%	2.8%	3.3%	3.7%
	Other social services	0.6%	0.5%	0.5%	0.5%
<b>F</b>	<b>Science</b>	0.3%	0.3%	0.3%	0.3%
<b>G</b>	<b>Non-classified expenditure</b>	0.6%	0.4%	0.4%	0.4%
<b>H</b>	<b>Non-distributed expenditure</b>	0.0%	0.0%	0.5%	0.4%

<sup>78</sup> During the program period the consolidated budget expenditure will increase by 7-8% annually in real terms.

726. Though both nominal and real growth is envisaged for all aggregated groups of expenditure by functional classification (including general and economic services) during projected period, nevertheless social services (particularly social protection, health and education) related expenditures will increase at higher speed resulting in increase of social expenditure share by about 14 percentage points in the non-interest expenditure of consolidated budget (Figure 24).

**Figure 24. Structure of consolidated budget non-interest expenditure by main function in 2013-2025, % of total non-interest expenditure**



Note: Total expenditure are considered excluding interest payments, VAT refunding expenditure, non-classified and non-distributed items.

### 37. POSSIBLE REALLOCATIONS AND ADDITIONAL FINANCING REQUIREMENT

727. Forecasts and targets defined in the first two sections of this chapter were made under a base scenario. However, if additional financial resources are available (both external and domestic sources) reallocations may be possible within the budget expenditures, aimed at funding additional expenditures estimated in a number of areas, which is particularly the result of the 2009-2010 financial downturn impact on public expenditures behavior.

728. According to estimates, in 2015-2025 compared with the base scenario, annual additional funding for total expenditures varies around 3-4.5% of GDP, the breakdown of which by year and aggregated directions is presented below table.

729. The three possible sources to meet the need of additional funding include:

- 7) In medium- and long-term perspective ensuring additional revenues from domestic sources due to additional efforts in the field of macroeconomic developments and tax policy;
- 8) Cross-sector reallocations within the base expenditure framework directed to sectors/programs in need of additional funding; and
- 9) Involvement of additional funds from external sources in form of grants and loan and credits.

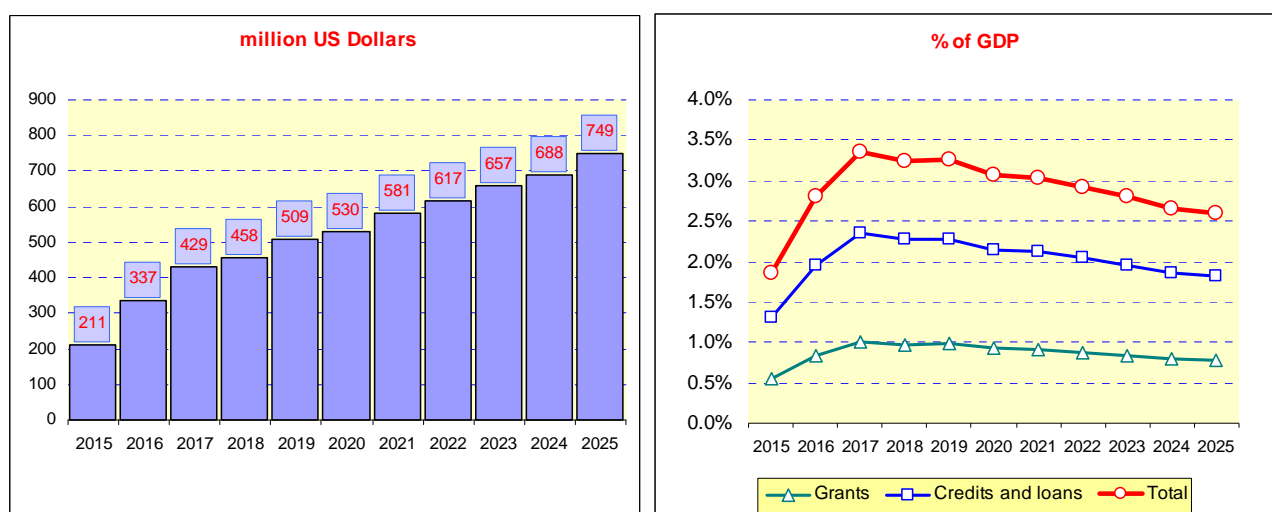
**Table 47. Estimated additional funding need compared with the base scenario by expenditure main function, % of GDP**

	Total additional funding needs	Social services			Infrastructure				Public administration
		Total	Education	Health	Total	Transport	Energy	Other economic	
<i>% of GDP</i>									
2015	2.9%	1.9%	1.2%	0.8%	0.6%	0.0%	0.4%	0.2%	0.3%
2016	3.8%	2.1%	1.1%	1.0%	1.4%	0.4%	0.8%	0.2%	0.3%
2017	4.6%	2.1%	1.2%	0.9%	2.2%	0.4%	1.6%	0.2%	0.3%
2018	4.4%	2.1%	1.1%	1.0%	2.0%	0.4%	1.4%	0.2%	0.3%
2019	4.5%	2.3%	1.2%	1.1%	1.9%	0.4%	1.3%	0.2%	0.3%
2020	4.5%	2.4%	1.2%	1.2%	1.8%	0.4%	1.2%	0.2%	0.3%
2021	4.4%	2.5%	1.2%	1.3%	1.6%	0.4%	1.0%	0.2%	0.3%
2022	4.3%	2.5%	1.1%	1.3%	1.5%	0.4%	0.9%	0.2%	0.3%
2023	4.4%	2.6%	1.1%	1.5%	1.5%	0.4%	0.9%	0.2%	0.3%
2024	4.2%	2.6%	1.0%	1.6%	1.4%	0.4%	0.8%	0.2%	0.3%
2025	4.2%	2.6%	0.8%	1.8%	1.3%	0.4%	0.7%	0.2%	0.3%

730. Taking into consideration the restrictions in expansion of internal revenues and cross-sector reallocations within base scenario budget framework, these sources, according to estimates, can cover only 30-40% of the additional expenditure need (annually in range of 1-1.5% of GDP), whereas 2-3% in GDP additional resources per annum from external sources is considered the main source for meeting additional expenditure needs.

731. In the midterm perspective it is expected to satisfy the 30% of demand for additional external resources in form of grants and the remaining 70% in form of borrowings. Nevertheless, possible decrease in the share of grant component of external funding sources has been considered for the last years of the programming period<sup>79</sup>.

**Figure 25. Estimated additional external funding need compared with the base scenario**

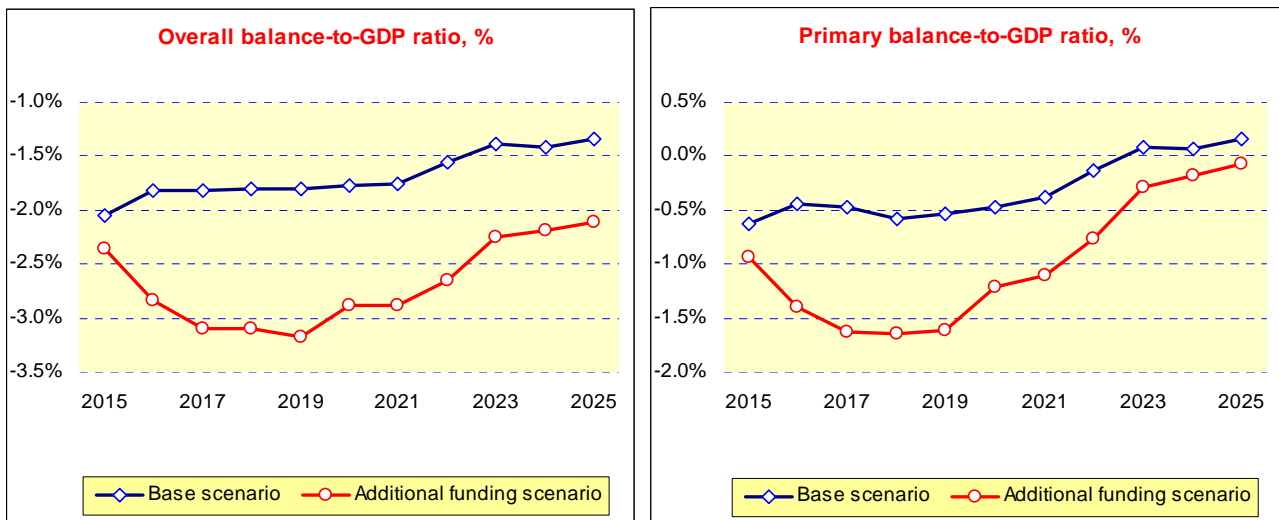


732. Under the additional funding scenario, the overall balance of the consolidated budget, being negative, expressed in absolute ratio of GDP in the medium-term will be higher by 0.5-1 percentage point that in case of base scenario. At the end of programming period this difference is mainly explained by expenditures related to servicing additional external

<sup>79</sup> When considering demand for additional external financing and its structure under additional funding scenario limitations to ensure stability of public debt has been taken into account.

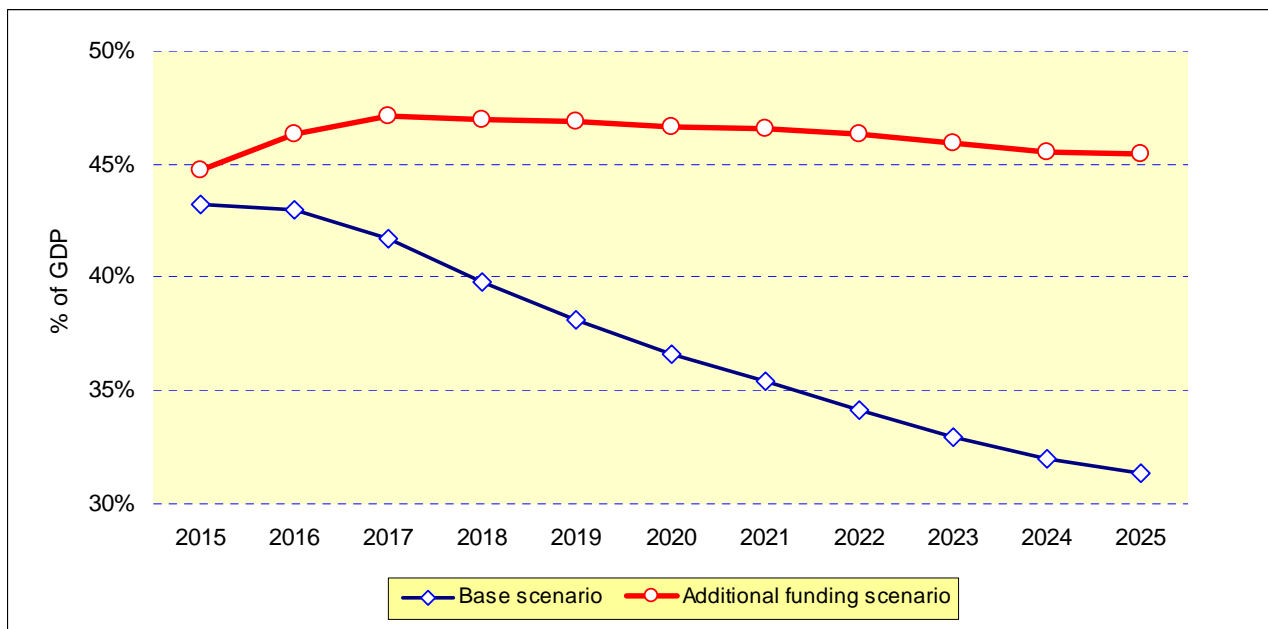
borrowings. This is particularly evidenced by the fact that in case of considered both scenarios the deviations in primary balances<sup>80</sup> of consolidated budget will be reduced more quickly and at the end of program period in both cases the primary balance will close to zero.

**Figure 26. Consolidated budget balance: base and additional funding scenarios**



733. Under the additional funding scenario, compared with the base scenario, the public debt burden will increase, while staying within the acceptable limits. Particularly during 2022-2025, interest payments on public debt-to-GDP ratio will increase by 0.5 percentage points, and the public debt-to-GDP ratio by 12-14 percentage points compared to corresponding indicators under the base scenario. Nonetheless, within the additional funding scenario public debt –GDP ratio will stay below 50% throughout the entire projected period.

**Figure 27. Public debt: base and additional funding scenarios, % of GDP**



<sup>80</sup> Overall balance excluding interest payments.