

## IDA AT WORK

## Armenia: Laying the Foundations for Sustainable Development

Over the past two decades since the collapse of the Soviet Union, Armenia's economic transformation has been profound. The economy today is market oriented and highly receptive to trade, capital, and technological innovation. From the late 1990s to 2008, gross domestic product (GDP) expanded by double digits, and Armenia now ranks as a lower middle-income country. As a result of sustained growth, ambitious reforms, and external inflows of capital and remittances, poverty plunged from over 55 percent of the population at the start of the transition to less than 28 percent in 2009. The poverty impact of the World Bank Group's activities in Armenia is difficult to underestimate. The International Development Association (IDA) has played a crucial role in reducing poverty by providing interest-free loans and grants for programs that boost economic growth, reduce inequalities and improve people's living conditions. The large share of infrastructure projects (mostly in IDA-terms) helped not only to improve access to markets and reduce the associated costs and time, but also created new jobs and offered incomes to many employees. IDA investments in the health and education infrastructure made an additional contribution to the reduction of non-income poverty by easing the access to basic social services for the poor and vulnerable.

### Challenge

The central challenge today for the government is to mitigate the economic and social impacts of the global crisis, which are likely to persist for some time, while persevering with the policy and institutional reforms that will be essential for recovery and long-term development. In addition to confronting these challenges, Armenia

needs to create new opportunities for development in the post-crisis period. The government has employed counter-cyclical macroeconomic policies within prudent limits, including actions on both the monetary and fiscal fronts, namely exchange rate depreciation, scaling back and re-directing public expenditure towards social protection and rapid infrastructure operations aimed at safeguarding or creating employment. The government has also been easing credit constraints on small and medium-sized enterprises (SMEs) by providing credit lines through banks.

Armenia has avoided the temptation to adopt a protectionist stance, as this would undermine economic recovery and growth in the post-crisis period. Moving forward, Armenia needs to address the fiscal consolidation challenge, since the limited tax base and escalated tax burden necessitate fiscal adjustments for the medium to long term. Bolstering financial stability is also key. Due to major reforms over the past decade, the liquidity and solvency of Armenia's banking system were strong at the start of the crisis. This strength needs to be maintained through flexible monetary and exchange rate policy, facilitating bank restructuring if needed, enhancing banking supervision, and broadening the reach of financial intermediation. Strengthening preparedness for natural disasters and climate change is another critical issue. Armenia is exposed to the impact of climate change through intensified droughts, but also landslides and hailstorms that affect rural communities and agriculture.

## Approach

The Bank's new Country Partnership Strategy (CPS) has been anchored on the two strategic

objectives of addressing vulnerability (for the short-term) and strengthening competitiveness for post-crisis growth (for the long-term). In the context of the global economic crisis, the World Bank has proposed a series of three annual operations to support Armenia's strategic objectives of addressing vulnerability to the current shocks by protecting the poor and supporting greater human capital development and improving competitiveness by encouraging better governance and fostering a more favorable investment climate.

Armenia was one of the first two countries that benefitted from a special fast track facility set up by the World Bank Group to help the world's poorest countries cope with the impact of the financial crisis. The World Bank's Board of Executive Directors has approved a package of three operations—the Lifeline Roads Improvement Project (LRIP), the Additional Financing for the Social Investment Fund (ASIF), and the Additional Financing for the Rural Enterprise and Small Scale Commercial Agriculture Development Project (RESCAD)—which helped Armenia mitigate the impacts of crisis on the country's economy and the well-being of its population. Investments included infrastructure (drinking water, gasification, anti-hail stations, irrigation and sewerage) and income generation (agricultural machinery, rural bus service, milk collection coolers, flour mills).

## Results

IDA's impact in Armenia has been felt across many sectors:

- Two dam safety credits (totaling to US\$33.3 million) helped to bring 71 irrigation dams in need of intervention to international safety standards and reduced the risk of

dam failure and flooding for about 500,000 people living downstream.

- A total of 160 km of lifeline roads have been rehabilitated with creation of over 12,000 person-months of employment in the most affected rural areas.
- Community-based economic development with around 165 subprojects supporting priority development and investment plans in 141 village communities have been supported through RESCAD.
- A total of 156 community infrastructure micro-projects are already completed under ASIF and have created 406,150 person days of employment and US\$6.59 million in wage income.
- With support from IDA, the government initiated reforms in the irrigation sector, including establishment of 44 Water Users Associations (WUAs). The Armenian experience in this regard is considered one of the most successful in the Commonwealth of Independent States (CIS) as well as in the Europe and Central Asia region. So far, the irrigated area increased by about 16 percent (from 112,000 ha in 2004 to 130,000 ha in 2009) and areas with high value added irrigated crops increased by about 20 percent (from 55 percent to 75 percent of irrigated hectares cultivated over the number of all irrigated hectares), contributing to an increase of the farm income by 30 percent on average. In addition, cost recovery rate of all Operation and Maintenance (O&M) expenses over O&M needs increased from 8 percent in 2001 to 45.2 percent in 2009, at the same time the quantity of electricity consumed per ha (kWh/ha) decreased from 2,240.8 kWh/ha to 1,712,7 kWh/ha.
- Rural development projects have strengthened applied agricultural research from 400 small farms; extended rural finance (in total US\$36.5 million for two credit projects) to over 17,500 under-served rural enterprises and farms; helped community groups implement proposals aimed at improving competitiveness; strengthened veterinary services; and piloted provision of extension services by private providers.
- The urban heating project has fostered the use of safe, affordable and clean heat supply for urban multi-apartment buildings and schools. By providing heating for some 106 schools, IDA has enabled many schools in remote areas to eliminate idle school days throughout the winter season. Also, 8,200 urban poor households finally received clean heating.
- IDA project financing and policy advice have helped Armenia shift from public to private sector management of Yerevan's water supply system. The government adopted a management contract and later fully transferred the system to a long-term private lease operator. Metering is nearly universal, collections have quadrupled from a low base of only 20 percent, service has improved since the duration of water supply has increased to 21.5 hours from 17.4 hours, and energy consumption has been reduced from 119 MWh at baseline to 24 MWh now (exceeding end of project target: 50 MWh).
- Rehabilitation and private management of water systems was supported outside the capital city, including the cost of the management contract, monitoring of contractor performance commitments, and financing of essential investments in

the service areas of the two largest water utilities of the country.

- Through the IDA-supported health reforms (three credits totaling US\$51 million), the allocation of public resources to health also rose from 1.2 percent in 2003 to 1.6 percent in 2010 (with high GDP growth, these increases have actually produced a substantial jump in absolute levels of expenditure). The gap in access of the poor to the basic health system has improved: for the period from 2006 to 2008, the difference in utilization of essential health services between richest and poorest quintiles of population decreased from 25.8 to 21.9 percentage points. Informal payments for the essential health services have been reduced from 60 percent in 2005 to 50.9 percent in 2008. Life expectancy, an indicator of overall health status, rose from 66.4 years in 2000 to 73 years in 2009.
- IDA assistance to Armenia has helped to design and strengthen a basic social protection system. The household surveys reveal the following results:
  - Overall, social protection programs have covered 97 percent of the poorest 20 percent of the population and 82 percent of the poor in 2009, an increase of 14 percentage points from the coverage rate in 2007. Although not an anti-poverty program, pensions cover a significantly large share of the poor (75 percent) and the extreme poor (91 percent), both significant improvements over pre-crisis coverage rates.
  - The family benefit (TSA) program has been well targeted and has played a major role over the last decade in reducing poverty generally and extreme

poverty in particular; it achieved a better targeting performance in 2009, about 61 percent of the resources went to the bottom quintile, making it one of the well-targeted programs in the region. About 70 percent of the resources accrued to the poor in 2009 compared to only 48 percent in 2007.

- There has been improved administration of pensions and those social assistance programs that have not been folded into the TSA.
- Up-to-date labor information has improved the functioning of a network of employment offices.
- A community-driven development program managed by the ASIF has helped to engage the poorest populations in tackling local issues.
- A well-trained, competent National Statistical Service able to use international best practice in monitoring and analyzing trends in household poverty has provided important inputs into social protection planning and implementation.

## **IDA Contribution**

As of December 31, 2009, the IDA/IBRD portfolio of active projects in Armenia consists of sixteen projects with a total commitment of US\$429.9 million of which US\$172.3 million is undisbursed (twelve IDA credits, including a Global Environment Facility (GEF) operation, three IBRD loans, and a Geothermal Energy Development Program (Geofund) Project). The projects address needs in various sectors including roads, energy, education, health, irrigation, rural development, public administration, and judiciary. The Bank also provided programmatic poverty and Public Expenditure Review (PER) support, including

support to the government in preparing a Public Expenditure Financial Accountability (PEFA), as well as financial sector advisory technical assistance.

Since the start of transition in 1991, IDA has provided about US\$1.2 billion to Armenia to support 51 projects. Armenia consistently ranks among the top performing countries in IDA's portfolio, measured by the IDA Performance-Based Allocation system. In 2008, Armenia also became eligible to begin borrowing from the International Bank for Reconstruction and Development (IBRD) and in March 2009 arranged an initial loan from IBRD to support SMEs facing credit constraints due to the global financial crisis. IBRD eligibility is a sign of Armenia's development success. The Country Partnership Strategy (CPS) provided for new IDA/IBRD lending of US\$545 million over fiscal years 2009-12. The CPS was frontloaded for both IDA and IBRD financing with the aim of mitigating the impact of the financial and economic crisis.

## Partners

Over the years, many donors have decentralized greater responsibility to their local country or regional offices. The Bank's Regional Director for the South Caucasus is now located in Georgia, and the Country Manager in Armenia participates in or chairs local donor meetings on a wide range of topics. IDA also joined forces with the United Nations Development Programme (UNDP) and other donors to support the government and local stakeholders as they prepared Armenia's first Poverty Reduction Strategy Papers (PRSP) and the follow-on Sustainable Development Strategy.

These consultative efforts helped promote dialogue and build consensus on medium and longer-term strategic goals. They also produced a framework within which Armenia's partners could support national development priorities. A number of donors (Japan, the United Kingdom, Netherlands, Sweden and the European Union (EU)) have channeled grant resources through Trust Funds managed through IDA. Partnership with the International Monetary Fund (IMF) has been close in the area of economic advice and policy-based lending. IDA and the Asian Development Bank (ADB) coordinate their transport, water and policy-based lending. The European Bank for Reconstruction and Development (EBRD) has co-financed IDA's renewable energy project with US\$7 million and the two agencies maintain a close relationship in water, financial and private sector development. The EU and IDA have provided complementary support to Armenia on judicial modernization through a grant from the Netherlands government in the amount of US\$4.9 million; from Germany in municipal infrastructure and SME development; the U.S. Agency for International Development in the financial sector, tax administration, social protection, and SME development; and the Millennium Challenge Corporation in irrigation. The Netherlands has also co-financed IDA policy-based lending; and the Russian Federation has provided additional financing to help Armenia to mitigate impacts of the global economic crisis. The major reason for the successful results of World Bank support, however, has been the close cooperation with the Armenian government. "The World Bank has been a reliable and trusted partner in our efforts to build a more diversified and competitive economy," according to Armenia's Prime Minister in February 2009.

## Moving Forward

In view of the global economic crisis, IDA/IBRD will continue supporting the government's two strategic objectives of (i) mitigating Armenia's vulnerability to the shocks and (ii) strengthening competitiveness for post-crisis recovery and growth over the medium term. To mitigate vulnerability, the Bank's further support will be centered on managing the impact of the crisis by maintaining a sound macroeconomic and fiscal framework while protecting the poor; and strengthening the management of education, health, and social protection programs. To strengthen competitiveness for recovery and growth, the Bank will assist the government in improving economic competition and the business climate; strengthening the regulatory environment in

infrastructure; improving competitiveness through the sustainable use of energy and natural resources; and improving public sector efficiency and effectiveness.

### Beneficiaries

For Rima Avanesyan, 68, a single pensioner living in an old hostel in a Yerevan suburb, the gas heater has been a long-awaited gift. "I had no heating whatsoever in the past. As a pensioner I couldn't afford the high cost of electrical heating—the only time I used it was to cook food or make tea, no more. Now I use my gas heater when I need it, and it has so far cost me about 4,000 drams (US\$10) a month. I am very grateful for this. And, you know—the attention and nice treatment I received from the project people [Renewable Resources and Energy Efficiency Fund] means a lot more to me—they have warmed my heart just like this heater warms my apartment."

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<http://www.worldbank.org/ida>