

**GOVERNMENT
OF THE
REPUBLIC
OF ARMENIA**

**SOCIAL AND
ECONOMIC POLICY
IMPLEMENTATION
PROGRESS**

in 2004

**YEREVAN
2005**



The booklet before you is an overview of the social and economic policies implemented by the Government of the Republic of Armenia during 2004 and their outcomes, which are annually presented to the Government by ministries and other public agencies in the form of detailed reports.

This booklet is available online
in the official website of the Government (<http://www.gov.am>).
The detailed reports of ministries and other public agencies can be found
in their respective websites.

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INTRODUCTION

implementation of the 2004 social-economic policy REPORT

In recent years, including in 2004, the Government of Armenia has successfully addressed numerous economic and social issues by means of continuously improving economic and social performance and implementing a policy program designed for the short, medium, and long terms.

Real GDP growth of 10.1 percent in 2004 bears witness to these successes. As a result, real growth of the economy during 2000-2004 averaged 10.5 percent per annum, which is rather high compared to the period in which Armenia has had economic growth. In 2004, due to such economic growth, Armenia's GDP reached 99.6 percent of its 1989 level.

State budget execution discipline has improved considerably. Tax and customs administration improvement, on the one hand, and improved expenditure efficiency, on the other, have minimized the length of time required to disburse expenditures contemplated by law. The execution of Armenia's budget has become less dependent on borrowed resources. The deficit-to-GDP ratio was about 2.3% in 2004, according to some preliminary estimates.

On account of fiscal deficit reduction and faster GDP growth, the Government managed to reduce foreign debt to 32.7% in 2004. The Government has successfully graduated the early repayment of non-concessional external public debt to The European Union and The Russian Federation.

The Government has productively sustained progress under development programs pursued jointly with international financial institutions, such as the World Bank and the International Monetary Fund. In 2004, the World Bank approved a four-year Country Assistance Strategy for Armenia, which contemplates an increase in the Bank-funded credit portfolio by up to US \$220 million worth of new investment projects over the next four years. The Poverty Reduction and Growth Facility implemented with the IMF has been completed successfully, and sufficient prerequisites have been created for the implementation of a new Program.

Reforms in the social sectors have continued. Education and health sector reforms have brought about an increase in the efficiency and targeting of state-implemented programs in such sectors.

The Government's activities in the areas of social security and insurance have focused on increasing the efficiency of scarce budgetary resources and using the available resources to address the most pressing needs of citizens who expect state assistance.

The policies of the Government in various sectors and their outcomes are presented in greater detail below.

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ECONOMY

Implementation of the 2004 social-economic policy

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Consistent implementation of economic policies was sustained throughout 2004. Legislative strengthening was accompanied with improved enforcement. The economic outcome for the year testifies to the success of the Government in overcoming a considerable share of transition economy difficulties.

Several dozen thousand key laws adopted with a view to enhancing the free market have facilitated a greater focus on economic security, active integration with the global economy, and scientific, technological, and innovation development.

Armenia's accession to the World Trade Organization (WTO) in 2003 has furthered its integration with the international economic system, which has been conducive of legislative harmonization with the international standards and best practices. Such harmonization, in turn, has been a major incentive for increased foreign investment attraction with a view to boosting economic activity in the country.

In this respect, it is worth mentioning that under the respective assessment of economic freedoms, Armenia is number 42 out of 155 countries, and is classified as a "broadly free" economy.

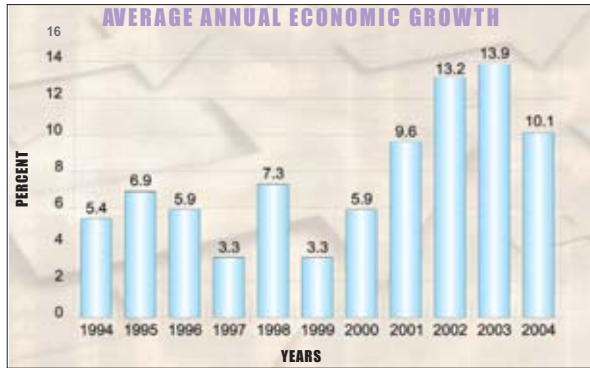
The privatization of applied science and research institutions has begun and is currently underway. This process will support the entry of the private sector into science and technology, which will improve efficiency in these areas.

In 2002, the Government of Armenia proclaimed the science and technology development priorities of Armenia. In 2004, a Concept Note on Innovation Activities in Armenia was drafted, which laid down the innovation policy principles pursued by the Armenian Government. Based on this Concept Note, the adoption of a Law on State Support to Innovation Activities in the Republic of Armenia in the near future will facilitate the formation of a knowledge-based economy.

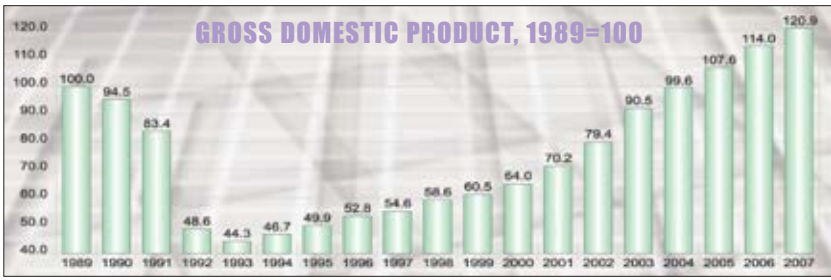
It can be concluded that economic reform, which has been underway for over a decade, has laid the groundwork for sustainable progress towards improving the living standards of Armenia's population.

In other words, the challenge at this last stage of transition is changing from one of structural reform to one of sustainable development.

Robust economic growth sustained in 2004 supports this assertion, in furtherance of the developments of previous years. During the period from 2000 to 2004, economic growth was twice as high as that in the previous five years. During 2000-2004, annual economic growth averaged 10.5 percent.



In 2004, the GDP reached 99.6 percent of its 1989 level. In 2005, it will exceed the 1989 level.¹ In 2004, per capita GDP was about US \$1,100.



In recent years, macroeconomic policies have focused on sustaining high economic growth, stabilizing price changes, developing the private sector, and creating equal conditions for competition and a favorable climate for investment.

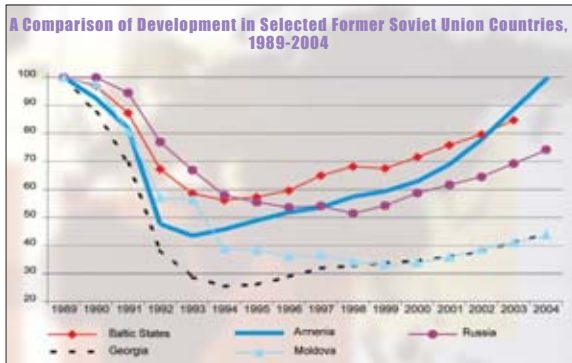
¹ Eight percent GDP growth is projected in Armenia for 2005.

The public-private dialogue, which is a key prerequisite of improving the business and investment climate, is effectively taking place.

The Business Support Council created in 2000 and led by the Prime Minister comprises representatives of both government and the private sector, including SMEs (at present, 44 businessmen are represented in the BSC). During the period from 2000 to 2004, the Council has reviewed numerous issues related to business climate improvement and has resolved disputes in areas such as tax and customs administration, among others.

Compared to the former USSR countries, Armenia's GDP performance in 2004 was quite impressive². In the years ahead, improving income distribution equity will be a priority.

The economic and fiscal sector policies have had a direct bearing in terms of increased household income. In 2004, the average salary was about 42,000 drams. During the year, salaries in the budgetary sector grew faster than those in the private sector (budgetary sector salaries grew by 20.5 percent in 2004 compared to 2003). As a result, the average annual increase in household income during the period from 2000 to 2004 amounted to 13.6 percent (in 2004—16.8%).



² Official growth figures of the Baltic States for 2004 are not available yet, but according to our estimates, their GDP growth will not exceed 7.3 percent. This growth in 2004 would bring the GDPs of the three Baltic States to about 90% of their 1989 respective levels.

Investments

Sustained investment growth is the collateral of economic development. Foreign investment is decisive for maintaining robust economic growth in Armenia. Therefore, foreign investment promotion has been a core aspect of the Armenian Government's investment policies.

As a result of the investment policies implemented by the Armenian Government, the volume of foreign investment in Armenia during 2000-2003 and the first nine months of 2004 amounted to US \$935.5 million, of which direct investment—US \$605.9 million. During the period from 2000 to 2004, the average annual increase in foreign direct investment was about 20%.

This increase is facilitated, among others, by public investment projects in key sectors of the economy, such as transport infrastructure, the irrigation network, and the like. In 2004, public investments were about 74.7 billion drams, focusing mostly on infrastructures, including the transport infrastructure and irrigation network, as well as capital renovation of schools. The policy of attracting foreign direct investment by means of privatizing state-owned enterprises has remained important.

The scope of Mutual Investment Protection and Promotion Treaties has been expanded considerably (to date, 31 such treaties have been signed with various states).

Savings in Armenia's economy are still insufficient to support an abrupt increase in the volume of investment and to create sustainable domestic sources of economic growth. Moreover, macroeconomic stability and reduced country risk have laid the groundwork for a significant increase in investments.



The share of investment driven by domestic savings has increased, as illustrated by the declining share of private and public consumption in GDP. During

the first nine months of 2004, the share of private and public consumption to GDP was 93.7 percent.

In 2004, a Law on Investments was drafted. Its adoption will provide equal conditions for domestic and foreign investors and shape a stable and predictable investment and business climate.

Privatization and Management of State-Owned Assets

The policies of the state have been anchored in supporting private ownership and enhancing its role in economic development. Expanded domestic and foreign direct investment and facilitated entry of such investments into new sectors of the economy has been the main strategy underlying the Government's privatization policies in recent years.

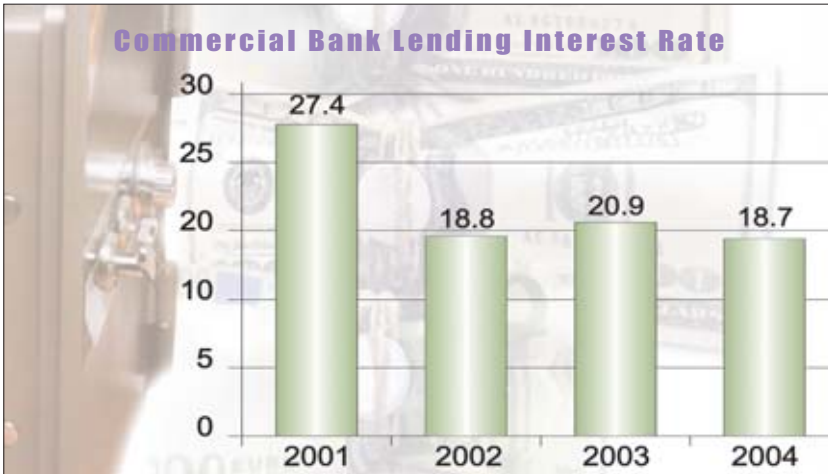
One of the achievements supported by privatization has been the increased share of the private sector in the GDP during 2004 (to more than 80% of output), owing to consistent efforts aimed at the attraction foreign and domestic investments and to an increase in the number of privately-owned companies.

As a result of the 2004 privatization process, the Government is monitoring 136 privatization and sale agreements laying down investment obligations and social guarantees.

During 2004, measures were taken to enhance the privatization and management of state-owned assets and the procedures of liquidation and bankruptcy. Legal acts were adopted to regulate both the privatization of moveable assets transferred to public administration institutions as the state's share in liquidated companies, and the valuation of unfinished construction facilities that had no book value. Financial and economic monitoring and the management of state-owned assets have been improved.

Interest Rates

The key to increased long-term investments is reduction of risks in the economy, which is mainly reflected in interest rate changes. T-bill interest rates continued to fall in 2004, reaching 9 percent.



This factor caused loan interest rates to fall during 2004. Commercial bank lending interest rates fell to 18.7 percent in 2004, which had a direct positive bearing on the investment climate.

Exports

Further integration with the international economy is an important precondition of Armenia's economic growth. WTO accession has guaranteed non-discriminatory treatment of Armenian goods and services in over 140 countries. This development, expressed most notably in the form of higher exports from Armenia, has been a crucial component of economic growth and increased household income in recent years.

Growth in net exports has been notable, due to both import substitution and export promotion.

Though exports of goods grew by 4.3 percent in 2004 compared to 2003, exports net of precious and semi-precious stones, metals, and jewelry grew by about 24 percent during the same period.



Small and Medium-Sized Enterprise

Small and medium-sized enterprise support has recently become a structured activity in Armenia, enshrined in the Poverty Reduction Strategy Paper and reflected in the social and economic policies of the state. Public investment in this sector remains far from adequate; however, the desirable magnitude of state support can be achieved by means of, first of all, strengthening institutions and mechanisms for channeling the support to comply with the needs of each and every SME.

The volume of state support to SMEs in the form of Annual SME Support Programs grows from year to year. To this end, certain measures have been taken during the period from 2000 to 2004 to provide business consulting to SMEs, to facilitate the introduction of innovation and state-of-the-art technology, to support access to finance, to ensure the implementation of quality control systems, and to guarantee access to assistance rendered by various public and non-public agencies. In 2004, over 4,500 SMEs enjoyed this type of support in Yerevan and other parts of Armenia during 2004 alone.

The state budget disbursed 234 million drams in 2004 for implementation of the 2004 State Program for SME Support. The 2005 state budget contemplates the allocation of 300 million drams for the Program in 2005.

In view of the importance of increasing access to state support for SMEs in the regions, the Government took a number of decisions in 2003 and 2004 on the creation and expansion of regional centers for SME support.

Public agencies were taken closer to the beneficiaries, which was designed to improve access to SME support services.

The Government's policies on SME state support have been reflected in the introduction of what is a favorable tax framework for SMEs.

Thanks to the creation of favorable legislation and infrastructures for SME activities and the implementation of comprehensive measures aimed at their development, general economic development has been accompanied with a considerable qualitative and quantitative increase in the share of the SME sector. In 2004, the SME sector contributed 39% of the GDP, which was about twice as high as the 2000 level.

During the last three years, about 20,000 SMEs have been created. In 2004 alone, according to some preliminary estimates, about 8,500 new SMEs with over 21,000 new jobs were created.

In general, over 70 percent of the measures contemplated under the 2004 SME State Support Program focused on increasing economic and business activity in the regions.

Comprehensive programs and activities aimed at sustaining and expanding SME development and state support to the SME sector are a necessary prerequisite of economic growth, job creation, improvement of the social situation, and poverty alleviation.

Tourism

In recent years, tourism has been a dynamically developing branch of the Armenian economy, which is confirmed by statistics. Incoming tourism has grown at 25-30 percent per annum starting from 2001.

The data collected suggests broadening of the geographic scope of inbound tourism. The vast majority of those visiting Armenia are from the following regions: the EU (30.2%), the USA (23.3%), the CIS (22%), and the Middle East (9.2%).

Inbound tourism growth has been coupled with dynamic

growth in domestic tourism, which grew by 12.8% during the first nine months of 2004 compared to the same period in 2003. Tourism is a key sector in terms of share in GDP and service exports. During the period from 2001 to 2004, tourism revenue crossed the line of 250 billion drams.

In recent years, the legal foundation has been laid for regulating the relationship between tourism industry beneficiaries, introducing quality standards in accommodation, and properly marketing Armenia's tourism product. Sharp increases have been reported in the quality and quantity of hotel, restaurant, transport, entertainment, and culture infrastructures and intermediary services related to tourism products.



Information Technology

The IT sector has broadly maintained its pace of growth.

As of 2004, about 140 enterprises were active in the IT sector. About 200 new jobs were created in the IT sector during 2004. The IT sector's share in GDP reached 1.7% (compared to 0.35% in 2001).

Activities in this field (including trade shows, contests, and conferences) have focused on expanded production, export promotion, IT integration with other sectors of the economy, capacity assessment and training of young experts, furthering innovation, and investment attraction.

The Law on Electronic Documents and Electronic Digital Signatures, which was submitted by the Republic of Armenia Government, was adopted in 2004.

Standardization, Measurement, and Conformity Certification

During 2004, activities in this field have mostly focused on legislative streamlining and harmonization with the respective EU directives in the areas of standardization, measurement, and conformity certification.

Some fundamental laws regulating standardization, measurement, and conformity certification were adopted, including the Law on Standardization, the Law on Unified Measurement, and the Law on Conformity Assessment. Clear regulatory procedures in the areas of standardization, measurement, and conformity certification have been introduced.

With a view to honoring WTO accession-related commitments, wide-scale activities have been undertaken to draft technical regulations on security of goods and services.

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AGRICULTURE, CONSTRUCTION, AND SERVICES

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Real growth in the agriculture sector was 14.5 percent in 2004; construction grew by 13.4 percent. Transport and communication services grew by 17 percent, while trade and public catering grew by 10.5 percent. In terms of contribution to GDP growth, the role of agriculture and services was significant in 2004: 7.4 percentage points of the 10.1 percent economic growth was due to agriculture and services. During the period from 2000 to 2004, average growth was 6.6 percent in the agriculture sector and 9.8 percent in the service sector.

During the period from 2000 to 2004, average annual growth in the construction sector was 26.6%. As a share of GDP, construction grew from 10.3 percent in 2000 to 15.3 percent in 2004.



BUDGETARY SYSTEM

Implementation of the 2004 social-economic policy

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Fiscal policies have recently focused on maximizing tax collection without increasing the tax burden, avoiding the buildup of new expenditure arrears and clearing the stock of existing arrears, and gradually lowering the state budget deficit.

With the aim of increasing the predictability of the fiscal process, the groundwork was laid for designing medium-term expenditure frameworks and integrating them with the annual budgeting exercise.

The general part of a unified Tax Code of the Republic of Armenia was drafted in 2004 in order to consolidate the extant tax laws and to improve the tax legislation.

The customs legislation has addressed a number of key issues with a view to improving customs administration and creating a favorable environment for importers and exporters. Customs valuation and country of origin determination rules, the provisions on the functions of customs authorities in respect of intellectual property protection, and the main customs procedures have been clarified.

Compared to a 2004 state budget revenue and grant target of 288.7 billion drams, actual performance was 297.9 billion drams. The tax revenue target of 257.0 billion drams was exceeded, and 267.0 billion drams of taxes were actually collected. Non-tax revenues, too, went beyond the target (12.0 billion drams actual compared to a target of 8.5 billion). Grants were below projected-9.7 billion compared to a target of 14.2 billion drams.

In 2004, unlike the past, direct taxes (personal income tax and corporate profit tax) grew faster than total tax revenue: direct taxes grew by over 50 percent, while total taxes grew by 17 percent. At the same time, tax refunds increased (mostly refunds of VAT credits by exporters). During 2004, refunds were 10.5 billion drams, representing a 2.8-fold increase over 2003.

Despite the over-execution of the tax revenue target in absolute terms, the tax-to-GDP ratio remains unsatisfactory. During the last two years, this ratio fell compared to 2002, which was mostly due to higher-than-projected GDP growth. In view of this fact, the Government continues to take measures towards improving tax and customs administration (which will be emphasized during the execution of the 2005 budget). It is planned that in 2005, an increase in the absolute amount of tax collected will be accompanied with the tax-to-GDP ratio exceeding the 2002 level.

Improved efficiency of expenditure management and discipline have enabled not only to avoid the buildup of new budgetary arrears, but also to clear those accumulated in the past. During 2004, expenditures were executed in the periods specified by law, and new arrears were not built up.

In line with the PRSP priorities, social spending grew faster than total budgetary expenditures in 2004. Under the 2004 state budget, social spending grew by 23.8 percent compared to 2003, while total expenditures of the state budget grew by 10.2 percent. Education spending grew by 21 percent compared to 2003, while health spending grew by 27.5, and social security and insurance-by 24.5 percent.

	2002	2003	2004
State budget expenditure increase over previous year, including:	7.9	18.5	10.2³
Education	0.2	19.8	21.0
Health care	1.4	22.8	27.5
Social security and insurance	-8.9	23.0	24.5
Total social sector expenditures	-2.9	21.6	23.8

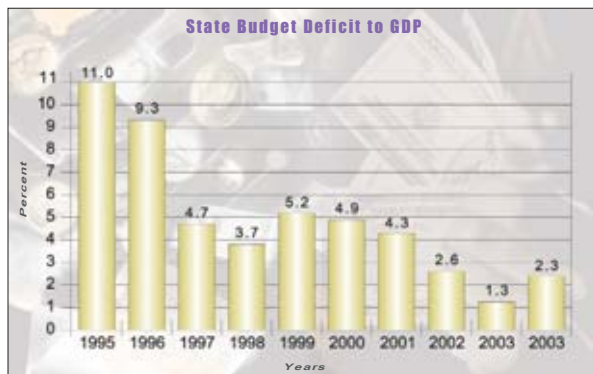
³ The 2004 social expenditure figures represent the targets, rather than actual performance under programs implemented by international financial institutions. Once the actuals are available, these figures will be adjusted correspondingly.

An important achievement of fiscal policies has been, among other, the reduction of the budget deficit to 3 percent of GDP.

Deficit reduction has been coupled with improved public debt management. The foreign debt management policy has

focused on concessional borrowing and early repayment of non-concessional loans.

Public debt reduction in recent years (to reach 32.7% of GDP in 2004) has been an important achievement.



In the frameworks of international financial cooperation, externally-financed loans amounted to 45.7 billion drams (US \$77.5 million) under the state budget law for 2004, of which about US \$52 million were from the World Bank, US \$12.2 million from the German KfW, and US \$8.3 million from the Japanese Government.

Actual disbursements in 2004 were about 45.6 billion drams (US \$87.8 million), including the World Bank's Poverty Reduction Support Credit of about 10.3 billion drams (US \$ 21.2 million—the equivalent of SDR 13.7 million), which was not projected under the 2004 state budget. Though planned in the state budget, the proceeds of the loan supported by the Japanese Government were not received. The German KfW loan disbursement fell short of the target by US \$8 million.

On May 20, 2004, due to the early repayment by Armenia of EUR 7 million (4,649.05 million drams) to the European Union as principal under the "28 million Euro Loan Provided by the European Union", the EU made a 5.5 million Euro (3,621.09 million dram) "Extraordinary Assistance Grant" to Armenia on July 7, 2004.

The state budget for 2004 projected the receipt of grants in the amount of about 14.2 billion drams, of which 9.7 billion drams were received according to preliminary estimates (excluding the Project Implementation Unit data).

During 2004, in the frameworks of the Food Security Program, the EU made a 9.5 million Euro (6,119.4 billion drams) grant available to Armenia in three installments; the third installment (4 million Euros, or 2,594.4 million drams) was received on December 12, 2004.

The legal procedures related to the Dutch Government's Grant planned in 2004 have been finalized, and disbursement is currently expected.

Under loan and grant agreements signed between the Republic of Armenia and foreign states and international financial institutions during 2004, the Republic of Armenia is planning to receive US \$112.5 million⁴ and EUR 40.4 million during the program periods (2004 and beyond).

Different loan agreements contemplate a total of about US \$109 million and EUR 4.7 million, the bulk of which is World Bank loans (about US \$109 million). Grant agreements contemplate about US \$3.5 million and EUR 35.7 million, of which EUR 35.7 million will be the EU's share.

⁴ The projected SDR loan amounts have been revised using the exchange rate effective on February 1, 2005, i.e. 1 SDR equals to US \$1.52.

In recent years, including in 2004, the Government of Armenia has productively cooperated with international financial institutions, such as the IMF and the World Bank.

On May 23, 2001, the Executive Board of the IMF approved the Poverty Reduction and Growth Facility (PRGF) to Armenia. The Program focused on areas such as improved tax and customs administration, further development and strengthening of the banking system, and a number of other measures. As a result of efficient Program implementation, Armenia received the US dollar equivalent of SDR 69 million during the period from 2001 to 2004.

On June 10, 2004, the World Bank Board of Directors discussed and approved the Country Assistance Strategy, which will allow the Republic of Armenia to borrow about US \$170-220 million over the next four years due to recognition of the World Bank's projects as best scenario implementation. It is important also to take into consideration that Armenia's economic performance, balance macroeconomic policies, and continuity of economic reforms due to the implementation of the World Bank's previous Country Assistance Strategy have made it possible for Armenia to be recognized as a best scenario borrower in order for Armenia's access to borrowing to be increased.

The Country Assistance Strategy to be implemented by the World Bank during the next four years has laid down Armenia's long-term strategic development objectives in keeping with the PRSP. Among such objectives is the promotion of private sector-led economic growth, making growth more poverty-oriented, and reducing income poverty.

Positive trends have been sustained in respect of the developments in the T-bill market. During 2004, T-bill yields declined in light of a considerable increase in maturities.

	Maturity of outstanding T-bills (in days)	Yields on outstanding T-bills
2000	152	24.52%
2001	209	20.05%
2002	263	16.43%
2003	353	13.72%
2004	754	9.01%

In 2004, the average maturity of outstanding T-bills was 863 days. Average weighed yields on T-bills placed during the year were 7.32 percent.

During the period from 2000 to 2004, domestic debt could be characterized in the following way:

	Emission (drams billion)	Placement (drams billion)	Deficit financing (drams billion)	Yields on placement (in %)	Maturity of placement (days)
1999	64.85	57.56	0.95	52.64	147
2000	47.23	44.85	1.78	24.82	219
2001	45.20	45.91	5.95	20.94	287
2002	41.94	41.88	3.95	15.72	382
2003	44.20	43.30	2.30	13.44	544
2004	43.9	43.9	5.58	7.32	863

From September 2004, it became possible to start issuing medium and long maturity voucher bonds. The long-term trends that emerged in the years before were sustained in 2004, and 7- and 10-year maturity voucher bonds were issued and placed. The policies planned for 2005-2007, which will aim at extending debt maturity and reducing the cost of debt, are logical follow-up on the debt management strategy applied in 2004.

Farming

In recent years, the Government has focused on the problems of rural areas; everyday efforts in this direction have rendered positive results.

During 2004, activities were implemented to supply high-quality seeds (potato and grains), mineral fertilizer, and plant protection facilities to farms and to organize automated work. As a result, planted agricultural areas reached 318.3 thousand hectares in 2004, compared to 314.6 thousand in 2003.

The establishment of vineyards and fruit orchards has become quite active in 2004, due to the sales of grapes and fruits becoming easier than before and the development of irrigation systems. During 2004, 1,500 hectares of vineyards and about 1,000 hectares of fruit orchards were established. Gross crops of grains were high: improved fertility was the reason for 88.5 percent, and larger planted areas—11.5 percent, of the 146.2 thousand ton increase in grain crops. Vegetable crops grew by 31.3 thousand tons, all of which was due to improved fertility. As for the increase in grape production (67.3 thousand tons), about 73.0 percent of it was by reason of improved fertility.

Considerable work has been undertaken to prevent livestock disease and to improve breeding practices.

The Government and international organizations have supported agricultural risk mitigation and natural disaster consequence management. Major activities have been carried out towards the rehabilitation of the hail protection service: 15 anti-hail stations have been installed in the Aragatsotn Marz, which are currently being tested and will have a positive impact in fighting natural disasters.

With the aim of mitigating the consequences of natural disasters, the Government has provided considerable support to land users who have suffered from natural disasters.

The acquisition of new hardware and machinery has continued with the aim of upgrading and supplementing the agricultural machinery and facilities available in the country. Under a grant program, contracts were signed on importing 2,550 tons of nitric fertilizer, 39 tractors, and agricultural tools. In the frameworks of a charitable project, 51 tractors and agricultural tools and spare parts were imported to Armenia and sold to farms by means of auctions.

Various counseling services were rendered in about 800 rural communities of Armenia throughout 2004, including 834 consultation workshops, 153 field shows, and over 600 different publications on agriculture.

2004

GOVERNANCE

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Public Administration

Recent years' economic and social achievements bear witness to the efficiency of policies implemented in the public administration sector.

Public administration reforms continued to enjoy the Government's attention in 2004. The stage-by-stage restructuring of ministries, agencies, and territorial administration and local self-government bodies has been implemented and continues at present. The adoption of the RoA Law on Community Service is an important achievement, which guarantees the office of community servants regardless of changes in the political authorities and defines competence and experience criteria for appointment to position.

The by-laws of ministries have been clarified. Redundant and atypical functions and units have been identified.

Public administration reforms have focused on strengthening of the policy-making and regulatory functions of public agencies. Inspectorates for Environmental Protection, Labor, and Education have been created.

Much attention has been paid to the quality and accessibility of services rendered by public agencies and to the transparency of their activities. Public relations units created in ministries of Armenia in 2004 were a sound institutional basis for improving cooperation with civil society and citizens.

In ministries and the governors' offices, as well as local self-government bodies, resource/visitors centers will facilitate compliance with the demands of citizens under the laws on freedom of information.

Measures are being undertaken to modernize the system of public administration. The Government of Armenia has approved a World Bank project for Public Sector Modernization, which will allow improving electronic documentation in public administration bodies and the systems of monitoring over execution of decisions. The Law on Electronic Documents and Electronic Digital Signatures, which

was adopted in 2004, provides the legal framework necessary for these activities.

As for improvements in the financial management system, preparatory activities were implemented in 2004 to support, in particular, the introduction of new internal and external audit systems and program budgeting on the basis of medium-term expenditure planning.

During 2004, public administration reforms focused on the achievement of the goals identified in the Anti-Corruption Strategy and the Poverty Reduction Strategy Paper. Notably, the Anti-Corruption Council and the Anti-Corruption Strategy Implementation Monitoring Committee were created, which comprised representatives of civil society, political parties, and the mass media. From 2004, Armenia has been a member of GRECO and the OECD's Anti-Corruption Network of Transition Countries.

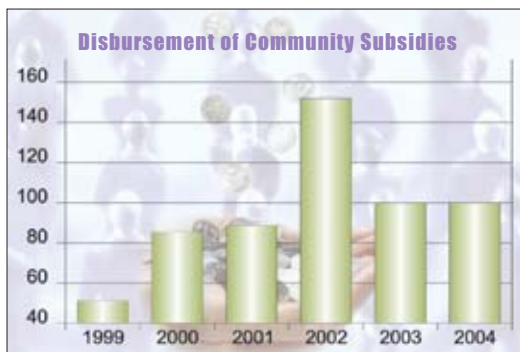
Local Self-Government

Local self-government reforms have been aimed at streamlining the rights and responsibilities of local self-government bodies and creating the prerequisites for development of local self-government.

The mechanisms of estimating and providing financial equalization subsidies and subventions from the state budget have been reviewed and clarified.

Starting from 2003, community subsidy disbursement execution reached 100 percent.

Measures aimed at improving the efficiency of local self-government systems continued in 2004, with a special focus on addressing urgent issues faced by borderline and highly-mountainous settlements.





2004

INFRASTRUCTURES

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Water

Water sector activities have mainly focused on the introduction of metering systems at irrigation and potable water intake and supply points, increasing the length of water supply, improving the quality of water, and reducing system losses.

During 2004, potable water utilities rendered the following services to consumers: 122 million cubic meters of water supply and 88 million cubic meters of water removal. Water user associations created under law rendered 705.1 million cubic meters of water supply services. The total cost of energy consumed in the system (potable and irrigation water utilities) reached 463.2 million kW/h, which was about 170.0 million drams or 8.9 million kW/h less than the cost in 2003.

During 2004, the Arpa-Sevan Tunnel was used to move 260.9 million cubic meters of water to Lake Sevan. As of December 31, 2004, the level of Lake Sevan was 1,897.65 meters, which was 41 centimeters higher than the level of the Lake in 2003.

Long-term reforms are contemplated in the potable and irrigation water sectors, mainly with the aim of enhancing their operational reliability and efficiency, reducing water losses, and improving the quality of water supply and removal services.

Roads

Development of the road network continued with a view to addressing the problem of physical isolation of people and communities. The quality of roads has an impact, among other things, on the costs and speed of doing business (especially for farms).

To this end, capital investments in roads remained a priority in 2004. About 7 billion drams' worth activities were implemented, of which 4.5 billion was funded from the state budget, and 2.6 billion was allocated additionally on the basis of a Government Decree.

A number of projects were implemented during 2004, which supported winter maintenance for 6,150.6 kilometers of national roads, current repairs, the fundamental repairs of 5 bridges and 9 road segments, and design work for community roads.

The additional funds allocated under a Government decree were used to repave the strategic road from Paravakar to Tsaghkavan to Tovuz to Berd and to subsidize road construction in 8 communities.

The World Bank's transport project financed US \$20.2 million worth of activities during 2004. A total of 88.7 kilometers of inter-state roads were repaved and some local roads were repaired as a pilot project.



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SOCIAL SECTORS

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Education

The Government has focused closely on the maintenance and further development of the education system—as the key to international competitiveness of the country. To this end, the path of gradual system reform was chosen.

Activities were undertaken to streamline the organizational and legal types of educational institutions offering curriculum at different levels of the education system, and to improve system governance and financial arrangements. Management in this sector has been decentralized, and a system of per-student funding has been introduced.

The School Optimization Program has been designed and implementation is currently underway. It has already resulted in vast improvements in public spending efficiency in the education sector and will support improved quality and accessibility of school education.

Over the last two years, in particular, funds have been allocated to improve school buildings and facilities and to provide heating with the aim of maximizing the continuity of the education process and boosting attendance. In 2004, the rehabilitation, repairs, and new construction of about 200 schools was completed. Starting from 2003, the amount of fuel provided for heating purposes and the duration of the season were increased and differentiated by the position of schools in the valley vs. mountainous and highly-mountainous settlements.

The average salaries of teachers have increased considerably with a view to reducing the turnaround of competent human resources, providing adequate quality of education, and improving the social situation of teachers. Compared to

12,600 drams in 2000, the average salaries of teachers reached 18,600 drams in 2003 and 30,600 drams in 2004. The policy of raising teachers' salaries has been sustained into 2005: from January 1, 2005, the average salaries of teachers will exceed 50,000 drams. The salaries of the administrative personnel of public educational institutions have increased considerably, as well.

From a standpoint of improving the quality and conformity of education, special attention is being paid to teacher training and upgrading methodology and technical facilities in schools. In 2004 alone, about 28,000 teachers attended training courses, of which 70 percent were from the regions outside of Yerevan. General Public Education Criteria were developed and the Knowledge Assessment Center created with the aim of modernizing the contents of education and introducing a system of knowledge assessment.

Free textbooks were provided to first-graders. Children from socially vulnerable families received the books required under primary education curricula. According to the Law on Education, free textbooks have been provided to all children in primary public schools starting from 2003.

In 2004, the Government created the Assessment and Testing Center and developed a new Concept Note on Knowledge Assessment. The first samples of tests were developed by working groups created for designing both an implementation strategy for the new system of learners' knowledge assessment and the school graduation and university admission examination tests in different subject areas.

A large volume of construction and renovation work was carried out in the public education sector during 2004. The state budget financed the construction of 25 new schools and the complete renovation of another 187. Projects co-financed by the Armenia Social Investment Fund supported the construction of 16 and the complete renovation of 148 school buildings.

In 2004, the Republic of Armenia Law on Crafts and Secondary Vocational Education and Training and the Strategy on Crafts and Secondary Vocational Education and Training were developed with the primary objective of creating an efficiently-functioning system of primary and secondary vocational education in Armenia as a ways of training qualified specialists in line with the demands of the economy and the labor market.

Reforms in higher education have mainly focused on the legal and regulatory framework. The Government drafted and submitted to the National Assembly the Republic of Armenia Law on Higher and Post-University Vocational Education, which was adopted in 2004 with the aim of regulating activities in the field of higher and post-university vocational education.

According to some estimates, state budget spending in the education and science sector amounted to 47.6 billion drams in 2004. The education expenditures under the 2005 budget have increased by about 29.5 percent (14.0 billion drams) compared to 2004; this increase will mainly be spent to raise teachers' salaries.

Health

A number of action plans have been implemented in the health sector with a view to improving performance and developing the system based on maximizing the efficient use of available resources to safeguard citizens' right to health care and to improve access to state-guaranteed free health care.

New principles and approaches have been introduced in the area of ensuring and improving the quality of medical services offered to the population.

Capital renovation and refurbishment of about 80 percent of the health care institutions of the system was implemented in 2004. Wards furnished with state-of-the-art medical equipment and technology have been created. Around 1 billion drams' worth state-of-the-art medical equipment has been purchased in a centralized manner and distributed to health care institutions under the 2004 health budget.

Family medicine is being introduced with the aim of strengthening primary health care; the share of funds allocated to family medicine is gradually increasing. Activities in this direction are currently underway. Two chairs of family medicine (in the respective medical schools) and 81 family physicians' offices are currently operating.

To date, over 450 family physicians and nurses have been educated and trained. Primary health care (PHC) service structure and functional improvement has been carried out in 13 health institutions of Armenia, and the new mechanisms and methods have been piloted with a view to implementing them in the whole system in the future.

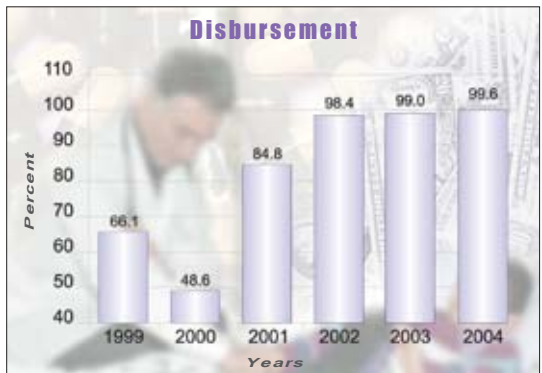
About one dozen program activities have been implemented in the area of mother and child health, delivery care, and reproductive health improvement. The implementation of a five-year National Program on Improvement of Reproductive Health and Child Care in Rural Areas (NOVA) began under US \$7 million financial support from USAID.

The fully-fledged implementation of the National Anti-Tuberculosis Program began in 2004 with the aim of protecting the public from tuberculosis and carrying out measures to reduce the number of primary cases and tuberculosis mortality. Provision of drugs, treatment, tools, and staff training for tuberculosis treatment are gradually being improved in the country. The donation of a reference laboratory in Abovyan by the International Red Cross Committee was an important measure supporting early detection and diagnosis of tuberculosis patients.

The increased importance of the primary health care system has been reflected in the state budget. The 2004 state budget allocated over 8.7 billion drams for this purpose, which was 2.2 billion drams greater than the 2003 level. The cost of one out-patient visit has been increased to 900 drams, compared to 450 drams in 2003. The daily cost of treatment per patient was increased to 8,300 drams in 2004, compared to 7,300 drams in 2003. Health funding will continue to grow in 2005 and will exceed the 2004 level by over 28 percent.

Timely and complete disbursement of allocated funds is important for enhancing the role of the primary health care system. Compared to 2000, disbursements of health expenditures grew more than 1.8-fold in 2004.

The total number of births in 2004 was 37,526, which was 4.8% higher than in 2003.



As a result of implementing targeted policies on health financing, the number of patient visits has increased. Starting from 2002, the number of patients admitted to hospitals grew (used to be 4.9 per 100,000 inhabitants in 2001, growing to 6.1 in 2002, 6.8 in 2003, and 6.9 (preliminary estimate) in 2004). The number of out-patient visits grew, as well (on average, 1.8 per inhabitant in 2001, increasing to 1.9 in 2002, 2.0 in 2003, and 2.1 (preliminary) in 2004).

Social Security and Insurance

The gradual introduction of stricter eligibility criteria for allowances during the period from 1999 to 2004 has considerably improved the efficiency of the use of family allowance funding: in 1999, 21.1 billion drams were used to reach out to 230,000 families, 12.4 billion drams in 2003 for 139,000 families, and 16.09 billion drams in 2004 for 134,000 families.

Activities at improving family poverty allowances have focused mainly on targeting minors. From July 2003, the per-minor bonus accrued to eligible families was increased (during the first half of the year) by 500 drams to reach 2,000 drams.

The family allowance increase was more dynamic in 2004. The base allowance was changed from 4,000 drams in 2003 to 4,500 drams in 2004. The per-minor bonus was changed to 2,500 drams for less vulnerable families (which scored 35-38 “points” on the vulnerability assessment scale) and to 3,000 drams for the more vulnerable ones (families scoring above 38 “points”). The differentiation of the allowance amount by degree of vulnerability marked the beginning of a fundamentally new approach, which will be developed further in the years ahead to improve public expenditure efficiency.

As a result of these changes, the average family allowance reached around 9,000 drams in 2004, compared to 7,000 drams in 2003. The allowance increased by over 28 percent in 2004 compared to 2003.

Measures aimed at improving the family poverty allowance scheme are continuing. In 2005, the eligibility threshold for a family to be classified as “vulnerable” will be changed from 35 to 34 points. The base family allowance will be increased from 4,500 drams in 2004 to 6,000 drams in 2005. The bonus for children under 18 has increased considerably—from 3,000 drams to 4,500 drams, differentiated on the basis of the eligibility score and the fact of residing in a highly-mountainous or borderline area. The lump-sum child birth benefit for families included in the family poverty scheme has been set at 35,000 drams.

The policy of raising pensions has been sustained: as of January 1, 2000, average pensions were 4,400 drams countrywide, increasing to 6,400 drams as of January 1, 2003, representing a 50 percent increase. Pensions continued to increase in 2004, and the average pension is currently about 8,200 drams (growth of 28 percent compared to the average pension in 2003).

Laws and other legal acts have been introduced to support gradual reform in the pension system; during the next 3-5 years, cumulative pension insurance will be introduced. Moreover, social cards have been introduced. As of January 1, 2005, the competent authorities have received and processed over 2 million applications, and 1.6 million citizens have already received social security cards.

During 2004, 410.1 out of 725.5 million drams allocated for state-supported programs of employment were spent. Professional training was provided to 512 unemployed and 50 disabled individuals.

As of January 1, job placement was performed for 7,893 individuals, of which 44 percent in Yerevan.

Under the UN WFP's "Food for Education" program, training in business fundamentals continued for over 10,000 unemployed job-seekers. Of the approximately 6,000 teachers laid off as a consequence of optimization, 1,734 were registered with regional employment centers. 327 of them received additional monetary aid in the amount of 30.4 million drams.

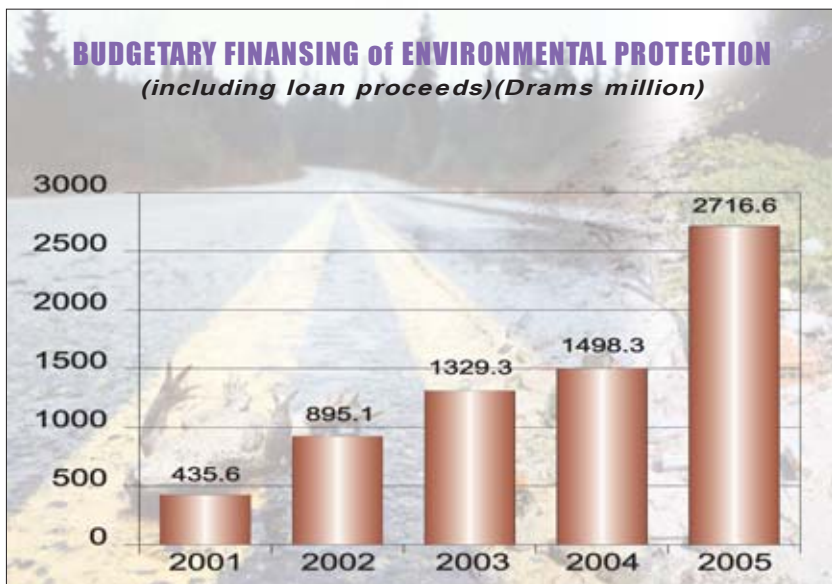
2004

ENVIRONMENTAL PROTECTION

Implementation of the 2004 social-economic policy

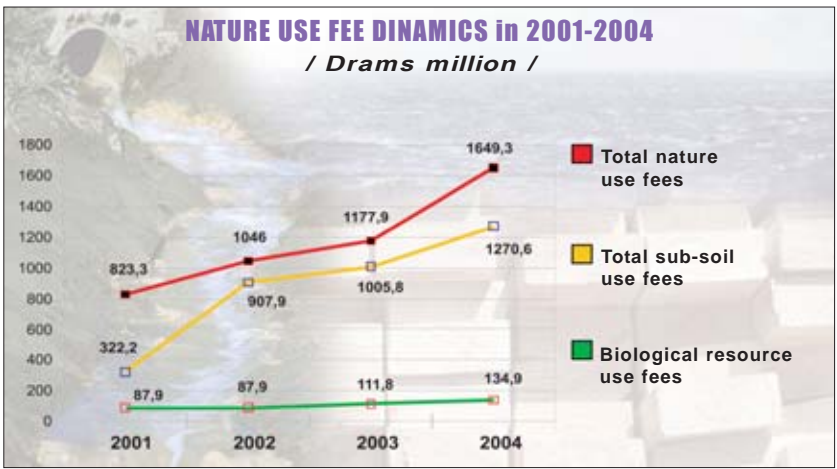
REPORT

The activities in this area have focused on further improving the legislation and addressing the priorities that remain.



Below is a list of the main achievements in the environmental protection sector in 2004:

1. Adoption of the Republic of Armenia Law on Wastes and adoption in first reading of the Law on Environmental Monitoring;
2. Continuous trend of increase in the level of Lake Sevan (by 44 centimeters in 2002, by 48 in 2003, and by 41 in 2004);
3. Increased state budget revenue from environmental fees owing to improved reporting of environmental use and enhanced performance of environmental audits (revenue grew by over 40 percent, or 471.4 million drams, in 2003).



About 90% of the water use was moved to the legal framework in which water use permits are required under the new Water Code of Armenia;

A number of strategic documents were adopted, including:

- The Republic of Armenia National Forest Policy and Strategy;
- The Action Plan to address issues related to unlawful forest cutting;
- The Concept Note on Reducing Hazardous Vehicle Emissions; and
- The 2005-2010 Action Plan of measures to be implemented in respect of the Stockholm Convention on Solid Organic Waste.

2004

POVERTY ALLEVIATION

Implementation of the 2004 social-economic policy
REPORT

Findings of household surveys carried out in 2003 were summarized in 2004 to suggest major progress towards reducing poverty. The key indicators of poverty, according to surveys carried out by the National Statistics Service in 1996, 1998/1999, 2001, 2002, and 2003, are presented in the table below.

Key Indicators of Poverty in 1996, 1998/99, 2001, 2002, and 2003					
Key indicators	1996	1998/1999	2001	2002	2003
Number of poor, in percent	54.73	55.05	50.9	49.7	42.9
Number of extremely poor, in percent	27.67	22.91	16.0	13.1	7.4
Gene coefficient in total per capita income terms	0.653	0.570	0.528	0.449	0.434
Gene coefficient in per capita expense terms	0.444	0.372	0.344	0.325	0.271

During 2002, the number of the non-poor for the first time exceeded that of the poor. Poverty reduction continued successfully in 2003, and the level of poverty was brought down to 42.9 percent.

The poverty reduction of about 12.5 percentage points in 2003, compared to 1999, represents major progress towards overcoming poverty. The number of the extremely poor fell sharply during the period from 2000 to 2003, from 22.9 to 7.4 percent, which is a direct outcome of improved targeting of the state's social policies.

The positive trends of poverty reduction reported in recent years have been due to both robust economic growth and mitigated inequalities of income distribution. The Gini coefficient of income distribution inequality fell from 0.57 in 1999 to 0.434 in 2003, which suggests a considerable improvement in the equal distribution of output.

During 2004, the Government started to carry out the measures prescribed under the 2004-2006 PRSP Implementation Action Plan. With the aim of developing the PRSP implementation participatory process, a Memorandum on Partnership Negotiation was signed in 2004 with different stakeholders involved in the negotiations. The PRSP Implementation Partnership Agreement signed in October 2004 laid down the medium-term implementation priorities and a governance arrangement for the PRSP. A decree on the creation of the PRSP Participatory Steering Committee was drafted and submitted for approval. A Concept Note on PRSP Monitoring Indicators was approved under Government Decree 1780-N dated November 11, 2004, which will be used to monitor PRSP implementation progress.



2004

UNITED STATES GOVERNMENT MILLENNIUM CHALLENGE ACCOUNT

Implementation of the 2004 social-economic policy
REPORT

Concerted efforts were exerted in 2004 to develop Armenia's proposal for the MCA. The Republic of Armenia Ministry of Finance and Economy has received and consolidated over 200 recommendations from various stakeholders, which constitute the basis for designing Armenia's Project Proposal for the MCA currently underway. Project priorities have been clarified during these discussions. The proposal prioritizes rural infrastructure, especially irrigation and community roads.



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Government
of the
Republic of Armenia
Social and Economic
Policy
Implementation
Progress
in 2004

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