

**USAID/ARMENIA
STRATEGIC PLAN
FY 1999 - FY 2003**



YEREVAN, ARMENIA
March 1999

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ABBREVIATIONS AND ACRONYMS

ANPP	--	Armenian Nuclear Power Plant
ASIF	--	Armenian Social Investment Fund
CEE	--	Central and Eastern Europe
CEELI	--	Central and East European Law Initiative
DOJ	--	US Department of Justice
EBRD	--	European Bank for Reconstruction and Development
ENI	--	Europe and New Independent States
EPAC	--	Environmental Public Advocacy Center
ESAF	--	Enhanced Structural Adjustment Facility
EU/TACIS	--	European Union Technical Assistance to CIS countries
GOA	--	Government of Armenia
IMF	--	International Monetary Fund
NGO	--	Non-governmental Organization
NIS	--	New Independent States
OSCE	--	Organization for Security and Cooperation in Europe
SME	--	Small and Medium Enterprise
UNDP	--	United Nations Development Program
USAID	--	US Agency for International Development
USIA	--	US Information Agency
USIS	--	US Information Service
WTO	--	World Trade Organization

USAID/ARMENIA STRATEGIC PLAN FY 1999 - FY 2003

PART I: Summary Analysis of the Assistance Environment and Rationale for Strategic Choices

A. Country Overview

Armenia is a small, landlocked, mountainous country with few natural resources covering an area of 29,800 square kilometers (about the size of the US state of Maryland). It is situated in the Caucasus Region, surrounded by Georgia, Azerbaijan, Iran and Turkey. The population is now around three million people and is overwhelmingly comprised of ethnic Armenians.¹ Armenia has had a troubled relationship with some of its neighbors, including a continuing conflict with Azerbaijan over the ethnic Armenian enclave of Nagorno-Karabakh located inside Azerbaijan. Although a cease-fire has held since 1994, Armenia continues to face a trade embargo and closed borders with both Azerbaijan and Turkey, in effect since 1989.

In a referendum in September 1991, Armenian voters opted for independence from the Soviet Union. In addition to an escalation of its geopolitical problems, independence coupled with the break-up of the Soviet Union brought an end to the commercial ties and protected markets which had helped to make Armenia among the most prosperous of the former Soviet republics. With the end of low Soviet prices for energy, transport, raw materials and guaranteed markets for its products, the Armenian industrial sector collapsed. A severe energy shortage and economic turmoil precipitated a new humanitarian crisis in a country then still recovering from the economic and social fallout of an earthquake in 1988 that resulted in the deaths of over 25,000 people and rendered 500,000 homeless. Over a decade after the disaster, more than 30,000 families still live in temporary shelters in the earthquake zone.

Initial public enthusiasm for economic reform and democracy was high in 1991. However, Armenia's checkered post-independence election history in combination with continuing economic stagnation, declining living standards, crumbling public services and endemic corruption have undermined the public's confidence in government and engendered widespread cynicism regarding the democratic process. Unemployment and underemployment together may affect 50-70 percent of the workforce and over half the population is estimated to live below the poverty line. The state financed social safety net is weak, and the education and health systems have deteriorated considerably as state support has diminished.

B. History of USAID Assistance

The USAID program in Armenia began in 1992, shortly after Armenia's independence from the former Soviet Union. From 1992 to 1995, the focus of the USAID program was on humanitarian assistance. It was, of necessity, only a "finger in the dike" aimed at preventing immediate and widespread human suffering and was not aimed at developing systemic reform.

¹ Though officials often still credit Armenia with 3.7 million people, the general consensus is that the population is about 3 million, after massive out-migrations since 1988.

Beginning in 1995, as the humanitarian crises began to lessen and the Government of Armenia (GOA) was taking steps toward economic reform, the USAID program gradually began to shift to a more development focus. From 1995 to the present, USAID assistance has increasingly emphasized systemic reform and institution-building as direct humanitarian interventions have gradually declined. This emphasis has assumed a "trickle down" of benefits to the Armenian population, as the laws, regulations, enforcement mechanisms, and institutional structures gradually improve the climate for economic, political, and social development.

While there can be no doubt that the emphasis on macro-reforms and institutions has been appropriate, it is also clear that it needs to be balanced with grass roots-level, direct human interventions. It has become increasingly clear to USAID over the past year that the "trickle down" approach will take a number of years to bear fruit and reach the majority of the population. In the meantime, Armenians are becoming increasingly frustrated by what appears to be, from their perspective, painfully slow and uneven progress.² Thus, while USAID intends to continue to emphasize systemic reform and institution-building in the coming five years, we also intend to add a new, balancing, "bottom-up" emphasis through more direct attention to improving and expanding grass roots assistance, while seeking to identify the most efficient and effective means of delivery.

The Vision: USAID began its strategic development with agreement on a long-term strategic vision:

USAID/Armenia is committed to working in partnership with Armenians for a prosperous and stable country that offers equal opportunity to all its citizens. This is achieved by a strong democracy and market economy, governed by the rule of law, which promotes the general welfare of the people.

Attainment of this vision will require at least one full generation, i.e., well beyond the five year timeframe of the strategy proposed in this document. The strategy outlined below is envisioned to be one of a number of steps (the first several of which have already been taken) toward the attainment of this vision. It is important from the outset to bear in mind that there are no "quick fixes" envisioned for Armenia's long-term, sustainable development. The road ahead will take a number of years of focused, active engagement by the Government and the people of Armenia, especially by the private sector, as well as by a variety of bilateral and international donors.

The vision as stated above views Armenia's development as an integrated and synergistic effort between the strategic sectors, between the public and private sectors, and between Armenian and international actors. This vision has been developed from the following general analysis of the main problems in Armenia.

C. Problem Analysis

Economic Restructuring: Armenia was one of the most industrialized republics of the Soviet Union, exporting industrial, military and high technology goods, mainly to

² According to the findings of a recent USIA survey, 75% of Armenians say that things are going in the wrong direction.

other Soviet republics, and in turn relying heavily on them for key inputs. During the 1970s and 1980s industry accounted for more than two-thirds of Net Material Product (NMP) and employed half a million workers. A major setback to the industrial sector occurred in 1988 when nearly 40 percent of production capacity was lost as a result of the earthquake.³ The subsequent break-up of the former Soviet Union (FSU) combined with the collapse of its trade, payments and financial system dealt a crippling blow to Armenia's industry. Armenia's Gross Domestic Product (GDP) is reported to have decreased by an estimated 60 percent between 1991 and 1993 and was accompanied by the decline of a number of large industries which employed the majority of the Armenian workforce [1].

Although market-oriented reforms were initiated in January 1992, further progress was delayed due to the conflict in Nagorno-Karabakh and the trade blockade imposed on the country. Unsustainable public expenditures and freely falling revenues combined with monetary chaos in the ruble zone to balloon Armenia's budget deficit to 48 percent of GDP in 1993 [1]. Armenia's reform efforts regained momentum in 1994 with the implementation of austere fiscal and monetary policies complemented by the introduction of the dram as the new national currency. These policies reduced inflation from almost 11,000 percent annually, in 1993, to about 32 percent at the end of 1995 [2]. Substantial progress has been made since 1994, both in structural reforms and macroeconomic stabilization.

Since 1994, there has been sustained reduction in the budget deficit and inflation has been reduced considerably -- reportedly 8.7 percent on average for 1998 [3]. Armenia's implementation of a suitable macroeconomic policy framework has been rewarded by positive GDP growth in successive years: 5.4 percent in 1994, almost 7 percent in 1995, 5.8 percent in 1996, 3.1 percent in 1997 and an estimated 5.5 percent in 1998. The first six months of 1998 witnessed a narrowing of the trade deficit,⁴ though this favorable trend is likely to have been reversed in the latter part of the year as the Russian economic crisis began to unfold. Since independence, external debt accumulation has grown rapidly but is expected to be manageable over the medium term. Foreign direct investment may have been as high as \$140 million in 1998 compared to \$51 million in 1997 [4].

In order to consolidate its stabilization gains, the GOA has moved to address, albeit unevenly, a comprehensive agenda of structural reforms. The focus of its 1999 development program is on continued progress in the areas of privatization, financial sector reform and energy sector restructuring. Simultaneously, emphasis is being placed on the reform of the health and education sectors in order to preserve Armenia's human capital base and ensure that the costs of the transition are socially sustainable [5].

In spite of the generally positive economic indicators and forward progress on structural reform, unemployment and poverty continue at very high levels. The former Soviet industries, with their high employment rates, are not likely to return. Thus, a

³ Industrial production includes energy output that was reduced because of the closure of the Medzamor Nuclear Power Plant for safety reasons in the aftermath of the earthquake.

⁴ The trade balance experienced unprecedented deficits in 1995-1997 as imports were greatly expanded to provide food and humanitarian assistance for sustenance of the population, and energy and raw materials for growth of the economy.

key problem facing Armenia since its independence is how to initiate and sustain appropriate new industries, technologies and services that will grow, create new jobs, raise living standards, and allow the country and its citizens to flourish with them as part of a broader regional and international community.⁵ Private sector operations in Armenia are a new phenomenon, and there is a generalized lack of market-wide as well as firm-specific knowledge, understanding, and systems that will support the growth of the private sector at the present. In addition, despite several recent years' work, there remains an inadequate and incomplete "enabling environment" which will encourage private investors to participate more actively and productively in the economy. It is clear that many people survive via the informal sector, the characteristics and scope of which is undocumented.⁶

While efforts to address both firm-specific and "enabling environment" problems will eventually help to reduce the currently high levels of unemployment and underemployment, and, hence, the high incidence of poverty in Armenia, these will not provide immediate (i.e., within the next 2-4 years) relief to the very tangible and widespread problems of unemployment and resultant low standards of living. In the absence of other, more immediate interventions, unemployment, underemployment and poverty levels -- and, with them, public cynicism and apathy -- can all be expected to remain high, though begin to decline modestly, over the coming five years.

Meanwhile, domestic growth is severely constrained by the closure of Armenia's borders with Azerbaijan and Turkey, both of which could be significant trading partners and transit routes for Armenian goods and services. The conflict over Nagorno-Karabakh continues and, absent a political settlement, even the best policies and reforms can have only a limited impact. There is recent evidence, on the Armenian side at least, of a willingness to support efforts at regional approaches which could bring the parties closer to resolution and foster greater regional integration.

Unfortunately, Armenia's economic prospects have been further damaged by last fall's financial meltdown in Russia. Over the past several years, many Armenian families have been able to survive at least in part on remittances sent by Armenians working abroad.⁷ According to some estimates, there are approximately 1.5 million ethnic Armenians residing in the other countries of the NIS, with the majority located in Russia [6]. Unrecorded remittances from Russia alone may have been in the range of

⁵ It should be noted that there is a vicious circle presently evident in Armenia: lack of employment opportunities leads to a lack of access to cash which in turn leads to an inability on the part of many Armenians to afford many basic goods and services. This inability to purchase basic goods and services not only serves to depress local demand, therefore constrain the local economy, but it also contributes to a decline in the basic welfare of many families, for example, as many Armenians forego both preventative and curative health care. This vicious circle serves to reinforce public alienation and disillusionment with what seems to be an endless transition process.

⁶ According to the Country Commercial Guide of the US Embassy in Yerevan, the shadow (informal sector) economy was estimated in June 1997 by Armenian authorities to make up 40-53 percent of GDP. In addition, the Embassy estimates that this figure can be as much as 70 percent or higher in the wholesale, retail, and consumer services sectors.

⁷ Since independence in 1991, up to 1 million Armenians may have emigrated in search of work, with the vast majority going to countries in the former Soviet Union.

\$150-200 million (8-10% of GDP) annually [5]. However, since late August 1998, Armenia began to experience adverse impacts as a result of the sharp economic downturn in Russia. In addition to the reduction in private transfers, there has been cancellation of some Russian private investment and Armenian exports to Russia have also fallen sharply in recent months.⁸ As a result, many Armenian families are already beginning to see a drop in available income which is likely to worsen, perhaps significantly, depending on the situation in Russia, before it begins to improve.

Democracy and Governance: Although the government has taken a broad array of steps to transform the economy, independent Armenia has not progressed as far in developing the necessary institutions for a democracy. Perhaps this should not be surprising given that in earlier years much human and financial capital was focused on the Nagorno-Karabakh conflict and dealing with the humanitarian emergency. Still, many of the institutions necessary for a functioning democracy are either in place or plans to create them are underway. Moreover, citizens are learning their roles and responsibilities in a democratic system. Despite instances of human rights abuses and some political repression of dissident voices, post-Soviet Armenia has generally been free of the worst excesses of authoritarian power. The greatest disappointment to date has been the flawed elections at the national level.

Although Armenians have participated in three national elections since independence, none has been free from criticism by international observers. Problems included unequal access for candidates to the media, improper voting by the military, ballot stuffing, and tampering with official results. Political parties have weak structures and organizations, are highly personalized and, therefore, have tended not to present serious opposition to incumbent candidates.

Despite the problems surrounding elections, Armenia has taken some critical steps forward in democratization. The Armenian Constitution, adopted through a national referendum in 1995, declares the establishment of a government based on the rule of law, and the separation of the executive, legislative and judicial branches of government. In addition, the more specific legal basis and principles of democratic local self governance have been formally established by separate legislation. Nonetheless, the flawed parliamentary elections of 1995 resulted in a National Assembly primarily composed of deputies more loyal to the powers who helped engineer their election rather than constituents. Similarly, at the local government level, accountability towards the citizenry appears to be low. Furthermore, local administrations are severely constrained by inadequate financial resources. Transparency and citizen participation also tend to be weak in local government decision-making.

⁸ Armenia began to experience spill-over effects of the Russian economic crisis almost immediately. By September 1998, estimated workers' remittances and private transfers from Russia were down 46 percent compared to the previous month, and exports to Russia declined by 31 percent in relation to September 1997. The IMF conservatively estimates a \$100 million (5% of GDP) adverse impact on the balance of payments through the end of 1999 on the basis of anticipated reductions in capital inflows and exports to Russia and other NIS countries. Moreover, the ripple effect on the economy associated with lower than expected exports, foreign investment and financing may halve real GDP growth in 1999.

A major constraint on Armenia's democratic, economic, and social transition has been the pervasive embrace of corrupt practices at all levels of government (see Annex 1 - Corruption). Despite severe penalties, bribery is widespread and the most common form of corruption. In addition, collusion between officials at various levels and private sector actors has hindered competition and fostered the emergence of powerful "clans."⁹ Legal, regulatory and judicial reform efforts together with substantive civil service reform are needed to reduce the extent of the problem. Substantial effort is being made at present to put these necessary reforms in place.

Despite these reform efforts, citizens still do not trust the legal, regulatory, or judicial systems to apply or administer justice impartially. Corruption exists throughout government systems and will take years to overcome. Laws are not yet being consistently applied or adjudicated. Enforcement agents, procurators, advocates, judges, and other government personnel need training and support so that they can function more effectively. In addition, enforcement of court judgments must be addressed so that courts decisions are upheld.

A major legacy of the former Soviet Union is a largely passive and alienated population. Furthermore, in Armenia, widespread unemployment, poverty, disillusionment with the length of time required for the transition process, and discouragement with such inhibitors to an effective transition as corruption have contributed to a deep strain of cynicism within the citizenry. Most citizens do not know how to work within the current system to advocate for changes. Elected officials and their appointees also do not yet understand why or how to address citizens' concerns. There are also not yet appropriate formal mechanisms in place for citizens to effectively petition government. In addition, accurate information about the government's plans or activities is not readily available, therefore, people are often forced to rely upon rumors, which can be false or misleading.

Improvements have been gradual. It will take many years for many Armenians to embrace fully their rights and responsibilities in a democracy. However, there are currently over 1,700 NGOs registered with the Ministry of Justice. Although many of these groups are not particularly active, about 20-30 of these have gained the skills to advocate effectively for change, as well as to strengthen their organizational capacity. Independent broadcast media, while not yet financially viable, is also able to provide objective news coverage that may be critical of the government without fears of being suppressed.

Social Sector Reform: Armenia at present is characterized by a very high level of poverty. Over half the population (54.7%) is estimated to be below the poverty line and more than a quarter (27%) below the food line [8]. This high level of poverty is to a large degree a consequence of economic and social problems precipitated by the collapse of the former Soviet Union (FSU). These problems have been exacerbated

⁹ Such collusion serves to explain at least in part the disparity in wealth currently found in Armenia. A 1996 household survey in Yerevan [7], conducted by the USAID-funded Center for Economic Policy Research and Analysis, found that the incomes of the top 20 percent of well-off families were 20 times greater than those of the poorest families. The same survey found that 10 percent of the families surveyed controlled 45 percent of incomes. With concentration of wealth also comes the concentration of access to quality social services such as health care, education and housing.

by the devastation of the 1988 earthquake and the economic embargo imposed by Azerbaijan and Turkey over Nagorno-Karabakh.

The incidence of poverty in Armenia is clearly and closely linked to the high levels of unemployment and underemployment in the country at the present time and is seriously amplified by the inadequacy of the basic social safety net to respond to the now widespread needs of the population. The former Soviet system of universal "cradle to grave" social service coverage and utilities subsidies has collapsed. At the same time, there is no recent tradition of the private provision of social services. While the Government of Armenia is struggling to provide a minimum coverage package for those most in need, its narrow revenue base is seriously constraining the public sector's ability to respond adequately. In addition, the health and education sectors can no longer be fiscally sustained without major restructuring efforts.

In the health sector, public perception of poor service at a relatively high cost has significantly reduced the demand for medical care [1]. This development in tandem with the difficult socio-economic environment has contributed to a worsening of adult health status, poor maternal and child health, and the re-emergence of poverty related diseases. Consequently, the government has taken steps to reform the health care system which is a legacy of the former Soviet model of central coordination by a powerful Ministry of Health. The system is characterized by chronic underfunding, low efficiency of services, low quality, and inequitable access to services [9].

Armenia's education system, which was well-regarded during the Soviet era, has been subject to an erosion in quality that threatens to reduce both near- and long-term human capital potential in the country. In 1999, the government has embarked on implementation of a strategy to reform the finance and management of school education and is beginning to study means for reforming higher and post-secondary technical education [5].

Commitment to Reform: While Armenia has been internally stable since its independence, the potential for political instability is large in the face of widespread poverty and corruption. If the economic, political and social problems are not addressed and the perceived inequities are not remedied quickly, the potential for political unrest, particularly from forces hostile to free market and democratic reforms, needs to be acknowledged. While the current government may not be a democratic ideal, it is committed to economic reform; there are no guarantees that a successor government would offer an equally reformist outlook.

D. The Proposed Solution

As should be clear from the discussion above, the major problems in Armenia are highly interrelated. As a result, the solutions need to be interrelated as well. The proposed strategy would address these problems from a number of different, but complementary, directions: first, we will strongly support the GOA's staying the course in macroeconomic reform, providing assistance to complete the comprehensive market reforms and energy restructuring now underway. In order to protect those reforms politically and attempt to address the current high levels of poverty more immediately, however, we will also emphasize the creation of new jobs in the economy, both through improvements in the business and investment environment

and through increased attention to grassroots efforts to create jobs, whether through small and medium enterprise (SME) growth or other experimental approaches to be explored over the strategy period. Key will be demonstrating more broadly the benefits of reform through job creation.

Closely related to improvements in the business and investment environment is the need for more enforcement and adjudication of laws that allow for greater equity in access to and support from the government. Of equal importance to the sustainability of reform will be continued support for widespread, democratic participation of citizens, approaching the process through both the governmental and non-governmental sectors, at the local level in addition to the national. Finally, our strategy contains a new focus on social sector restructuring, following the same logic as our job creation emphasis: if average citizens do not perceive that reforms are benefiting them directly, the political support for both democracy and free market economics will disappear. More attention to the social safety net for the most vulnerable, as well as viable social insurance systems for those who can pay, will increase confidence that a market democracy offers a better way of life for everyone, not just the wealthy.

USAID has developed six strategic objectives to lead us toward the attainment of our vision:

1. **Growth of Competitive Private Sector:** The key problem in Armenia is the lack of sufficient productive employment and/or adequate income generating opportunities. Thus, USAID proposes to put a primary focus on employment creation, targeted at promising sectors and supporting a sectoral development strategy. Because employment in the privatized state industries may not increase, sustainable job creation in the future will be derived predominantly from newly created private enterprises. USAID will increase support for SME development by improving business skills, strengthening the business climate, and improving access to broader markets. Since these efforts are based largely on "trickle down" of benefits to employment and, therefore, are not expected to create a large number of new job opportunities immediately (i.e., in the coming two to four years), USAID also proposes to implement several different, locally-based pilot development efforts to demonstrate more immediate employment generation opportunities, which can be replicated by others for a wider employment impact and which demonstrate the potential impact of macro-level reform.
2. **Investment Increased:** Domestic and foreign investors must have confidence in Armenia's future in order to invest, thereby expanding employment opportunities. That confidence will be instilled through the creation of an enabling environment that is supportive of a market economy. Although Armenia has already taken steps to put into place a legal environment conducive to business, work still needs to be done to put in place mechanisms that ensure the rules are predictably and equitably applied and enforced. USAID will also support increasing Armenians' access to financial capital, through direct credit programs, an improved banking system, and by providing access to investment opportunities domestically and abroad. USAID will also continue its programs supporting the creation of a transparent capital market structure, land registry system, improvements to bank

- supervision, and tax reform, all of which will lead to an improved investment climate.
3. **A More Economically Sustainable and Environmentally Sound Energy Sector:** Continued structural reform of the vital energy sector is also needed: to ensure adequate service delivery for the growing economy; to provide a basic utility to the population as a whole; and to reduce the potential for fiscal destabilization. In addition, the energy sector may offer opportunities for regional activity enhancing both Armenia's development and regional integration.
 4. **Laws are Enforced and Adjudicated Impartially:** One of the key reasons that economic investments are not increasing and, therefore, employment opportunities are not expanding as rapidly as might be hoped is the perception by potential investors of widespread inequities in enforcement and adjudication -- one major aspect of corruption in the country. While combating corruption is likely to be a long-term effort with only gradual and modest successes over the course of the five year strategy timeframe discussed here, it is clearly an essential part of expanding employment opportunities and lessening poverty in Armenia.
 5. **Increased Citizen Participation in the Political, Economic and Social Decision-making Process:** While economic, political and social improvements can be made institutionally from the "top down," they can only be politically sustainable over the longer term if the broader population understands and supports them. Thus, public participation is an essential part of Armenia's lasting development.
 6. **Strengthened Social Safety Net:** Sustainable social services will require a sound economic base which will allow for the payment of services -- through public and private mechanisms -- over time. Thus, while the improved provision of social services is essential immediately for the majority of Armenians, sustainable improvements in this sector depend on improved economic and political circumstances. USAID proposes to work on ways to improve the effectiveness and efficiency of basic service provision over the current strategy period so that, as the economic circumstances allow for expanded investment in the social sector, improved systems will be developed and ready for expansion and/or replication.

E. U.S. Foreign Policy Interests, Other Donors and Customers

U.S. interests in the Caucasus region are complex: commercial, geopolitical, geostrategic, as well as historic, as the region has played a key role in the shifting balances of power in this part of the world for literally thousands of years. U.S. ties to Armenia are many and varied, from the large Armenian-American diaspora community to ties of culture and history; the level of USG assistance to Armenia is one of the highest per capita in the world. Some of that assistance has responded to the humanitarian crises Armenia has suffered in recent years. Now, however, both the Armenian and U.S. governments are keen to see assistance directed at the longer-term socioeconomic and political development of Armenia.

In order to accomplish this goal, as well as to contribute to greater stability in the entire Caucasus region and beyond, the U.S. recognizes the importance of Armenia's

integration into the surrounding region. Armenia itself has shown evidence of wanting to move away from its decade-long isolation and towards more cooperative relationships with its neighbors, including Azerbaijan and Turkey. This relatively recent change presents opportunities for the USG to help Armenia become more integrated into the surrounding region, which simultaneously improves the prospects for resolution of one of the region's destabilizing conflicts: the dispute over Nagorno-Karabakh. Such resolution is very much in the foreign policy interests of the USG. USAID can support those interests in part by taking advantage of opportunities to promote regional integration but primarily by using its development resources to promote economic growth, political maturation and social service sustainability which will enable it to participate fully in the development of the region's resources and therefore contribute to regional stability.

USAID will work closely with USAID/Caucasus in Tbilisi to ensure that regional strategic synergies (e.g., in expanding access to regional economic markets, especially through improved regional transport linkages, and in sharing lessons learned in a variety of areas) are identified and capitalized upon wherever possible (see Annex 2 - Approach to Regional Programs).

The strategy as very briefly outlined above was developed by USAID to reflect consultations directly with the GOA regarding its priorities as well as with the broader U.S. Government community and other donors. We are thus confident that this strategy is wholly consistent with GOA and other donor interests and concerns. There is an increasingly widespread recognition of and interest in the problems of unemployment and related poverty issues in Armenia. The GOA, very much aware of its political vulnerabilities, is interested in seeing donor assistance focused on sustainable employment creation and on assistance to poverty alleviation on a sustainable basis. Other donors, through a variety of mechanisms, many of them complementary to USAID's proposed strategy, are working in a similar direction (though many may not have yet articulated the problems or the solutions in quite the same terms as USAID does here). Specific reference to GOA and/or other donor efforts as it relates to the USAID strategy as presented here will be made where/as appropriate throughout Part II of this document.

In addition, USAID has undertaken some preliminary direct customer assessment work (see Annex 3 - Customer Appraisal Results), which also has informed the proposed strategy.

F. Assumptions

There are, of course, a number of key, strategy-wide assumptions which need to be made explicit early on in the outline of the strategic plan:

- ◆ The dispute over Nagorno-Karabakh could well continue, albeit under cease-fire conditions, for the duration of this strategy period. As a result, the blockade by both Turkey and Azerbaijan could continue as well. If a mutually-acceptable peace agreement is achieved, then results as outlined in this strategy, particularly on the economic side, should improve rapidly. USAID assumes that the situation in Nagorno-Karabakh will not deteriorate to the point of internally destabilizing Armenia (see Annex 4 - Nagorno-Karabakh).

- ◆ Other disputes in the Caucasus, e.g., Abkhazia and southern Russia, are also likely to continue. These disputes, while not directly affecting Armenia, will continue to constrain regional cooperation and communication/transportation initiatives.
- ◆ Armenia and its neighbors, especially non-governmental actors in the case of Armenia vis-a-vis Turkey and Azerbaijan, will continue to make efforts among themselves, despite internal disputes noted above, to improve regional political relations and economic cooperation and integration. Georgian and Armenian governmental, private sector and NGO efforts are likely to expand significantly, given domestic and international political support (see Annex 2 - Approach to Regional Programs).
- ◆ The educational system will continue to deteriorate in the short run and disparities in educational attainment will likely widen, but as employment, therefore incomes, begin to increase, Armenians will be better able to invest in their own family's education, given that there is already a high social value on education in Armenia.
- ◆ Political will is likely to remain fairly strong but at a less than optimal level, i.e., there will be varying levels of commitment among individuals and across sectors and issues, with senior political and government officials more committed than lower-ranking individuals.
- ◆ Parliamentary elections have been scheduled for May 30, 1999. The current parliament has supported many of the executive branch's reform proposals in the economic sphere. If the new parliament is not generally supportive of market reform initiatives, then economic restructuring progress might be significantly retarded.
- ◆ In spite of some modest improvements in the impartiality of enforcement and adjudication and in the responsiveness of government to citizens' concerns, public apathy and perceptions of powerlessness will decline only very gradually. It will take a long time for public trust in government systems to be restored.
- ◆ The economic crisis in Russia will continue to have a negative impact on Armenian poverty levels for at least the next several years, largely due to the decline in remittances, investment and export opportunities.
- ◆ Populist pressures on the GOA to deliver the fruits of years of reform will intensify, particularly in the run-up to parliamentary elections. The GOA will be especially sensitive to the concerns of the residents of the earthquake zone. However, social peace is expected to be maintained even as the GOA stays the course with painful structural reforms.

None of these assumptions will adversely affect the mission's ability to address the results outlined in the strategy. In developing targets, we have taken the most cautious approach. Thus, our expectation is that, if any of the circumstances should improve over what is stated in these assumptions, our targets should be exceeded.

G. Graduation

Given the magnitude and the severity of Armenia's problems, it is unrealistic to expect that this five-year strategy will see Armenia to developmental "graduation." Thus, this current strategy document should be seen as a continuation of the first phase of U.S. development assistance (which began around 1995 with the first economic and democracy programs as the direct humanitarian assistance began to phase down). We expect that, at the end of this proposed five-year strategy, Armenia will have largely completed its "reform" phase of development, having put in place most of the institutional (legal, regulatory and, most importantly, enforcement) structures necessary for a free market economy, a democracy, and a sustainable social safety net system. In its "post-reform" phase of development, Armenia will need to place more emphasis on the implementation of the reforms and enforcement mechanisms it has put in place, for example, encouraging more rapid private sector economic expansion, solidifying political pluralism and public advocacy, and capitalizing social insurance systems.

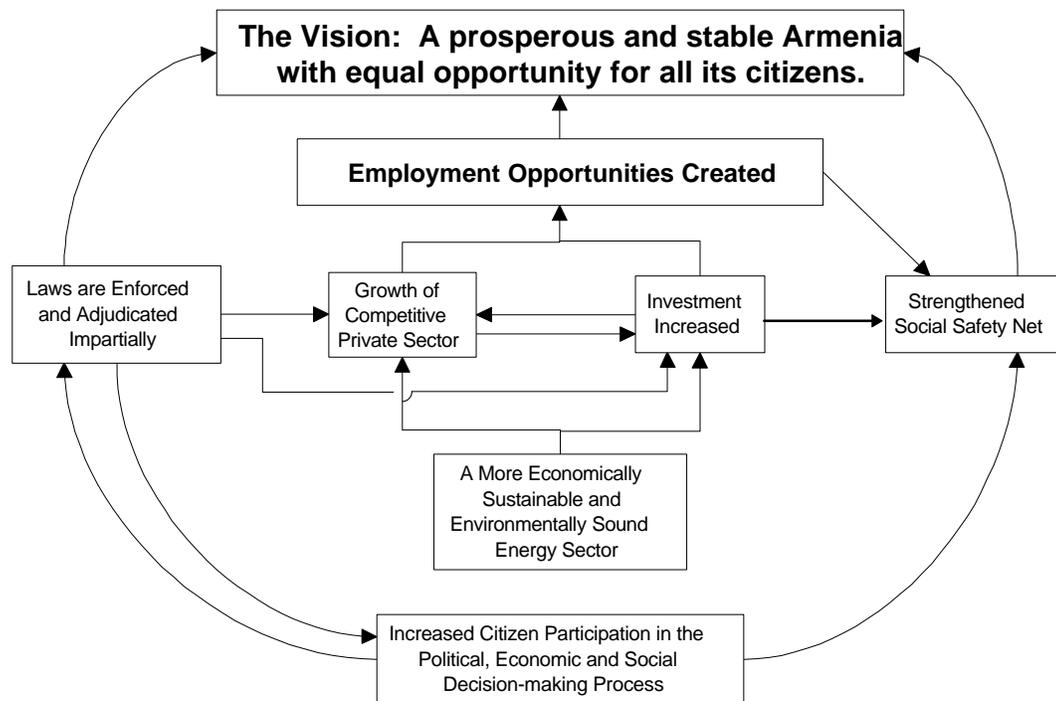
It needs to be emphasized that there are no "quick fixes" foreseen for Armenia's development. The problems that exist have been years in the making, therefore the solutions of necessity will take years as well. Many of the problems are, at heart, attitudinal in nature, e.g., the political will required to ensure that enforcement of laws and policies is impartial and that short-term gains are not pursued at the expense of longer-term, nation-wide benefit; attitudes will not change overnight but will take a generation or more of experience and exposure to non-Soviet systems and styles of operation. Graduation will also require resolution of the external political constraints on Armenia's growth and development.

PART II: The Strategic Program¹⁰

A. Overview

Attainment of the vision for a prosperous and stable Armenia with equal opportunity for all requires an integrated development approach. As described in Part I, USAID has developed six main strategic objectives to lead us toward the attainment of that vision: *Growth of Competitive Private Sector; Investment Increased; A More Economically Sustainable and Environmentally Sound Energy Sector; Laws are Enforced and Adjudicated Impartially; Increased Citizen Participation in the Political, Economic and Social Decision-making Process; and Strengthened Social Safety Net.* These objectives are all closely linked to one another and to the vision (see Figure 1).

Figure 1



Growth of the private sector will not only increase employment and therefore opportunity and prosperity, but will also increase investor confidence leading to more investment, both domestic and foreign. Increased investment will help both the private and public sector expand efficiently, again leading to employment, opportunity and prosperity. Improvements to the energy sector will strengthen one type of infrastructure essential for economic revitalization. Increased private sector growth and investment will improve the social safety net, by reducing the number of people needing direct assistance (via increased employment), by providing people

¹⁰ The presentation of strategic objectives in this section follow the logical flow of the mission's articulation of its strategy and does not in any way imply prioritization or relative emphasis or importance to be placed on any given strategic objective or sector over another.

with incomes sufficient to pay for their own social needs, and by increasing the revenue base of the government, private, and NGO sectors to care for those who still require assistance. Ensuring basic services for all its citizens leads to a stable political and economic environment. Strengthened rule of law will increase investor confidence and the general business environment while providing for fair and impartial treatment of citizens, which in turn leads to a more stable democracy. An active citizenry, participating in the nature, pace, and direction of its own economic, political and social development is essential to all aspects of Armenia's future success and stability.

Emphasis on Employment: In response to the poverty problem evident in Armenia, USAID has identified the *Creation of Employment Opportunities* as the mission's highest priority -- and, as a result, a higher order "strategic goal" -- over the five year strategy period. Over the next five years, USAID will work in cooperation with the Armenian government, the private sector, and other donors to expand the economy's ability to create sustainable jobs. Two strategic objectives are necessary to attain this goal: *Growth of Competitive Private Sector*; and *Investment Increased* (see figure 2).

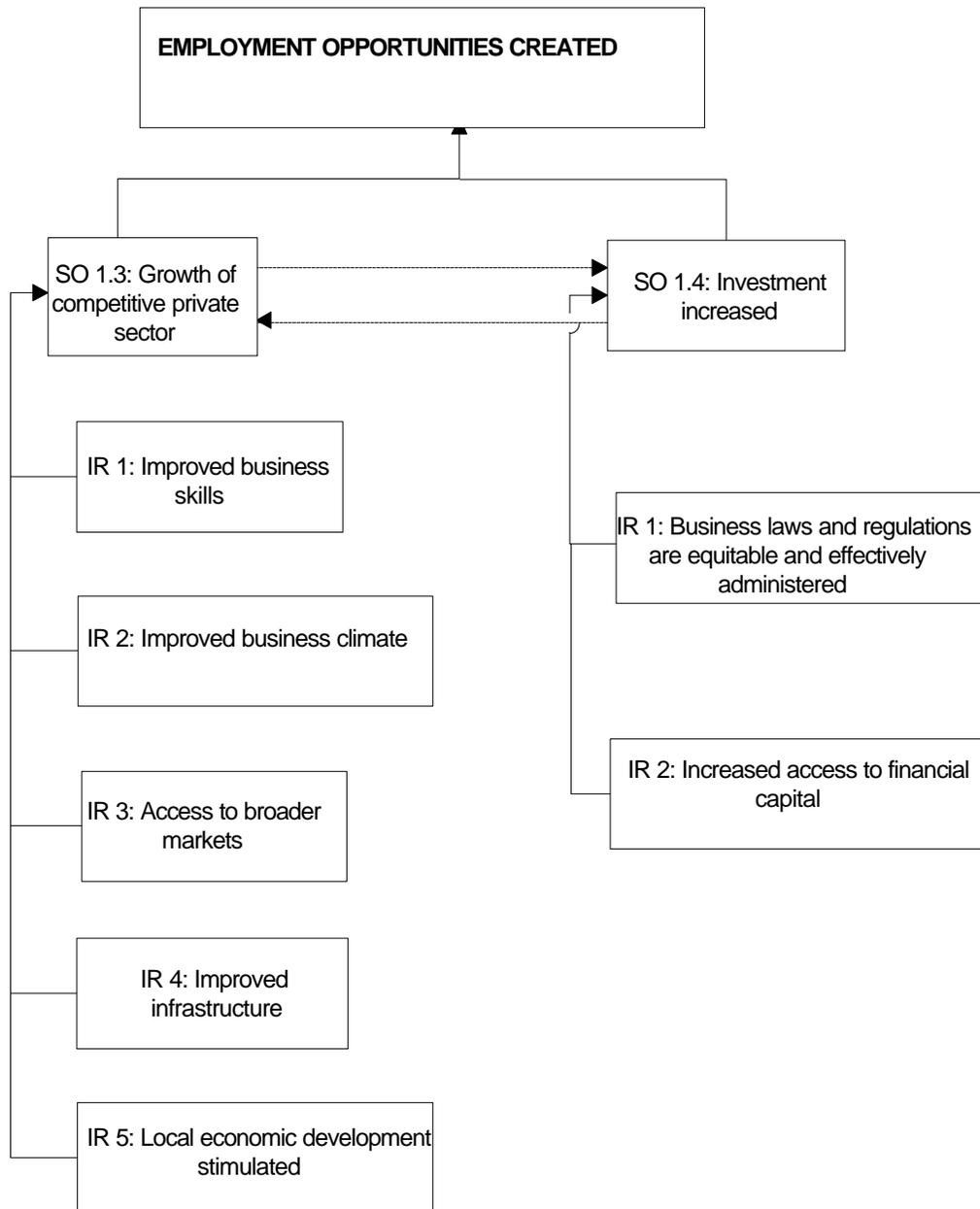
Two key problems will complicate and constrain the attainment of this strategic goal and therefore need to be acknowledged up front:

First, it should be recognized that many established Armenian businesses and government units have low productivity levels due to excessive employment. In the short term, the creation of efficient and competitive private enterprises and government units offering sustainable employment will necessitate the elimination of redundant employment which, in the short run, will work against decreasing unemployment overall.

Second, progress toward this strategic goal is highly dependent on Armenian firms reaching beyond the limited domestic market and selling to the 50 million consumers in the neighboring region. Continuation of the blockade, however, cuts off roughly half of the potential population in this regional market and adds to the transport costs of selling Armenian goods to other parts of the market [10]. Hence, political resolution of the Nagorno-Karabakh dispute is essential to Armenia's near and long-term prosperity.

While both of these acknowledged problems will clearly constrain the ability to expand productive employment opportunities in Armenia over the strategy period, the potential costs of not directly addressing the very tangible problem of unemployment are too great to ignore. The mission acknowledges limited expectations for measurable increases in new, productive employment opportunities and/or measurable decreases in unemployment and underemployment over the strategy period. As a strategic goal, the mission will measure changes in employment but will not hold itself accountable for achievements at this level.

Figure 2



B. Employment

Background on Employment: While the economic growth rate has been fairly robust since 1994, it is clear that poverty is chronic. High unemployment rates and low wages for those who are employed place the already weak social safety net under extreme pressure. Structural and economic reforms have added to the population's distress by the required elimination of most subsidies, deregulation of prices on items such as bread and some transportation, and steadily increasing tariffs for utility services. These changes, while economically appropriate and necessary, have extracted a significant personal toll on much of the population.

The condition of Armenia's people is reflected by the following:

- In 1997, wages comprised 26 percent of household income compared to 76 percent in 1985. Primary dependence for many now is on humanitarian aid, both from Government donors and NGOs and from relatives, including the diaspora and Armenians working abroad [11].
- In 1998, the average wage in the state sector was \$34 per month, barely 20 percent of the estimated minimum required for a family of four [12].
- Each year between 40,000 and 50,000 graduates of secondary and tertiary institutions enter the labor force. There are roughly 25,000 retirees each year, but many, probably the majority, of their positions will never be refilled, as government and industrial entities attempt to streamline and downsize their workforce. According to the GOA, the economy generated only approximately 8,000 new jobs in the first 10 months of 1998. Judging from these statistics, likely only half of these graduates will find employment [13, 14].
- A survey of 1,200 households conducted by the Ministry of Statistics in November 1996 revealed that 62 percent of unemployed had been in search of jobs for more than one year [15].
- State support for those registering as unemployed is \$5 per month. Moreover only 15 percent of those registered actually receive these payments [12].
- While Armenia was justifiably renowned in the Soviet Union for high educational and skill levels, educational and training facilities are severely underfunded or relying on outmoded subject matter and teaching techniques or both. Armenia's greatest asset, its human capital, is eroding both absolutely and relative to many of those with which Armenia must compete.

From economic, political, and social standpoints, both collectively and individually, this situation is potentially destabilizing without the safety valve of continuing out-migration. Those possibilities have become more limited by the economic crisis throughout the FSU where most emigrants have traditionally found work. Addressing the problems of unemployment and underemployment must be faced, both directly

(through firm and community level assistance) and indirectly (through legal, policy, regulatory and financial sector reforms).

Armenia's Current Resource Situation: Armenia's overall natural resource endowment is poor. The country does possess some mineral wealth, such as gold, iron, copper, and building stone, but these are insufficient to support growth. Due to its dry climate, high altitudes, and generally poor soils, Armenia's agricultural potential is limited. While there is some scope for agriculture-based specialty products, such as brandy, wine and fruits, Armenia is and will continue to be a net importer of foods and fibers. Finally, Armenia's energy resources are poor. As has already been discussed, Armenia's greatest resource is its human capital (particularly in natural sciences and engineering, but also in the arts as well as wide variety of other fields), but this advantage is eroding under current circumstances.

Armenia historically has been at a crossroads for trade and travel. This historically strategic location is currently severely constrained by the closed borders to both Turkey and Azerbaijan, which effectively eliminate east-west trade opportunities for Armenia at present. Its history may offer Armenia some potential in the form of niche tourism, particularly among diaspora Armenians.

The diaspora of Armenians scattered world-wide is another, often underestimated resource for Armenia. Concentrated in the United States and France, but found throughout the world, many diaspora Armenians are highly educated and skilled, have personal financial wealth, and considerable interest in helping the "homeland." However, they have been reluctant to undertake major economic investment given the problematic investment climate and concerns about the rule of law in Armenia.

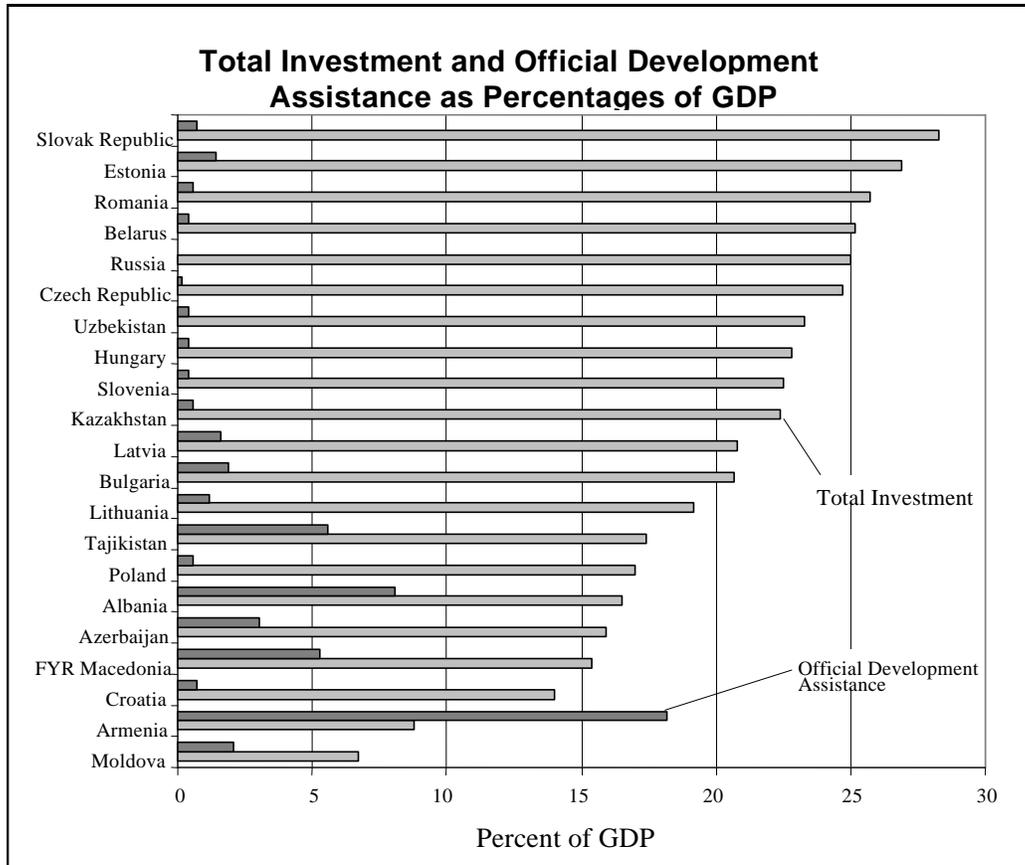
As is generally true throughout the FSU, Armenia's capital stock is outmoded and poorly maintained. This is true both for the infrastructure --- e.g., water, energy, transport, communications --- and for production facilities. Lack of investment, poor management and maintenance systems, and lack of market-based pricing/tariff structures all contribute to the continuing deterioration in capital stock.

Armenia's domestic market is exceedingly small and, by itself, will be able to attract and support only limited development. Under current circumstances, even Armenia's limited domestic market potential is seriously underdeveloped. To convey a sense of this, based on its purchasing power parity GDP, the Armenian economy is equivalent to a U.S. city of 325,000 (such as Peoria, Illinois); based on the dollar value of its GDP (which is probably a more relevant measure for foreign investment and trade), the Armenian economy is equivalent to a U.S. city of 57,000 (such as La Crosse, Wisconsin). Thus, there is significant room for growth within the current domestic economy, but, even under the best of circumstances, this domestic economy will never be sufficient to support the country. In isolation, Armenia will remain poor. It must seek external market opportunities to succeed.

By virtually any measure, investment levels are poor in Armenia. The EBRD reports that total investment equals 8.8 percent of GDP, among the lowest in the FSU and Eastern Europe (see Figure 3). The very low investment rate is particularly surprising in view of the very large volume of assistance to the country. As a percent of GDP, Armenia receives more official development assistance (ODA) than any

other nation in the FSU and Eastern Europe. In Armenia ODA is twice the magnitude of investment. In addition to ODA, Armenia receives large cash infusions from the diaspora and remittances from Armenians working abroad. Clearly, the very large majority of these infusions are being used for current consumption, often on imports, or are leaking out of the economy as capital flight, rather than being used for investment. In other words, domestic saving/investment rates are actually negative. Unless the inflow of funds from ODA, the diaspora, and remittances is considered permanent, Armenia is not only poor, it is living beyond its means.

Figure 3 [16]



In addition to a low overall investment rate, investment by foreigners is low. In 1997 there was \$51 million in foreign direct investment (FDI) in Armenia. In terms of GNP, Purchasing Power Parity GDP, or on a per capita basis, this is one of the lowest FDI rates in the FSU (see Figures 4 and 5).

Figure 4 [17, 18]

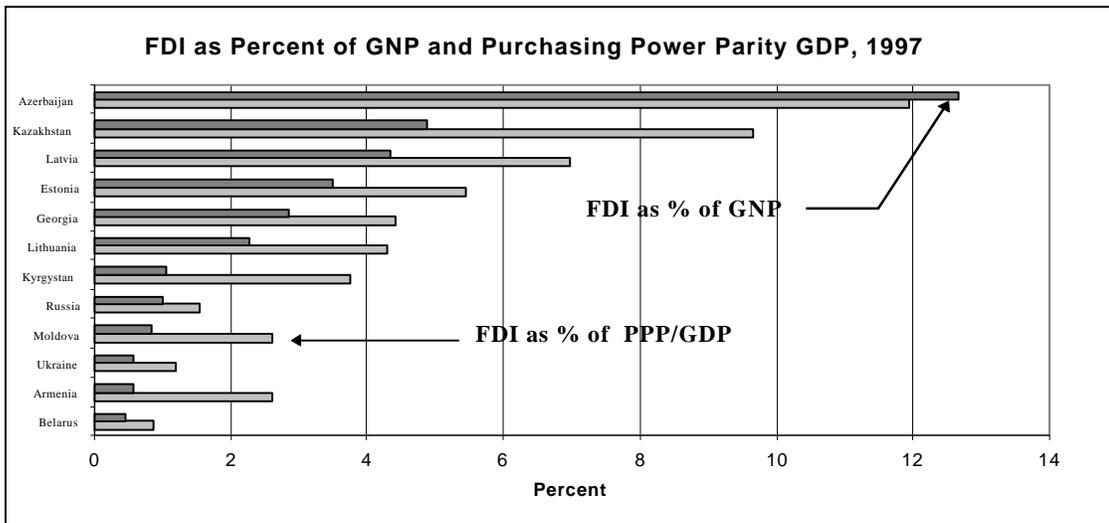
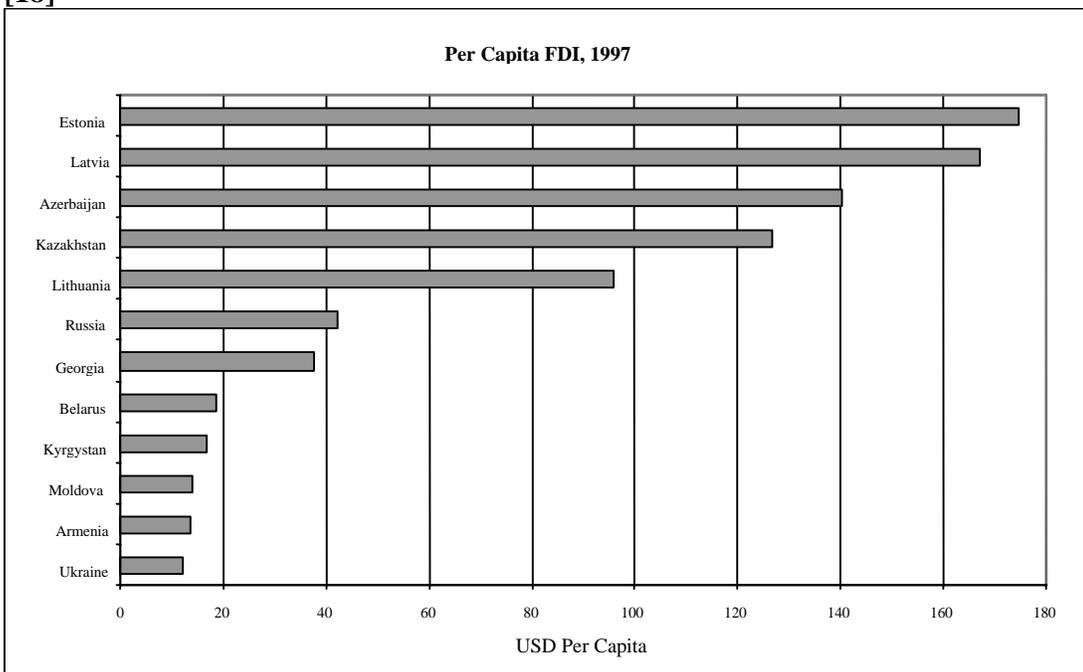


Figure 5 [18]



Armenia's external trade performance is also poor. In Figure 6, exports as a percent of purchasing power parity GDP are shown for twenty small nations with narrow resource bases. Armenia's exports are only 2.5 percent of its purchasing power parity GDP. Moreover, Armenia's external trade performance is deteriorating. Between 1994 and 1997, export levels were stagnant, while imports more than doubled (see Figure 7). Armenia now imports nearly four times the value of its exported goods and services. It is highly doubtful this is a sustainable situation and, even if sustainable, it cannot lead to prosperity.

Figure 6 [19]

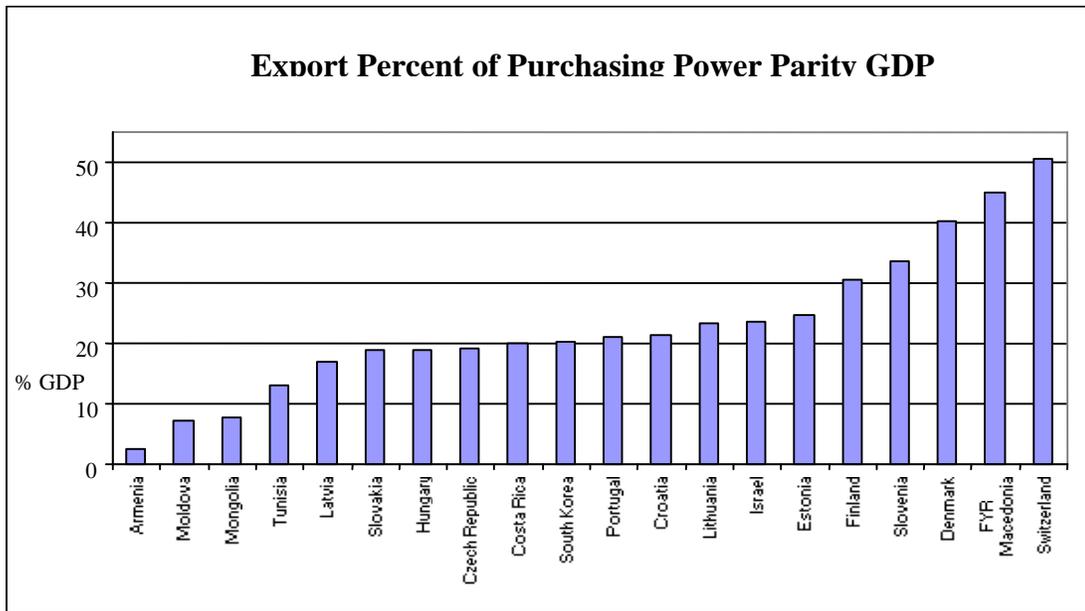
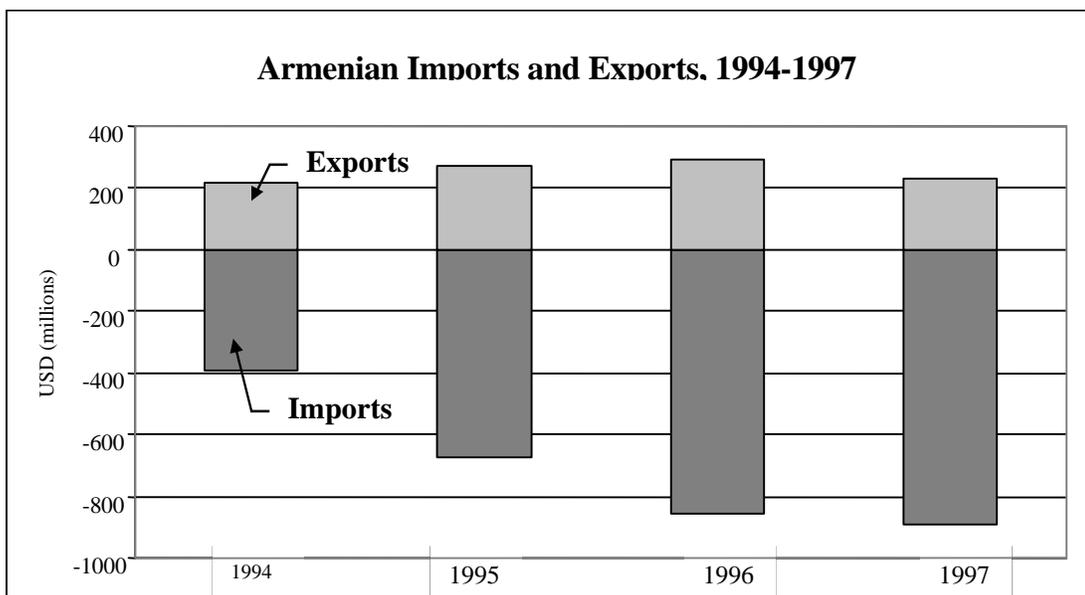


Figure 7 [20]



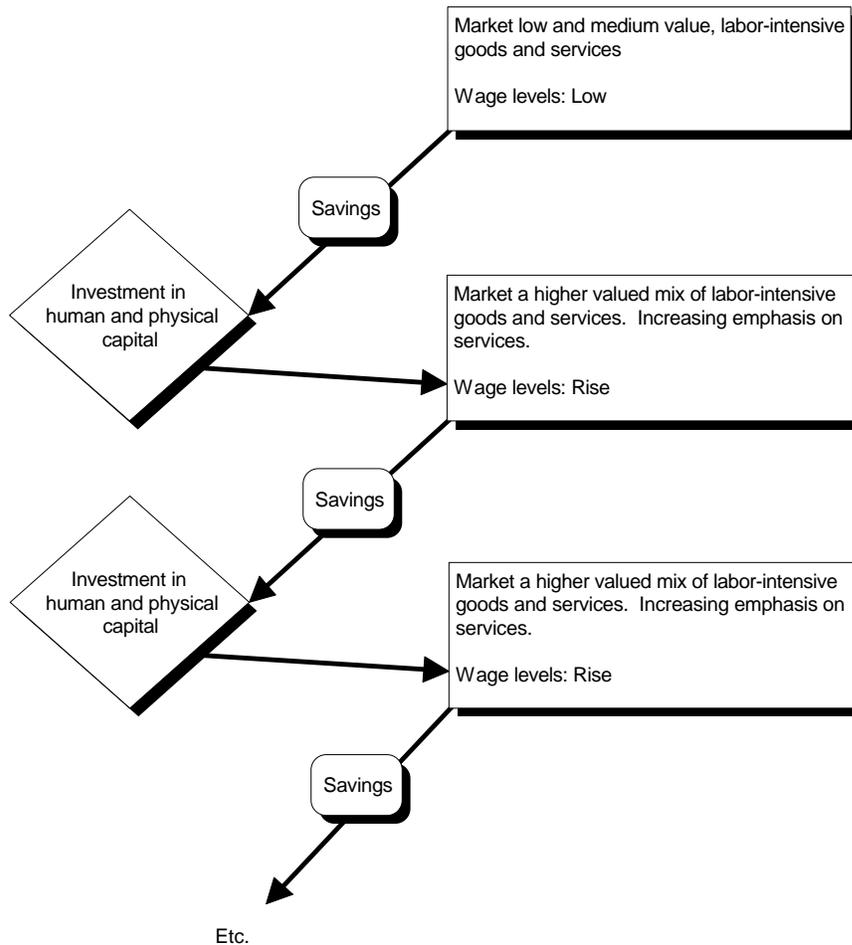
The international political situation related to Nagorno-Karabakh and other reasons for friction between Armenia and both Turkey and Azerbaijan have a negative effect on the economy. Uncertainty, reduced trading opportunities, and increased transport costs combine to reduce domestic and foreign investments and lower both the amounts and dollar-for-dollar benefits of international trade. For example, it is estimated that Armenia's exports in 1997 were \$62 million lower than expected with open borders because of virtually eliminated trade with Turkey and Azerbaijan [10].

The positive impacts of any program to improve Armenia’s economy are significantly lessened by the current blockade.

A Vision of Armenia's Development: Armenia's poor natural resource base does not, in itself, condemn its people to poverty and dependence. Some of the highest living standards and economic growth rates are enjoyed by nations and regions with poor resource bases. Examples of these include: Switzerland, Singapore, Japan, Denmark, Israel, South Korea, The Republic of Ireland, Taiwan, the Baltic Republics, and New England. A poor natural resource base does mean that development depends upon having high investment rates and fully exploiting the skills and initiatives of the population -- i.e., human resources -- to compete in world markets. Successful development in Armenia could follow a similar path to the other just-mentioned countries and regions (see Figure 8).

Figure 8

Schematic of Development Path for Resource Poor Countries and Regions



As with Israel and Ireland, Armenia’s diaspora is large relative to its own population and economy. There are an estimated 4 to 5 million individuals who are not citizens or residents of Armenia, but who claim Armenian descent. As with Israel and Ireland, Armenia’s diaspora is a source of moral and financial support and talent,

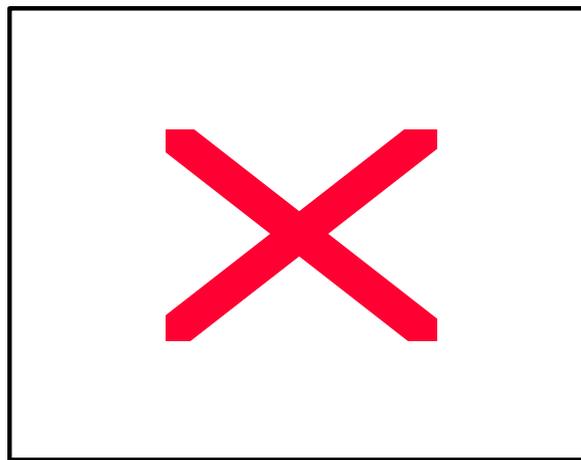
which is vital to enable Armenia to realize sustainable growth and economic independence. USAID will, through its program, look for possible ways for the diaspora and others interested in Armenia to participate more actively and productively in Armenia's development.

Measures needed to attract investment and business activity in Armenia by members of the diaspora are the same as those needed for Armenian nationals and non-diaspora foreigners. In all cases, such activities are encouraged by improvements in the consistency and transparency of laws and regulations and their application, political stability, and access to credit and information. For Armenia to realize sustainable growth, the primary source for investment and business activity must be the Armenians themselves and the business environment must be attractive to all potential foreign participants, diaspora and non-diaspora alike.

Given high transport costs from this landlocked nation to most major markets, such as Europe, East Asia and North America, and its poor resource base, it seems certain that initial investments in the Armenian economy will gravitate toward labor-intensive goods and services with relatively low transport costs and requirements per unit value. This will include light consumer goods, such as textiles and clothing, small appliances, some processed foods and drinks, jewelry, pharmaceuticals, and handicrafts; some intermediate goods, such as chemicals, software and other computer-related services, electronics components, and small machinery; and services, such as niche tourism.

If and as the political situation allows increased trade with its neighbors, expanded production of more transport-intensive goods will be possible, such as building stone, cement, large appliances, and heavy machinery. As the level of sophistication of Armenia's economy increases, the relative importance of higher valued goods and services, such as electronics and software development and financial services, will grow relative to those lower in value.

Investment and trade are the engines that can provide employment opportunities for the Armenian people. It is evident that:



Unfortunately, Armenia's performance to date regarding investment and trade is poor.

Employment growth has been and will continue to be in the private sector. Job creation has largely been confined to small businesses, chiefly in the trade and distribution sectors.¹¹ While employment in some of the now privatized state industries may recover, job creation in the future will come largely from growth in newly created private enterprises. Hence, fostering favorable conditions for private enterprise growth is fundamental to raising employment.

It is important for USAID programs to be responsive to market demands and local as well as international circumstances. As a result, at this point at least, rather than USAID specifying exactly which sectors will be the focus of employment attention, we will say that further analysis is needed to determine which labor-intensive options may be most appropriate to exploit Armenia's comparative advantages and how Armenia can make these comparative advantages more competitive both domestically and internationally. USAID will undertake further analyses as the strategy period progresses.

The GOA's Openness to Reforms: At this time, there appears to be political will at the highest levels of the GOA needed to sustain a program of broad-based economic reform that can, if maintained, fundamentally transform the country. The GOA's economic reform program aims to consolidate the macroeconomic stabilization gains already achieved, to improve prospects for sustained economic growth, to ensure that the costs of the transition are socially sustainable, and to preserve Armenia's highly educated and skilled workforce. These efforts are supported by the IMF's Enhanced Structural Adjustment Facility (ESAF) and the World Bank's Third Structural Adjustment Credit (SAC III). Together these institutions are scheduled to provide Armenia with \$124 million in loan support in 1999. USAID's strategic program is fully consistent with these objectives. Through measures to strengthen the social safety net and to improve the consistency and transparency of the legal and regulatory framework affecting business (both described elsewhere in this document), the social and economic costs of Armenia's transition to a modern market economy will be reduced.

Recognizing the importance of human capital, the GOA has assigned a high priority to reform in sectors such as health and education and has increased their shares in the national budget. These structural reform efforts are largely supported by World Bank programs. The USG will contribute significantly to the country's educational capacity through its endowment to the American University in Armenia; this institution provides the only MBA program available in Armenia.

One of the key areas where the GOA has made substantial progress in structural reforms is the energy sector, particularly the power sub-sector. The resulting

¹¹ Data from the Ministry of Statistics indicate that the "non-state" sector accounted for 57 percent of the employed population in 1997 compared to about 30 percent in 1992. While employment figures for the large informal sector are not available, data show that employment in the trade and catering branch of the economy rose by 57 percent between 1992 and 1997. Similarly, agriculture's share of employment increased from 18 percent in 1990 to more than 41 percent in 1997 [12]. Outside of subsistence farming, most of the economic activity in this sphere centers on marketing and distribution of produce. Most of these workers are informally employed. That is, not apt to be registered as business persons or accounting for their receipts to the tax authorities.

improvements in the energy supply have contributed substantially to Armenia's modest economic recovery. USAID and the World Bank have taken the lead in assistance to restructure and commercialize Armenia's energy sector. Economic and energy reforms to date will be discussed more specifically as/where appropriate in the following sections of Part II.

C. Strategic Objective (1.3): Growth of Competitive Private Sector

This strategic objective corresponds most closely to ENI Objective 1.3: "*Accelerated development and growth of private enterprises*", and to Agency objectives 1.1: "*Critical, private markets expanded and strengthened,*" and 1.3: "*Access to economic opportunity for the rural and urban poor expanded and made more equitable*".

Upon the collapse of the Soviet Union, employment in Armenia's state owned industries plummeted and income dropped to a third of prior levels. While economic growth returned in 1994, job creation has largely been confined to new, small, private businesses. To support private sector growth, major reforms already have been undertaken by the GOA, notably privatization of agricultural land and housing and the substantially complete privatization of small enterprises, price and trade liberalization, adoption of a civil code creating the legal framework for property rights and contract enforcement, and the legal and institutional framework for commercial banking.

While employment in some of the now privatized state industries may recover, job creation in the future is most likely to derive largely from continued growth in newly created private enterprises. Since Armenia is a country of only three million people, enterprises need to reach out to export markets to grow and realize economies of scale. However, overall exports were stagnant between 1994 and 1997 and their share of GDP declined [12]. Armenia's immediate surrounding region includes 50 million people and a purchasing power parity approximating \$100 billion [10]. While the blockade impedes trade to roughly half of this area, there are still major opportunities for export in the immediate region. From a macroeconomic (as well as a more micro employment) standpoint, export growth is critical; remittances and transfers are declining both as a result of the Russian crisis and as concessional assistance is reduced. Without substantial growth in exports, Armenia will be unable to finance the current volume of imports. Indeed, the level of Armenia's current account deficit (now roughly 28 percent of GDP) cannot be sustained into the future [21].

For new private enterprises to survive and grow, they must be able to compete both in export markets and the domestic market where barriers to imports have deliberately been set low to force Armenian industry to be economically competitive. To maintain a competitive edge, Armenian enterprises need access to the skills and training required to make their marketing and production operations efficient and profitable. In addition, a favorable and supportive business climate is essential to fostering creation of new enterprises and the growth of existing ones.

Armenia is landlocked, blockaded, and poorly endowed in agricultural, energy and other natural resources. For these reasons, it is all the more necessary that the costs

imposed by these poor resource endowments and isolation are not raised even higher by inefficient delivery of energy, communications, water, transport, and other infrastructure services needed by the private sector operating in a global open economy.

By the end of the five year strategy period, USAID expects to see a stronger, more productive and more dynamic private sector in Armenia that offers expanding opportunities. While this private sector will be serving the domestic market, in some cases eliminating the need for the current high level of imported consumer goods, it will also be exporting more and to a broader variety of countries. While expectations for employment creation in this emerging and strengthening private sector are modest, as businesses expand their production and their markets (toward the end of the strategy period and beyond), employment opportunities should also begin to increase.

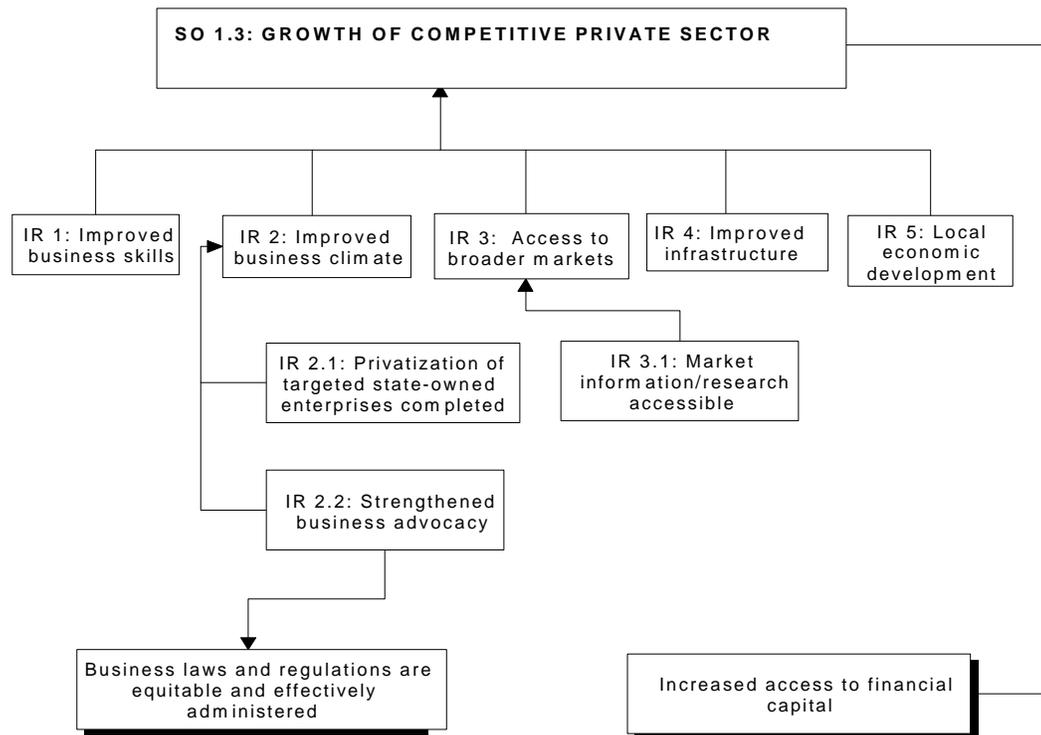
Proposed Program: This strategic objective is primarily focused on the direct firm and community level interventions needed to stimulate and support private sector growth which in turn will generate growth in employment. It is clearly and directly related to the following strategic objective, *Investment Increased*, which focuses on the more indirect "enabling environment," which will also stimulate and support private sector growth. These two strategic objectives together will address the creation of employment opportunities in Armenia.

Five intermediate results have been identified under this strategic objective (see Figure 9):

- ⇒ improved business skills
- ⇒ improved business climate
- ⇒ access to broader markets
- ⇒ improved infrastructure
- ⇒ local economic development stimulated

Improved Business Skills: Despite a large and growing number of small registered private enterprises (40,000) and a network of business support centers assisted by a variety of donors (including USAID and US Peace Corps), training and information support for business is generally inadequate be it in entrepreneurship, business start up, business operations improvement, marketing, etc. Self-help business and enterprise start-up literature is generally not available, in stark contrast to the plethora of such literature in Central and Eastern Europe (CEE) and other Newly Independent States (NIS) transition economies. Small business entrepreneurs, 70 percent of whom have university degrees, cite marketing and advertising as their highest priority for training followed by financial management and business planning [22].

Figure 9



To capitalize on Armenia's prime asset of a well educated and readily trainable workforce, and to insure competitive enterprises, skills in such areas as overall business management, marketing and sales management, cost accounting, finance, product design, technical production, and other areas of modern business practice and production must be brought to comparable international levels. Universities typically do not offer training in these skill areas apart from the MBA program at the American University of Armenia (AUA), the recently started, USAID-supported accountancy training, and, reportedly, some smaller, newer private schools of business. Continuing education in business skill areas, entrepreneurship, business plan development, and related areas is not widely available. Use of outside expertise to supplement lack of experience or training within firms is rare. The knowledge and experience base of the Armenian trainers and consultants furnishing enterprise advisory services is limited. Hence, improving training of business skills is critical to fostering private sector growth and productivity. The development of appropriate vocational skills for young people not bound for universities or similar institutions is also a crucial ingredient for private sector growth.

To address these needs, USAID will continue on-going support to the development of the Armenian accounting profession. Armenia has adopted by decree the most critical of the International Accounting Standards, and internationally accredited accounting and auditing training is underway. To broaden the range and availability of other business skills training, USAID will support the development of business skills training packages both in formal institutions of learning as well as on a continuing

education basis, taking advantage of past business skill curriculum development efforts in other FSU and Eastern European countries. Close coordination with EU/TACIS business support services will be required to avoid duplication and enhance reinforcement of training efforts.

In addition, USAID will train a core of Armenian trainers and consultants to deliver business advisory services on a fee-for-service basis; steps to develop a market for such services will be included in the USAID intervention. USAID also will continue to provide limited direct firm and farm level technical assistance and training. Increasingly such assistance will emphasize team consulting so that the core of Armenian business consultants trained by USAID receive practical hands-on training in furnishing expertise to businesses.

In later years of the strategy period (e.g., FY 2001 and beyond), consideration may be given to the need for retooling/upgrading of technical skills of those employed in production and manufacturing. The orientation and content of such potential curricula would need to be market driven and revised so as to provide manpower (both new entrants as well as retrained employees) appropriate to modern production methods and technology.

Improved Business Climate: While several business associations exist, none have been providing member services or become articulate advocates for representing business interests before government. If momentum is to be sustained in economic reform and business laws are to be equitably, transparently, and predictably administered, businesses need to be active in monitoring and lobbying government actions. They need to broaden the base of public support for continued economic reform and pressure the government to take action in support of broader access to markets which will allow private business to grow and, with them, increase employment opportunities. To bolster this role, USAID will provide modest assistance to selected business associations.

Continued movement on privatization will demonstrate government commitment to private sector development and open further opportunities for private sector development. Despite substantial progress on privatization, the program is far from complete. Out of an original inventory of some 10,000 state owned enterprises, unfinished construction, and other facilities, some 3,000 remain in state hands and are programmed for privatization. These remaining resources locked up in state owned enterprises, including industrial land, need to be released through privatization or liquidation so that they can be put to more productive use in the private sector. USAID will consider continued assistance of these to-be privatized firms in the medium and larger enterprise categories, if/as GOA commitment to the process is maintained.

Conveying full ownership rights to urban/industrial land is key if businesses are to commit to making major fixed asset investments for production of goods and services and if land is to be used effectively as collateral to obtain needed credits. With USAID assistance, key laws on land registration and transfer of state industrial land have already been drafted and a methodology tested for rapid surveying, registration, and titling of land. Both the EU/TACIS and the World Bank are furnishing financing

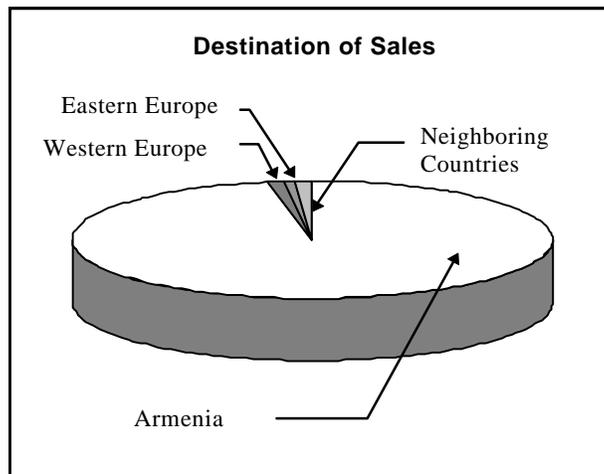
to implement titling nationwide, based on the procedures being developed with USAID. With this financing in hand plus progress made to date, little further technical assistance beyond the current USAID land registration activity is likely to be needed.

Access to Broader Markets: If Armenian private enterprises are to expand, existing and new export markets need to be tapped to their full potential. To date, most new private Armenian enterprises have focused on sales almost exclusively to the domestic market (see Figure 10); of total sales by Armenian owned enterprises, only an estimated three percent are exports [10]. Information support to Armenian enterprises is generally inadequate. Information on taxation, customs clearance, registration requirements, and legal changes is only sporadically available. Further, businesses have little market information available to them; surveys show that businesses rely heavily on general media and family and friends for market information rather than detailed business sources. To correct these deficiencies, USAID will work to establish Internet access and linkages to databases to provide Armenian businesses with knowledge of domestic and foreign market conditions and opportunities. Assistance will also be furnished to develop market research practitioners. Included in these trade promotion efforts will be specialized assistance for a select number of sub-sectors in production technology, product design, packaging, quality assurance, and marketing for export development. In addition, continued but limited firm and farm level direct technical assistance is anticipated to further equip Armenian firms to compete in export markets.

Improved Infrastructure: A key constraint to private sector growth is lack of a well-maintained infrastructure. In a separate strategic objective, USAID highlights and addresses the particular problem of the energy sector in Armenia. However, other infrastructure, such as roads, railroads, telecommunications and water/wastewater, are also extremely important inputs to private sector growth and development (as well as increased investment) in Armenia. USAID recognizes their importance both to domestic growth and increases in international trade. However, given current program budget levels and management capabilities, we are unable to initiate activities in these areas (and will confine our attention and resources for the time being to energy). This strategy acknowledges the importance of these infrastructure inputs and allows for the possibility of our involvement (not, it should be emphasized, in physical construction but in improved infrastructure management which would leverage the investments of other donors, such as the World Bank, needed for actual construction/reconstruction) over time, if/as funding and other circumstances allow.

Local Economic Development Stimulated: Throughout Armenia, in urban and rural communities, opportunities to create jobs and generate income are constrained. As noted in Part I, a lack of cash is a frequently cited problem that is related in a circularity of low demand for goods and services, resulting in a low availability of economic opportunities. Donor attention has increasingly focused on credit programs, business development skills, and targeted technical assistance as means of promoting small-scale businesses with family income and/or limited employment generation potential. USAID will continue to support these programs (see SO 1.4, *Investment Increased*, for details). However, all of the intermediate results

Figure 10 [10]



discussed above have focused on the need to support private sector growth as the primary means of expanding job opportunities. While this is clearly important, in the short-run more immediate focus directly on job creation may also be necessary.

Despite Armenia's limited base of arable land, the land privatization of 1991 created a large group of small landholders that has enabled survival of the rural population and better income earning opportunities from the production and sale of agricultural produce. Still, the rural population is to a large degree underemployed and the small size of individual landholdings limits agricultural sector efficiency. In addition, the rural landless are largely at risk for poverty. At the same time, unemployment and underemployment are also visible problems in small urban communities and poverty rates tend to be higher in urban than in rural areas. In both urban and rural areas, local governments have limited ability to raise revenues and deliver services. Resources of the fledgling domestic NGO sector are quite limited and tend to be focused on the needs of the larger urban areas.

As the market economy develops, there is a danger that smaller communities (as well as marginal urban communities) will become increasingly isolated from the mainstream economy as it develops. Already many of the young people have left to try their luck in Yerevan or abroad. Thus, in addition to its efforts to expand employment through private sector growth noted above, USAID will devote itself to limited experimentation in more direct efforts to generate employment. In the end, there may not be a significant difference between a focus on private sector growth and one on employment, but USAID considers it important to explicitly focus on employment in an effort to identify what may and may not work most effectively.

Pilot initiatives will build on lessons learned from the experiences of the Armenian Social Investment Fund (ASIF) and USAID's Community Development Program, among others, and/or identify new and creative opportunities to increase employment opportunities through community-based interventions. Various actors, including local government, private businesses, and NGOs need to find mechanisms for cooperation that will help to remove obstacles to job and income generation that can have broader

community spread effects. USAID will develop a program which will: (1) assess appropriate sectors and/or subsectors for specific targeting of opportunities at the community level; and (2) likely be open on a competitive basis to local governments, community organizations, associations of producers, and other non-governmental organizations for the purpose of financing investments aimed at creatively increasing local level employment opportunities and incomes. Experimentation in community based employment creation -- linked to market reforms and USAID's overall employment strategy -- would be encouraged. Activities that might be considered for such financing include, for example, conversion of municipal properties to productive use, development of business incubator space, small scale irrigation rehabilitation and expansion, conversion of "social" assets to productive and income producing use such as tourism, start-up of private sector provision of local government services, and economic use of natural resources on a sustainable basis (e.g., sustainable fuel wood production). Every effort will be made to ensure that women are provide equal opportunity in access to employment and income generating opportunities (see Annex 4 - Gender).

Complementary to these initiatives are the microenterprise credit programs financed by USAID and a variety of other donors (see section on SO 1.4, *Investment Increased*, for details). As new employment and income generating opportunities are created as a result of local economic development initiatives, microbusiness credit programs (as well as the small business loan programs) can provide the financing needed for entrepreneurs to take advantage of these opportunities.

D. Strategic Objective (1.4): Investment Increased

This strategic objective corresponds most closely to ENI Objective 1.4, "*A more competitive and market-responsive private financial sector*" but also includes elements of ENI Objective 1.2, "*Increased soundness of fiscal policies and fiscal management practices.*" The most closely related Agency Objective is 1.1: "*Critical, private markets expanded and strengthened*".

Increased investment both by and in the private sector and in public sector infrastructure is essential if the private sector is to grow and create jobs. Current levels of overall investment at roughly 10 percent of GDP are totally inadequate given Armenia's dilapidated stock of fixed assets and obsolete production techniques. While considerable progress has been made in putting into place the legal framework for markets to work, that framework is not yet complete. Further, inconsistencies in existing laws, coupled with a lack of transparency and unpredictable administration of laws (most especially of those applying to customs clearance and taxes), creates uncertainty which discourages business investment.

Access to financial capital is also essential to increasing investment in the efficient production and sale of goods and services and public infrastructure. The banking sector requires further deepening if it is to serve its role in meeting the savings and credit needs of businesses and households. Equally, Armenia's nascent capital market requires substantial investment in infrastructure and significant improvement in the underlying level of economic activity before it can function effectively. A singularly important impediment to further development of Armenia's financial sector and

improving access to financial capital remains the low level of domestic savings and a government deficit that absorbs what little deposits there are in the banking system and generates high interest rates. Armenia's external debt of some \$800 million represents a comparatively large (48%) proportion of GDP, but given that most of it comprises loans made on a concessional basis, debt service remains low as a proportion of exports of goods and services (15% in 1997) [21]. Nonetheless, debt service as a percent of export earnings is slated to increase; hence it is all the more important that insofar as possible, future investment be financed domestically, as the room for servicing further external debt is limited.

As noted in Part I, USAID anticipates that, by the end of this five-year strategy period, Armenia will have largely completed its "reform" phase of development, having put in place most of the institutional (legal, regulatory, and most importantly, enforcement) structures -- many of them the focus of this strategic objective -- necessary for a free market economy.

Proposed Program: This strategic objective is clearly and directly related to the previous strategic objective, *Growth of Competitive Private Sector*, in addressing the problem of unemployment and underemployment. This strategic objective addresses the more indirect "enabling environment" that will encourage and support investment. In this regard, it is also very closely connected to the strategic objective, *Laws are Enforced and Adjudicated Impartially*, since both are focused on reducing corruption and other disincentives to investment.

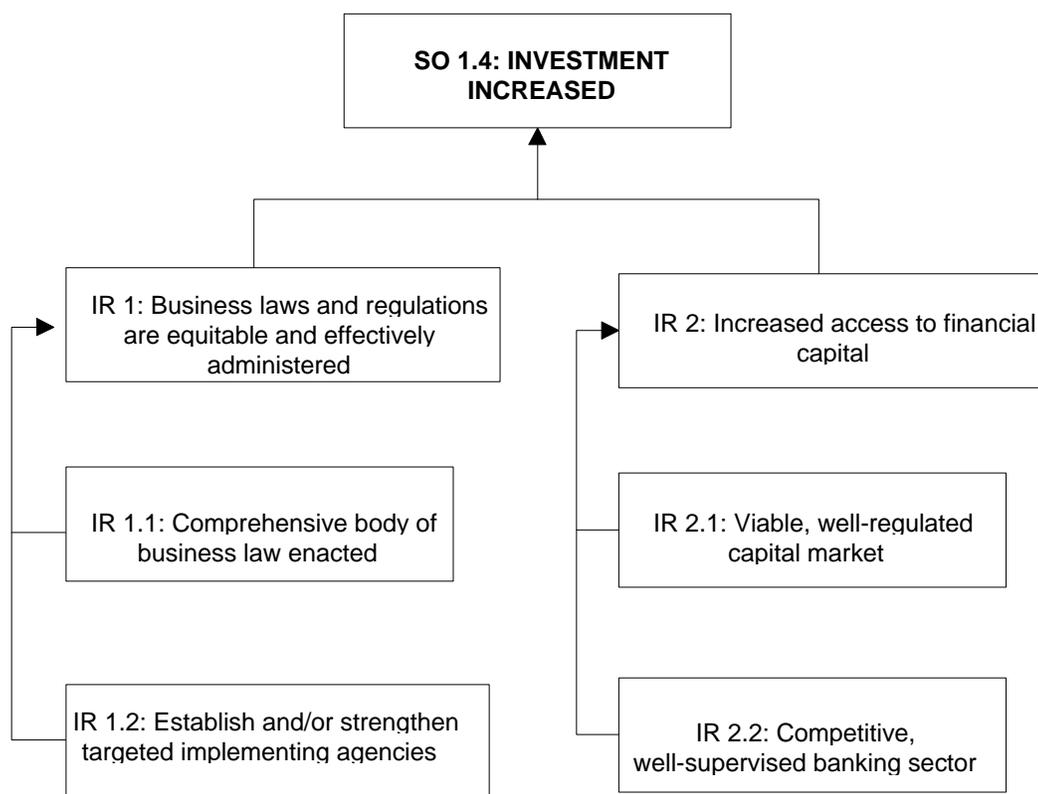
USAID has identified two intermediate results to achieve this strategic objective (see Figure 11):

- ⇒ business laws and regulations are equitable and effectively administered
- ⇒ increased access to financial capital

Business Laws and Regulations are Equitable and Effectively Administered: Private sector investor confidence is nurtured when the rules of conduct are clear, equitable, business friendly and predictably applied and enforced. While Armenia has taken great strides to put into place a legal and tax structure conducive to private business, further progress is required.

Given Armenia's small size and limited resource base, ready access to inputs is vitally important to all Armenian business. However, Armenian and foreign businessmen uniformly cite the uncertainty of treatment and delays in customs clearance as a major barrier to business expansion and hence increasing investment. Similarly, investor confidence is adversely affected by lack of clarity and consistency in interpreting and applying tax provisions with a resulting wide disparity in determinations of tax liability. While many of these problems are caused by inconsistent application, inconsistencies and disincentives to investment persist within the tax code itself. Ongoing USAID and other donor efforts have already lead to some improvements, e.g., a modernization plan for the tax department. USAID will continue work with the International Monetary Fund (IMF) and the U.S. Department of Treasury in assisting Armenian customs and tax

Figure 11



authorities to improve the customs and tax codes and their administration. World Bank assistance in civil service reform will support these efforts.

USAID will also provide assistance to assure completion of the legal framework for private sector growth and investment, notably with respect to company organization (especially in such matters as the limits of liability of enterprise founders, rights of minority shareholders in joint stock companies), securing surety of interest and pledging interests in real and movable property, foreclosure and bankruptcy, registration of for profit and non-profit entities, and authorizing (and most especially delineating) the scope and underlying rationale for government licensing activities. Assistance to ensure open and fair government procurement through a new government procurement law will also improve the overall business climate by helping to eliminate the possible scope for corruption (see also Annex 1 - Corruption).

Finally, laws conducive to private sector growth and investment will have little effect if their enforcement cannot be assured. For this reason, strengthening of legal and judicial training in areas of business law and other rule of law activities (linked to strategic objective 2.2) directly reinforces achievement of this intermediate result. Beyond assistance in legal drafting, assistance will also be provided to make operational some of the organs of government created by new business laws, such as the collateral registry, the office of government procurement, and a company registrar.

At the present time, the mission has no specific plans for environmental legal or regulatory interventions. As the strategy period progresses, however, there may be increasing interest in the inclusion of laws covering environmental protection and/or the environmental liability of privatizing industries (see Annex 6 - Environment).

Increased Access to Financial Capital: The availability of domestic savings for investment is severely constrained. Drastic cuts in household income levels, the past erosion of household savings by hyper-inflation, and the past closure of banks all have contributed to extremely low (if not negative) household savings and a marked lack of confidence in financial institutions. While government expenditures have been cut, tax revenues remain low and the government's fiscal deficit (even after substantial foreign grants) remains high at 5-6 percent of GDP [21]. The resulting financing of the deficit absorbs the limited pool of domestic savings available within the financial sector, bids up the price of money, and crowds out the ability of the private sector to obtain formal financial sector financing. Raising the future level of domestic savings in the formal sector is highly dependent on continued growth in personal incomes (hence employment creation is so necessary) and creating the financial institutions, instruments, incentives, and regulatory oversight that will mobilize households savings. Further, increased tax collections would provide resources for needed public investments and reduce public sector borrowing and the squeeze it puts on resources available for private sector investment.

Increased levels of domestic savings in formal financial institutions will raise the availability of funds for financing. Improving access to finance, however, requires the development of financial market institutions and instruments. Their development, in turn helps to raise the level of domestic savings. In addition, their development can stimulate the flow of foreign investment; first by creating a financial market and instruments with sufficient liquidity to be of interest to foreign portfolio investors, and second by making it possible for foreign direct investors to tap local financial resources for working capital and expansion needs.

Armenia's current four stock exchanges do little to increase access to finance because of their low level of activity, low transparency and lack of liquidity. Activity on the stock exchanges is further hindered by the absence of an integrated capital market structure, including a share registry, clearance and settlement system, depository, and trading system that centralizes all bids and offers. USAID's already initiated program is designed to correct these deficiencies by furnishing assistance to establish independent, regulatory oversight over the capital market and to develop the related capital market infrastructure. The lack of liquidity will be more difficult to overcome, and will require development of a shareholder base among the general public plus institutional investors, notably investment and pension funds.

Production and distribution of reliable financial information will be essential if investors are to make decisions based on their internal calculations of risk and likely return. USAID's ongoing successes in developing standards of financial disclosure and training in financial accounting will continue to fill this need. Currently, the number of individual shareholders are few (roughly 130,000) and largely represent employees of state owned enterprises who received shares as a result of privatization. Institutional investors are totally lacking, and even the legal structure for the

development of investment funds and privately managed pension funds is absent. Development of a shareholder and institutional investor base will allow enterprises and organs of government to tap the capital market for long-term financing for investment. A functioning capital market plus assistance in establishing investment and venture capital funds should also serve to attract foreign portfolio investment, especially from the Armenian diaspora.

To bring these conditions about, USAID proposes to furnish continued support to capital market development beyond the current activity in order to assist Armenian enterprises to tap the capital market via new public offerings to raise capital and via introduction of investment funds. As a part of this program, USAID will investigate the advisability of creating a business investment fund. A modest USAID equity contribution could possibly leverage a proportionally larger Armenian diaspora investment in the venture fund.

Further to bolster the development of institutional investors and thus realize the investment in capital market development, USAID may consider support to pension reform in coordination with World Bank activities (currently in the initial stages of development), and eventual establishment of the regulatory and institutional structure for pension funds. Such an activity would need to be closely coordinated with the strategic objective, *Strengthened Social Safety Net*, which will also be addressing pension reforms from a social welfare perspective.

Armenia's banking sector is currently comprised of 31 commercial banks, 29 of which are privately owned. Supervision over them has been tightened, but public confidence in banks remains low with a consequently low, though growing, level of deposit mobilization. Further improvements to bank supervision, such as the implementation of on-site bank examinations and improved loan risk and performance classification criteria, should bolster public confidence. Consequently USAID, in cooperation with the IMF, will furnish assistance to assure that Armenia's central bank can enhance its bank supervision through improvements in these areas.

Finance for business is limited given the low level of deposit mobilization; most business financing is only available through commercial bank implemented donor credit programs for small and medium business. In addition to the resources extended to support private sector growth, the value of these programs lies in inculcating credit appraisal skills in bankers and demonstrating the profitability of lending to smaller, private businesses. Bank training reinforces these skills. However, for the demonstration effect to hold and banks to make such loans out of their own resources, default rates on these loans must be kept low, and penalties on default enforced. To assure that business has access to credit and that banks continue to learn the appraisal and collection skills needed for commercial lending, USAID will continue its existing credit program for small and medium enterprises and has started up a new credit program in FY 1999 that will target both small and micro businesses.

Other constraints to obtaining bank finance relate to the lack of a framework for pledging land or other assets as collateral for loans. While the recently enacted civil code provides the essential legal framework for commercial transactions, other essential laws to assure surety in property rights and commercial transactions are not yet in place or enforced. While agricultural land has been privatized as have most

apartments, registration of property title is only now beginning as is a system for registering mortgages and other pledges on property. Without such a system and well defined procedures to foreclose on pledged properties and an active land market which allows for reasonable estimation of value of pledged land and ready liquidation of pledged assets, banks find it difficult to lend their own funds against property. For this reason, USAID will continue its work on title registration and related mortgage laws and provide assistance to assure that a collateral law on immovable property is developed and made operational. The work on title registration is in concert with EU/TACIS and the World Bank.

Access to finance is in a very broad sense further confined by the high cost of money. With Treasury bills commanding rates in excess of 50 percent, share offerings on a stock exchange will be difficult to place and access to bank finance is limited to comparable rates. Improved tax collections are thus vital to increasing access to finance, for without collection improvement, public sector borrowing will not be reduced and the pressure on domestic savings relieved. Hence, improving tax administration, a continued key USAID activity, coupled with civil service reform being undertaken by the World Bank, is an essential prerequisite for improving access to finance. USAID support for re-organization of district tax offices, automation, revisions to the tax code, and tax payer education are all aimed at increasing the number of taxpayer filings. Better management also needs to be introduced to the government's system of social transfers, including pensions. Improved knowledge about the extent of future liabilities and careful introduction of funding alternatives can assure a sounder basis for the development of Armenia's financial system and take advantage of USAID's investments in capital market formation.

E. Strategic Objective (1.5): A More Economically Sustainable and Environmentally Sound Energy Sector¹²

This strategic objective matches ENI Objective 1.5, and corresponds most closely to Agency objectives 1.1: “*Critical, private markets expanded and strengthened,*” and 5.4: “*Use of environmentally sound energy services increased*”.

The development of an efficient, reliable and cost-effective energy sector is critical for sustainable economic growth, environmental protection and social welfare. Moreover, Armenia is poorly endowed in terms of energy resources and cannot afford to squander limited finances and increase its external debt burden by subsidizing inefficient consumption and neglecting needed energy improvements. It also risks a regional environmental disaster of great magnitude by continuing to operate the Armenian Nuclear Power Plant (ANPP).

During the Soviet era, the provision of cheap energy to industry and residential consumers resulted in wasteful consumption patterns on a wide scale. In the wake of

¹² As noted in the “Infrastructure” intermediate result under SO 1.3, the mission recognizes the importance of infrastructure beyond just energy. While USAID only proposes an energy strategic objective at this time, we would like to open the discussion with ENI/Washington on the appropriateness and importance of an expanded strategic objective covering infrastructure more broadly defined (more than likely with intermediate results focused on investment and efficiency as already proposed for the energy-specific strategic objective).

the Soviet Union's demise, overall energy consumption declined dramatically as a result of the collapse of Armenia's industrial base. However, the energy sector, particularly the power subsector, continued to serve as a source of subsidies to enterprises and the population at-large through low tariffs and low collections. The resulting low revenues have been insufficient to cover maintenance and investment needs, as well as the costs of imported fuel. Over the past several years, the GOA has made significant progress in reducing these quasi-fiscal subsidies and implementing other measures to financially rehabilitate the sector. Nonetheless, further deepening of reform in this sector is needed to reduce its burden on the state's budget, thereby freeing financial resources for more productive purposes. Strong opposition to increasing the electricity tariff, both within and outside of the government, slowed the implementation of the GOA's reform program in 1998. In 1999, the financial operations of the energy complex are expected to result in a net loss of \$62 million (3% of GDP) [4].

Since 1995, USAID has reduced humanitarian assistance to the energy sector and concentrated more resources on the systemic reform of the sector. This strategy, which is coordinated with the World Bank's program, has contributed strongly to achieving a number of key successes including: the passage of an Energy Law; the creation of an Energy Regulatory Commission; the complete restructuring of the electric power sector; the improved financial viability of energy enterprises through increased collections and introduction of International Accounting Standards (IAS); the privatization of 13 mini-hydroelectric plants; and the identification of replacement power projects that could be developed to enable the closure of the ANPP by 2004.

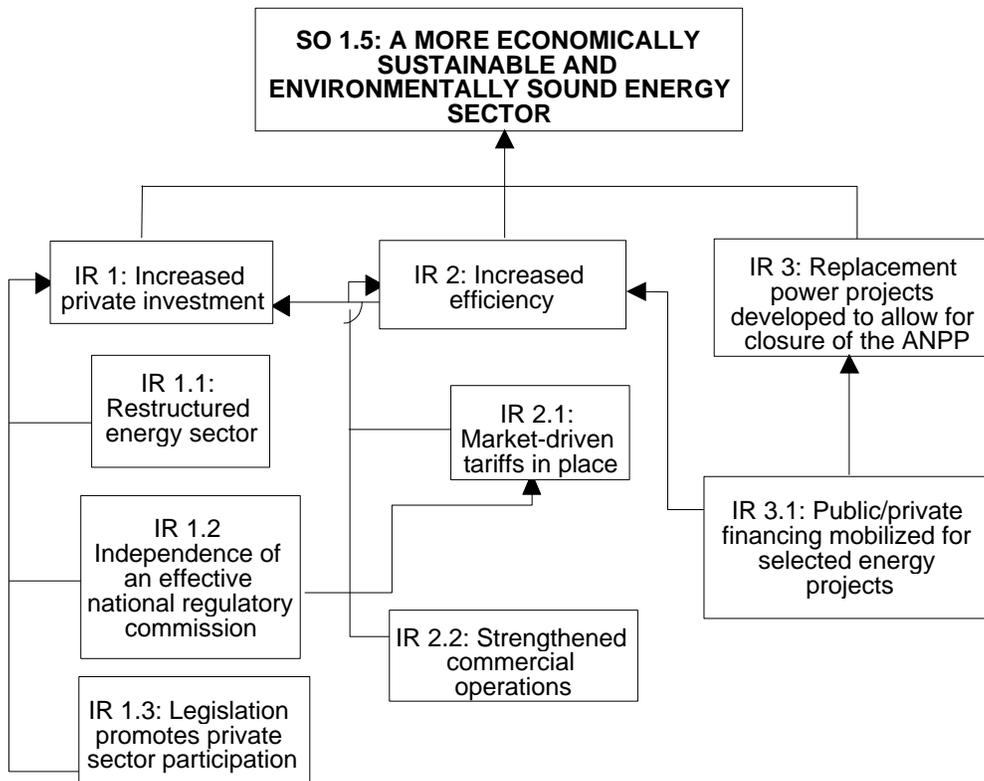
By the end of the proposed strategy period, USAID expects to have completed its contributions to the energy sector and to leave behind a sustainable and efficient system. Reforms and management improvements are already well along but need continued support for several more years.

Proposed Program: To achieve this strategic objective, USAID has structured its program around three major intermediate results (see Figure 12):

- ⇒ increased private investment
- ⇒ increased efficiency
- ⇒ replacement power projects developed to allow for closure of ANPP

In addition to the above objectives, USAID will work in conjunction with the USAID regional mission in Georgia, the U.S. Embassies in the region, the World Bank, and the EBRD to consider an initiative to promote regional cooperation within the Caucasus on energy matters. This initiative could focus on energy trade contracting and pricing, looking at energy investments from a regional as well as a

Figure 12



national perspective, examining electricity and other energy export potentials, and regional power dispatch.

Increased Private Investment: By the end of FY 1998, the power sector had been organized in keeping with the recommendations made by the USAID program in 1995. USAID will continue to support power sector restructuring that will result in a functionally unbundled sector with clear market rules, supported by a funds administration function. The funds administrator will significantly improve the transparency of payments from retail customers to the various power sector companies while providing incentives for the distribution companies to increase collections. However, the recommendation for further restructuring of Armenergo that would result in a new wholesale contracting entity is expected to be difficult to achieve as there is a lack of consensus on the need for such a step.

Legal and regulatory reform work will be undertaken to enhance the framework to support private sector involvement in the energy sector. Activities will encompass the natural gas and district heating subsectors, but the main focus will be on the electric power sector. USAID will work with the Energy Regulatory Commission (ERC) and MOE to attempt to ensure that amendments to the Energy Law are rational and help to advance the legal framework in the energy sector. Another possible avenue of involvement for USAID would be to support legal and regulatory issues that are expected to arise as part of the strategic investor privatization process. Outside of the power sector, USAID is supporting the passage of a petroleum law that is consistent with a market oriented oil and natural gas sector and provides a legal framework to support private investment in these sectors. Where and as appropriate, linkages will

be made with other strategic objectives, in particular, *Laws are Enforced and Adjudicated Impartially*.

Although the GOA committed to move forward with strategic investor privatization of the power sector in 1997, privatization has moved slowly and tenders have not yet been developed. However, there are signs of renewed momentum in this process in order to meet a condition for the release of the second tranche of the SAC III credit from the World Bank. At a minimum, strategic investors will be invited to acquire 51 percent ownership in each of the companies. USAID's focus in the privatization process will be to help the GOA achieve consensus on a sound process and timetable for privatizing distribution companies as well as other elements of the generation sector. This will include an understanding of the implications of privatization on tariffs and on GOA investment decisions, as well as the potential impacts of privatization on management and employment at the current state-owned enterprises. As a follow-up to the Energy Investment Conference (October 1998), USAID plans to support the development of a focused investment strategy, with the promoting of foreign investor involvement in strategic projects.

Increased Efficiency: Increased efficiency in the power sector will result from improved price signals at both the wholesale and retail levels, as well as proper reorganization and decentralization of various functions in the sector. USAID will work primarily with the ERC to rationalize tariff methodologies, issue and enforce effective market rules and procedures, and establish good procedures for soliciting public involvement and dealing with enterprise and customer disputes. USAID will also support implementation of a financing mechanism that will more likely result in the commission's independence since the ERC's key role in setting tariffs makes it a political lightning rod. The ERC's inability to charge license fees to support itself hampers its independence and increases its vulnerability to politically motivated attack.

The adoption of measures to enhance the economic efficiency of power sector enterprises should increase these companies' attractiveness from an investment perspective. Specifically, improved commercial practices should directly result in better financial performance, thus permitting the enterprises to more easily fund investments from their own resources or to attract capital in the marketplace. USAID intends to support the GOA's accounting reform objectives by assisting with the implementation of new accounting practices within the energy sector. It is noteworthy that USAID's previous assistance to selected enterprises in the energy sector helped to forge a consensus to fully implement international accounting standards economy-wide. In tandem with this effort, USAID will attempt to increase awareness of the need for improved financial controls and provide the GOA and energy enterprise management with an improved understanding as to the components of an effective internal control environment. USAID will also work on improving sound business management practice in the energy sector through the development of increased capabilities of mid- and senior-level officials.

A major new initiative to improve the commercial operation of the power sector was launched late in FY 1998. USAID and the GOA had been planning on a purchase of \$15 million of natural gas. After the spring presidential election, the GOA requested that the USG fund electricity metering, billing and collection improvements for the

transmission network and the distribution subsector instead. USAID has begun work on the implementation of this program which will provide technical assistance and training, and procurement and installation of targeted equipment. Simultaneously, USAID is working with the MOE and the management of selected enterprises to develop improved awareness of appropriate management and business processes that can be used to increase collections for electricity.

The efficiency of the power sector is directly affected by the efficiency of other energy subsectors. For instance, the collapse of the natural gas distribution system led to substitution of electricity for heating purposes and placed excessive demands on the power sector. Reform of other energy subsectors (e.g., refined petroleum products) is critical if the power sector is to operate in an economically efficient fashion. USAID is working with the ERC to improve the price signals in the natural gas sector through the adoption of tariff reform recommendations and by development of staff capability to use and update the natural gas tariff model already developed. USAID will also pursue avenues for convincing the GOA and enterprise management of the need for reforms in energy subsectors including refined petroleum products, natural gas and coal.

Replacement Power Projects Developed to Allow for Closure of the ANPP: The GOA has committed itself to the closure of the ANPP by the end of 2004 assuming there is adequate replacement power. In the interim, the USG has supported a program of safety improvements at the facility, which produced 25-40 percent of Armenia's energy in 1998, and strengthening of the Armenian Nuclear Regulatory Authority. The US Department of Energy and the US Nuclear Regulatory Authority will continue to provide this support through funds transferred from USAID.

USAID has funded work to identify replacement energy generation options that could be developed to ensure on-time closure of the ANPP. In 1997, building on a least cost investment plan developed with World Bank assistance, several power supply and demand projects were identified that might be technically and economically viable within the given time frame. Follow-on analyses of these projects were completed in FY 1998. USAID is now funding additional work leading to the completion of bankable documents to attract investment either from private sources or loans from International Financial Institutions (IFIs) to implement selected projects. Analytical work for two new power projects will also be undertaken so as to further assist the GOA to close the ANPP by 2004. In addition, USAID will support the short term education and training of senior GOA technical and management professionals to expose them to U.S. power generation equipment and technology, design and construction standards, contracting procedures and operating practices.

USAID is funding technical assistance that involves working with the GOA, ERC and the energy enterprises on energy investment planning and development in order to expedite the realization of needed investments in the energy sector. The focus areas will be: least cost planning, including new models that better incorporate both the effects of the power market and environmental considerations into the analyses; domestic fuel resource analyses, including the potential for using geothermal waters for district heating and for the existence of higher quality coal; enhanced power project definitions and analyses; information and investment promotion, especially as

a follow-on to the Energy Sector Investment Conference held in October 1998; and project negotiations assistance, with the main emphasis being on the development within the GOA of teams that can carry on negotiations without outside support. EU/TACIS provides planning assistance through its support for the MOE's Energy Strategy Center.

Greater energy efficiency through a cost-effective demand side management program has been identified as a potential means to reduce energy generation needs. USAID has supported work that included analysis of the existing electrical supply and demand situation, load profiles, tariff structures and sectoral end-use characteristics.

F. Strategic Objective (2.2): Laws Are Enforced and Adjudicated Impartially

This strategic objective relates most closely to the ENI SO 2.2, *Legal systems that better support democratic processes and market reforms*, and to the Agency wide objective 2.1, *Strengthened rule of law and respect for human rights*.

A legal system can be characterized in terms of its three consecutive temporal segments: (1) before court, when citizens are or are not obeying laws, and the government is administering laws; (2) during court, when cases brought to the judicial branch are adjudicated; and (3) after court, when decisions rendered by a court are carried out. Each of these aspects of the Armenian system needs work; the Armenian legal system is widely considered to be ineffective at its main task of dispensing justice. Public perception is that judges are influenced by politics, that advocates¹³ are ineffectual, and that regulatory agencies are swayed much more by bribes than by their own regulations. Some factors that contribute to the problem are:

- *Economic circumstances:* While judges are paid well relative to other public servants, their absolute wages remain low. Employees of regulatory agencies are paid even less. Until judicial and executive branch employees are paid higher wages, they will continue to be corruptible by individuals with sufficient means.
- *Low level of risk:* Few of those participating in corruption are caught; those who are, rarely receive severe penalties. Adoption of codes of ethics for legal professionals, and independent disciplinary bodies to enforce them, should improve this situation.
- *Lack of judicial independence:* There is a close tie between the executive and judicial branches of government dating back to Soviet times, when the judiciary was an agent of the Communist Party. Despite independence and the new 1995 Constitution, the judiciary retains many formal and informal links to the executive branch. Two examples: (1) the Constitution provides that the Council of Justice, headed by the President, the Minister of Justice, and the Prosecutor General, has influence over judicial selection, discipline, and training; and (2) judges have

¹³ Note that in this document, "advocates" has the usual NIS connotation, referring to private, independent attorneys acting on behalf of clients. It does not include procurators, notaries, or in-house attorneys.

continued to follow the lead of prosecutors and the government, leaving advocates little role to play.

With assistance from USAID and other donors, Armenia has shown substantial progress in the past year in terms of structural changes in the legal system. Constitutional amendments to increase judicial independence are under consideration. New laws on the judicial system, the role of judges, advocate service and the enforcement of court judgments have been passed, among others. Judges have been appointed to the new trial courts and Court of Appeals. However, it will take considerable political will to continue to make further reforms encouraging judicial independence.

Corruption is a systemic and intractable problem, and cannot be solved quickly or be assigned to one particular area or strategic objective. However, there are elements of corruption that can be and are addressed in this strategic objective and in other parts of the strategy. (See Annex 1 - Corruption.) Improvements in the impartiality of enforcement and adjudication of laws will be very gradual and long-term. By the end of the five year strategy period outlined in this document, we expect that legal and enforcement professionals will have improved the effectiveness of their respective systems and that, as a result, corruption will be perceived to be on the decline. Ordinary citizens will have increasing faith in the legal and regulatory systems as a means of solving disputes and will begin to believe that legal decisions are based on law rather than on personal connections and/or bribery. A rise in judicial and enforcement agencies' salaries is highly desirable but outside USAID's manageable interests.

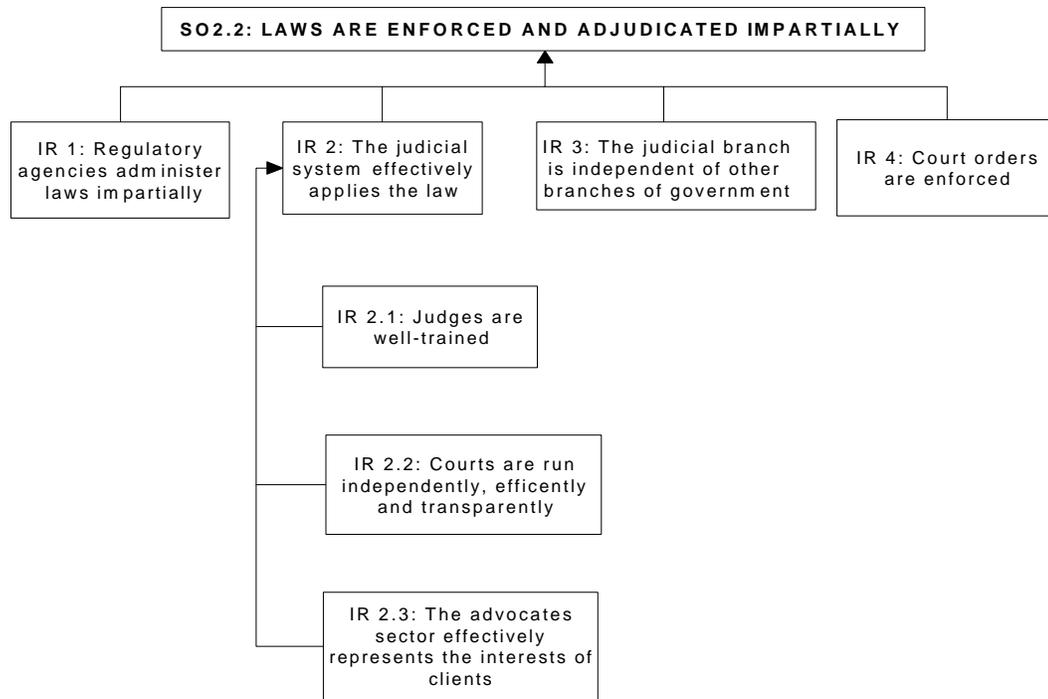
Proposed Program: As the attached framework for this strategic objective shows, the mission has identified four necessary intermediate results (see Figure 13):

- ⇒ regulatory agencies administer laws impartially
- ⇒ the judicial system effectively applies the law
- ⇒ the judicial branch is independent of other branches of government
- ⇒ court orders are enforced

Regulatory Agencies Administer Laws Impartially: A key element in ensuring impartiality in government regulatory agencies is to educate personnel about their proper role in administering laws. It is important, especially in new institutions, to create a culture that attempts to apply laws evenhandedly and based on the merits of particular cases, rather than on the basis of bribes or personal connections.¹⁴ While USAID can address the issue of wages only indirectly (through improvements in the broader economic situation in Armenia under other strategic objectives), part of USAID's overall assistance to Armenia will be in careful and appropriate creation of new regulatory institutions, restructuring of existing ones, and training of both staff

Figure 13

¹⁴ It is important to note that Armenia's current legal, regulatory and enforcement environments are generally gender-neutral, i.e., laws and policies do not differentiate on the basis of sex. In practice, of course, this may not always be the case. USAID will make every effort to ensure that regulatory and enforcement mechanisms are developed to ensure gender neutrality is equitably practiced as a matter of course.



and the public in the proper role of regulatory bodies. While this aspect of the strategy is largely addressed under the prior strategic objective, *Investment Increased*, the work will also be coordinated with additional efforts under this intermediate result. For example, while training related to new regulatory institutions (e.g., customs, tax, and capital markets) will be provided under the previous strategic objective, more focused training under this strategic objective may be required to emphasize proper administration. USAID may also support training for the Ministry of Environmental Protection, and other existing ministries.

Regulatory agencies currently operate under a variety of agency or institute specific laws and regulations. Many of them lack detailed and well-planned administrative appeal and redress provisions, as well as provisions for citizen participation. This strategic objective will continue and encourage work on an administrative procedures act, which would create unified general procedures for agencies to use. Such a law would greatly increase the transparency and accessibility of regulatory agencies by simplifying and harmonizing rules among agencies. Some related laws will also likely be considered under this strategic objective, such as a law regulating public procurement. As with any law, of course, adoption and final form are greatly dependent on the existence of the political will to adopt it. USAID, however, is confident that, by the end of the five year strategy period, substantial progress will have been made toward a comprehensive Administrative Procedures Act, including some or all of the following: a general agency appeals procedure (including access to courts), freedom of information provisions, rulemaking procedures, and guidelines for public involvement.

Other international donors will also likely be working in the area of enforcement. EU/TACIS is expected to do some work with the police. The World Bank is expected to provide assistance on civil service reform, an area which can have a number of positive impacts on enforcement issues.

Finally, one approach to improving the impartiality of enforcement is to minimize claims by ensuring that citizens are well aware of their rights and responsibilities, and are able to guide their actions accordingly. This aspect of the USAID strategy is addressed under the strategic objective, *Increased Citizen Participation in the Political, Economic and Social Decision-Making Process*.

The Judicial System Effectively Applies the Law: While an individual court case ideally has a relatively short duration, it is clearly one of the crucial elements of a smoothly functioning legal system. This is true both mechanically (cases should move quickly and efficiently through the system), and philosophically (cases should be decided according to the law).

The mechanical element generally involves court administration issues, such as efficient docketing of cases, timely rendering of decisions, knowledgeable budget and court management, as well as widespread distribution of court decisions and procedures and other issues. This strategic objective will address court administration, including continuation of current assistance related to implementation of the new court system. Specifically, USAID will work with the Council of Court Chairman to ensure that smoothly functioning case management and personnel systems are adopted, to help the Council develop budget planning and management techniques, and to encourage the judicial branch to assert its authority against the executive branch. Other donors working in these areas include GTZ (material support to courts) and the World Bank (court administration and rehabilitation of court buildings).

It is commonly accepted that several other items are important to ensure that court decisions are rendered properly and impartially (i.e., the philosophical element). The independence and training of the judiciary are discussed below. Skilled, ethical advocates are another important item.

The 1995 Constitution required a fully new court system. The highest court, the Court of Cassation, was appointed in the summer of 1998. Judges for the remaining courts (the courts of first instance and the Court of Appeals) were appointed on January 12, 1999. About 55 percent of the appointed judges had been judges under the old structure. Training judges is therefore a clear priority. EU/TACIS is funding a Judicial Training Institute, expected to begin operation in late 1999. This strategic objective will support judicial training in the interim, especially in procedural and ethics issues. After the EU/TACIS-funded Institute begins operation, USAID will collaborate with it to develop and refine curricula, and possibly support other judicial training (including environment-related training), as needed. The World Bank is also likely to work in judicial training. The various donors are coordinating their assistance.

Court cases in Armenia have generally been dominated by judges and the powerful prosecutors' office. Advocates have had limited access to investigatory materials, and, in some cases, to their clients. Their effectiveness in court has been severely limited. In order for court decisions to be properly rendered, and, equally important,

for them to be accepted and respected by the public, it is important for advocates to have a strong, genuine, and equal role in court proceedings. USAID intends to support the advocates sector both directly and indirectly. At the end of the five year strategy period, USAID expects to see a reasonable availability of affordable attorneys in Yerevan and, to a lesser extent, in the regions outside the capital.

Indirectly, USAID will continue to support improvements in legal education, with the idea of training young advocates and other legal professionals in new ways of approaching the practice of law. While the current law faculty program is rigid and very much lecture based, the dean of the law school is very progressive, and USAID expects to continue to work successfully in this area. Specifically, USAID plans to support better trained faculty, a higher number and quality of interactive classes (possibly including some elective and specialized courses), the development of new, durable educational materials such as textbooks, and a long-term faculty and course development plan.

Directly, USAID will support development of a strong and active bar association, Continuing Legal Education for licensed advocates, an ethics code for advocates, and an effective advocacy organization for issues affecting advocates and other legal professionals. Not only must advocates be trained and aware of ethical issues, they must be available to the public, including the poor. USAID will continue to support the development of *pro bono* services.

The procuracy is the other main element of the judicial sector. While USAID is prohibited from working with police and some of the other elements of the judicial sector related to criminal law, it can work directly with procurators, and has done some work in this area in the past. However, the Department of Justice's CEELI project (DOJ/CEELI) has recently assigned a criminal law liaison to work in Yerevan who works directly with the procuracy and others on criminal law issues. USAID will coordinate closely with DOJ/CEELI on criminal law issues and assumes DOJ/CEELI will take the lead in programming. USAID's assistance will be limited to US-based training through the USAID training project.

An important element of achieving a truly effective and impartial justice system in Armenia will be to reduce the influence of the procuracy. USAID will concentrate on strengthening and making more independent the judiciary and the advocates, which necessarily entail limiting the current influence of the procuracy.

The Judicial Branch is Independent of Other Branches of Government: As noted above, judicial independence is important to ensure that court decisions are rendered properly and impartially. The Soviet judiciary was essentially an arm of the Communist party. The Armenian judiciary continues to be heavily influenced by the executive branch. A key connection between the two is the Constitutional provision for a Council of Justice, which oversees the judiciary, and is headed by the President, and heavily laden with other members of the executive branch. Amendment of this provision to remove executive branch influence is crucial to achieving true independence of the Armenian judicial branch. An amendment is currently under consideration. While naturally USAID has limited influence over the amendment decision, it has provided expert help to the Constitutional Amendment Commission on this and other issues and will continue to monitor the status of amendments.

The Ministry of Justice retains influence over the judiciary in other ways, including appointment of and discipline of judges. Judges are also sometimes uncomfortable with the responsibility of independent decision making. USAID will continue work with the Judges' Association, with the goal of fostering a sense of independence among judges and of building the Association into an organization which can be actively involved in issues affecting judges, such as discipline, training, salaries, and new appointments.

Court Orders are Enforced: Once a judge has rendered a judgment, it clearly becomes important for the judgment to be executed promptly and efficiently. Armenia's new Service for the Execution of Court Orders will be the body responsible for this portion of the process, as part of the Ministry of Justice. USAID will continue to support the development of this body as an efficient, reliable, and trusted institution, in coordination with the World Bank and GTZ. In particular, USAID will address procedures for personnel, appeals, and speed of execution of judgments.

G. Strategic Objective (2.1): Increased Citizen Participation in the Political, Economic and Social Decision-Making Process

This strategic objective links most closely to the ENI SO, *Increased, better informed citizens' participation in political and economic decision making*, and to the Agency objectives 2.2, *More genuine and competitive political processes*, and 2.3, *Increased political development of a politically active civil society*, and 2.4, *More transparent and accountable government institutions*. Aspects are also included of ENI SO 2.3, *More effective, responsive, and accountable local government*.

As noted in Part I, Armenia is currently characterized by high levels of public apathy and cynicism as well as a widespread public perception of powerlessness, largely as a result of economic collapse and endemic corruption. As part of the Soviet Union, people were not encouraged to advocate on behalf of their own interests or concerns in any and all sectors and lacked the information and the mechanisms to do so. Thus, it will take some time for people to come to trust that negative repercussions will not happen to them if they speak out, but that it is their responsibility to do so in a democracy.

Armenia is slowly making this transition to democracy. Many of the institutions necessary are either in place or plans to create them are underway, and citizens are learning their roles and responsibilities. Armenia has stumbled at times, most notably in its national elections, but progress can be seen in a variety of areas, such as with independent media and NGO development.

USAID began a full-scale citizen participation program in 1996, covering political party development, NGO development, elections administration, civic education, and independent broadcast media. These programs were designed to provide the legislative basis and build the institutions necessary for a democracy and to enable citizens to participate more fully in the political process in which they express their opinions and advocate on behalf of their concerns across the full spectrum of events affecting their lives -- economic, political and social.

Significant institutional progress can be made in five years. Much of the legal basis for citizen participation has been established, and over the next five years it is expected that these laws will be further refined and the necessary institutions will be in place. However, it will take longer than five years for many Armenian citizens to embrace these changes and fully participate in their democracy.

USAID is the lead donor in supporting citizen participation in Armenia. Other donors, including Open Society Institute, EU/TACIS, UNDP, and USIS, provide limited assistance to the media and NGOs, but USAID has the most comprehensive program which addresses these sectors as a whole. In addition, around the election period, international organizations such as the Organization for Security and Cooperation in Europe (OSCE) and the Council of Europe provide assistance to the Central Election Commission and other institutions responsible for administering the elections, but USAID is the only organization which provides ongoing assistance in this area.

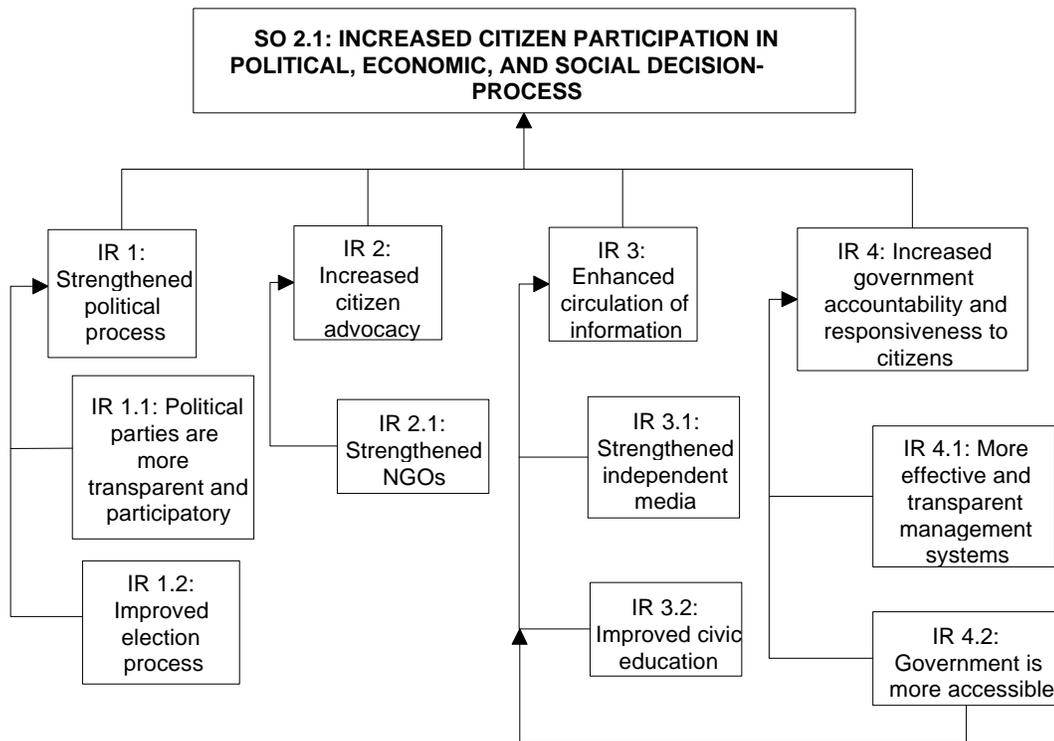
Proposed Program: This strategic objective is intended to encourage and enable citizens to engage elected officials and their appointees in dialogue. In order to achieve this dialogue, Armenia needs: (1) elected leaders at all levels of government who are accountable to their constituencies; (2) citizens who are well-informed about pending issues and know how to voice their opinions to elected officials; and (3) governments at all levels which are willing and able to respond to their constituents.

USAID has identified four intermediate results under this strategic objective (see Figure 14):

- ⇒ strengthened political process
- ⇒ increased citizen advocacy
- ⇒ enhanced circulation of information
- ⇒ increased government accountability and responsiveness to citizens

Strengthened Political Process: Since independence, no elections in Armenia have been without serious flaws. Although free elections are just one element of a healthy democracy, in Armenia the allegations of fraud symbolize many of the problems that Armenia is facing during its transition to a free-market democracy. Many people point to election observer reports (such as the OSCE's) that cite numerous fraudulent incidents during elections and comment that Armenia's citizens cannot fairly participate in the political process. Compounding this problem is that the organizations which participate in the political process, primarily political parties, do not have strong voter support. Political parties in Armenia rely more on personalities than platforms to attract members. While this may help in presidential elections, in parliamentary and local elections many voters cannot identify the party with the platform. Further hindering broad-based support, most parties have a top-down structure, in which the leader dictates the party's platform and selects many of the candidates running for office. Although some parties boast large memberships, members do not have a voice in deciding the platform or selecting candidates for office. Political parties need to strengthen their internal structures so that communication can flow both top-down and bottom-up. In addition, parties need to

Figure 14



gain skills in order to reach out to voters so that they understand party platforms and can make educated decisions in the polling booths.

Previous elections in Armenia have been plagued both with administrative problems and fraud. Ultimately, if political leadership wants to rig an election, it can do so, but mechanisms can be devised to ensure a smoother, more transparent process that can be observed more closely. On the administrative side, USAID will continue to work with election commissions at all levels to provide technical assistance in the implementation of the newly passed Universal Electoral Code (UEC). USAID will also assist the Central Election Commission to institutionalize a training program, so that when election officials change, a system will be in place to train new ones. In order to avoid fraud, Armenia needs domestic organizations which have the capacity to monitor elections. International observers cannot monitor every precinct, nor do they have the capacity to understand fully the dynamics on election day. Therefore, USAID will continue its technical and limited financial support of such groups in order to develop this capacity.

Increased Citizen Advocacy: Armenia inherited a legacy of the state dictating to citizens what they want or need, and little consideration was given to what citizens actually wanted or needed. Although citizens now have the right to place demands on their government, many of them do not possess the skills or knowledge of how to do this.

Over 1,700 NGOs are officially registered in Armenia, although most of them are not active. USAID will continue to target the most effective advocacy NGOs across different sectors (including environmental and women's issues) in order to increase citizen participation in governmental decision-making. These advocacy NGOs provide a voice for groups (such as pensioners, the disabled, etc.) within Armenian society that cannot adequately represent themselves alone. Support will also be given to NGOs that play the role of watchdog to ensure that the government is obeying the law.

Although USAID's NGO development program (which is already underway and planned for continuation under this strategy) specifically targets advocacy NGOs, other types of NGOs may deserve attention in support of other strategic objectives. For example, certain social sector programs may strengthen health NGOs as a way of educating the population. The main purpose of those programs is improved health, and strengthened NGOs are a positive side outcome of the program.

It deserves mention that citizen advocacy can also be done on an individual basis, but for this strategy, USAID is focusing only on NGO development, as it is difficult to measure how individual citizens are advocating change. Citizen advocacy with non-governmental entities -- e.g., private business to provide specific goods and services -- is also important but not an explicit part of this strategic objective.¹⁵

This advocacy result links to the *Strengthened Social Safety and Growth of Competitive Private Sector* strategic objectives. As the strategy progresses, there may be links between advocacy and improving enforcement as well. This intermediate result is also linked to the another under this same strategic objective, i.e., "Enhanced circulation of information," as NGOs play a critical role in educating citizens. As part of strengthening NGOs, emphasis will be placed on NGOs not only lobbying the government for change, but also for NGOs to reach out to citizens and educate them on the issues.

Enhanced Circulation of Information: In order for citizens to make informed decisions, they need to have accurate information. Media is the primary vehicle for distributing information, although educational institutions and NGOs play a vital role as well.

Media provides the best way to get up-to-date information disseminated quickly and over 80 percent of Armenians get their news from television. Armenia has two state television channels as well as municipal stations throughout the country. These stations' news coverage usually only provides the government's point of view. Independent stations cover events which can present a more balanced view and differing opinions.

Independent television stations have made great progress since independence. The quality of journalism and news production has improved and business managers are

¹⁵ Through successes under this strategic objective, it is expected that citizens may gain the skills required to advocate their interests and concerns with other, non-governmental individuals and entities (e.g., private sector businesses, private social service providers) as well -- but this is not a specific focus of this USAID SO.

starting to increase stations' revenue. However, given the weak economy, there are currently no independent stations which are financially sustainable; instead, they must rely on donors to keep themselves on the air. Even the most advanced stations still need help to improve their business management skills.

Independent newspapers have not made nearly as much progress as television stations and most daily newspapers are mouthpieces for political or business interests. Articles tend to contain more opinions than facts and advertising is minimal. Because circulation of newspapers is only about 140,000 copies a week, USAID's program will mainly support broadcast media. However, print media does play a role in educating the public and its quality needs to improve dramatically. USAID support in this area to date has been the provision of an independent printing press, which will be fully operational in early 1999.

This intermediate result will focus primarily on the mechanisms of ensuring information is accessible. It should be noted that this result will have strong links to much of the rest of this strategy since the dissemination of information on a wide variety of subjects -- economic reforms, employment, environmental concerns and requirements, improvements in enforcement mechanisms, changes in social and health benefits available, to name but a few -- is essential to ensure that citizens are receiving accurate and timely information necessary for them to make informed choices and advocate their views with appropriate government officials.

Much of the current and projected citizen participation program focuses on building institutions (both governmental and non-governmental) and training individuals involved with those institutions. The general public may feel the impact of these programs over time, but in the short-term democratic principles remain abstract. As a way to emphasize the importance of a democracy in meeting basic human needs, civic education is needed to help citizens learn their rights and responsibilities in a democratic society. USAID-funded civic education programs take place primarily in secondary schools, although NGOs can also play a role in educating adults about their roles in a democracy.

Increased Government Accountability and Responsiveness to Citizens: Success with the other three intermediate results under this strategic objective cannot be achieved without an accountable and responsive government. If citizens are to engage more in the decision-making process, it is critical that governments at all levels are willing and able to respond. Otherwise, citizens cannot participate in the decision-making process as governments will disregard the will of their constituents.

Although this applies to governments at all levels, in the near future USAID's efforts under this intermediate result will focus on local governments and with the national government on matters related to local government. The regional (marz) level government is appointed by the central government and, therefore, is not accountable to the marz residents but to the presidential apparatus. For the national level, parliamentary elections in 1995 were deemed "free but not fair" by the OSCE, and USAID in consultation with the U.S. Embassy made a determination that a comprehensive parliamentary program would not be effective. Parliamentary elections are scheduled for May or June, 1999; there has also been some discussion

about restructuring the marzes. Therefore, this strategy leaves the door open for work beyond the local level should opportunities arise, but does not systematically address programs at those levels.

In addition to the problems with working with the higher levels of government, there are positive reasons for a local government focus. First, these local governments know the needs of their communities and are accessible to citizens on a day-to-day basis. Second, by working to move resources under greater local control and making local officials more responsive to their citizenry, the democratic process can be linked with improvements in the daily lives of the residents, rather than remaining an abstract ideal defined by participation in occasional elections.

A recent local government assessment has pointed out a number of problems facing local governments and opportunities that need to be addressed:

- ◇ legal authorities, including budgetary, need to be transferred to the local level so that local governments can fulfill their mandates; with this transfer of authority, however, comes the need for training of local officials to enable them to exercise those authorities; and the need for local citizen groups to learn how to interact effectively with their government;
- ◇ change is needed in both existing power relationships and technical processes necessary for effective service provision so that scarce resource can be allocated effectively and efficiently and so that citizens learn that they have a stake in the process and can benefit directly from the outcomes;
- ◇ both public and private actors need to be involved, whether through the political process or in the very practical means of service delivery, in order to realize the full benefits of the initiative.

USAID proposes to address these problems and opportunities through a new activity (or series of activities) focused on local government development. One of the greatest constraints that local governments face is lack of resources to carry out necessary services and programs. Although much of this is dependent upon a greater resource base (i.e., improved economy and better tax collection), local governments can devise programs which better utilize available resources. For example, some city services such as garbage collection can be contracted out at an overall savings (and possibly an employment generator) and with possible environmental benefits (e.g., more effective waste disposal, improved water distribution/wastewater treatment). Local governments need to explore such options and apply what would work best in their cities. They must work with citizens in order to identify priority areas, as given a lack of resources it is impossible to address all problems.

Assistance also needs to be provided to the central government to revise the 1996 Law on Local Self Governance. While the law devolved some power to local governments, it also imposed an unwieldy bureaucracy whereby the central government still controls the purse strings. The current law hampers the ability of local governments to respond in a timely manner to their constituents, as every budget request must receive approval from the central government. This has delayed

payments months at a time to local governments, and in many cases full budget allocations are not made.

Local governments also need to have greater transparency in all their activities. They cannot effectively address their constituents' concerns if they do not allow citizens to participate and view each step of the budget process, from formulation to procurement and payment of services.

Citizens need to have formal mechanisms to approach the government in order to publicly express their views. Currently at the local level citizens line up to meet with the mayor, but this is not time effective nor does it address problems of the community as a whole. Formal mechanisms, such as budget hearings, allow citizens to approach officials in a public forum to address their concerns.

USAID does not presently implement any activities in the local government area. A design which addresses the problems outlined above and which will link local government to a variety of other aspects of the strategy, such as *Growth of Private Sector* and *Strengthened Social Safety Net* strategic objectives, will be developed in late FY 1999.

Clearly, this strategic objective is intimately connected with other segments of the strategy. The need for Armenia's citizens to feel more empowered and thereby better able to contribute to their own well-being cannot be underestimated.

H. Strategic Objective (3.2): Strengthened Social Safety Net

This strategic objective is most closely related to ENI strategic objective 3.2, *Improved sustainability of social benefits and services*, and to the Agency-wide goal 4, *World population stabilized and human health protected*.

The collapse of the Soviet system and Armenia's subsequent economic transition to date have had severe negative consequences for the majority of the population as discussed in earlier sections on unemployment. The decline in quality, affordability and availability of services has resulted in a dramatic increase in the form and magnitude of vulnerability which did not exist before 1991. Under the previous state system of socialist protection, all citizens of Armenia were provided with protection from a wide range of social needs, including old age, illness, injury, and unemployment. The State also provided a broad range of subsidized services. Today, the State cannot provide adequate social protection or the delivery of services for those most in need. The private sector has not yet developed enough to help alleviate this social protection nor do people as yet have the incomes available to pay for such private service provision. (Increased employment and incomes are addressed elsewhere in this strategy). Consequently, the level of poverty and vulnerability in Armenia is high.

While Armenia needs to invest more in its social safety net, it should be noted that the GOA's current fiscal deficit is already high (crowding out private sector access to financing). Therefore, increased investment in social services must be: 1) coordinated within the broader GOA budget; and 2) made as efficient and effective as possible.

These current high levels of poverty and vulnerability are exacerbated by the declining quality and accessibility of services to the population, particularly to those living closest to the economic margin. The Ministry of Health recently reported that health care facilities are working at a maximum of 40-50 percent of pre-independence levels. A UNDP report indicates that 60 percent of the population surveyed resorted to self-diagnosis and treatment rather than seeking out professional medical attention [23]. Pensions currently average \$7 per month, while unemployment benefits are approximately \$5 per month and the "family benefits package" is \$12 per month. All of these payments are well below the established minimum living standard of \$34 per month.

It is important to note that this aspect of the strategy is not simply a continuation of previous humanitarian efforts. While some of the efforts under this social side of the strategy will provide direct assistance to the most vulnerable, they will be undertaken with a focus on identifying the most effective and efficient means of delivering such services in the long term, including, wherever possible, identifying the most cost-effective means of paying for such services. In this regard, it is also important to note that USAID's expectations for the social safety net are not that it will be fully capitalized and operational within the five year strategy timeframe. Instead, it is expected that key social insurance/service delivery systems will be created and/or improvements identified. Widespread implementation of the new/improved systems will likely be the subject of USAID's next five year strategy (i.e., beyond 2004) and/or the subject of extensive donor coordination during the current five year strategy. While capitalization and implementation of social insurance systems will be expensive, it should be borne in mind that the development of such systems will proceed simultaneously with improvements on the economic side, leading to the expectation that Armenians themselves will be in an increasingly solid position to pay for/into social insurance and service delivery systems over time.

It is important to note that Armenia has already begun to demonstrate the capacity, political leadership and commitment to pursue a rational social reform agenda:

- The GOA, supported by USAID since 1994, has developed and implemented a sophisticated and model system for targeting assistance to the most needy;
- The Ministry of Social Welfare has recently developed its own strategy which is divided into two elements: social protection and social insurance;
- The GOA has also recently raised the retirement age from 60 to 65 for men and from 55 to 63 for women; after 2000, the GOA plans to begin eliminating social pensions, a significant drain on the economy at present, and replace them with targeted welfare;
- Efforts are also under way to design a unique number identification system to improve pension accounting and tracking and to use in future social insurance programs;
- Improvements and refinements in the "family benefit package," a cash transfer to qualifying households, will continue this year and modifications such as graduated benefits and improved targeting will appear shortly;
- The National Assembly, in consultation with the government, has drafted a new law on the Provision of Social Services which specifies the rights of citizens for

social protection and the specific rights which the State should guarantee. According to the draft law, the State should provide cash and non-cash benefits, the latter to include psychological counseling, home visits and a wide range of other types of services.

However, in spite of these many reforms, there continue to be serious constraints faced by the government, for example, a chronic lack of financial resources; data deficiencies; a lack of access to information about exemplary policy, implementation options and legal instruments; and a lack of understanding of the technical details associated with managing and monitoring modern social assistance programs. The GOA has made significant initial steps in the direction of systemic social reform, and sufficient political will would seem to exist to continue aggressively in that direction, thereby offering an opportunity for USAID and other development partners to have significant impacts in a reasonable timeframe.

Armenia continues to receive a great deal of attention from the major international donor community. Of particular importance is an EU/TACIS program, to be completed by mid-June of 1999, to design a unique number identification system linking workers with actual contributions and benefits. EU/TACIS also has an ongoing unemployment database project. The World Bank is currently making plans to support reform of the existing pension system through technical assistance; the Bank also supports a database of pensioners project. Also, the Bank will be supporting the implementation of a second Armenia Social Investment Fund, designed to strengthen community and local government, as well as public sector health and education policy and financing reform efforts.

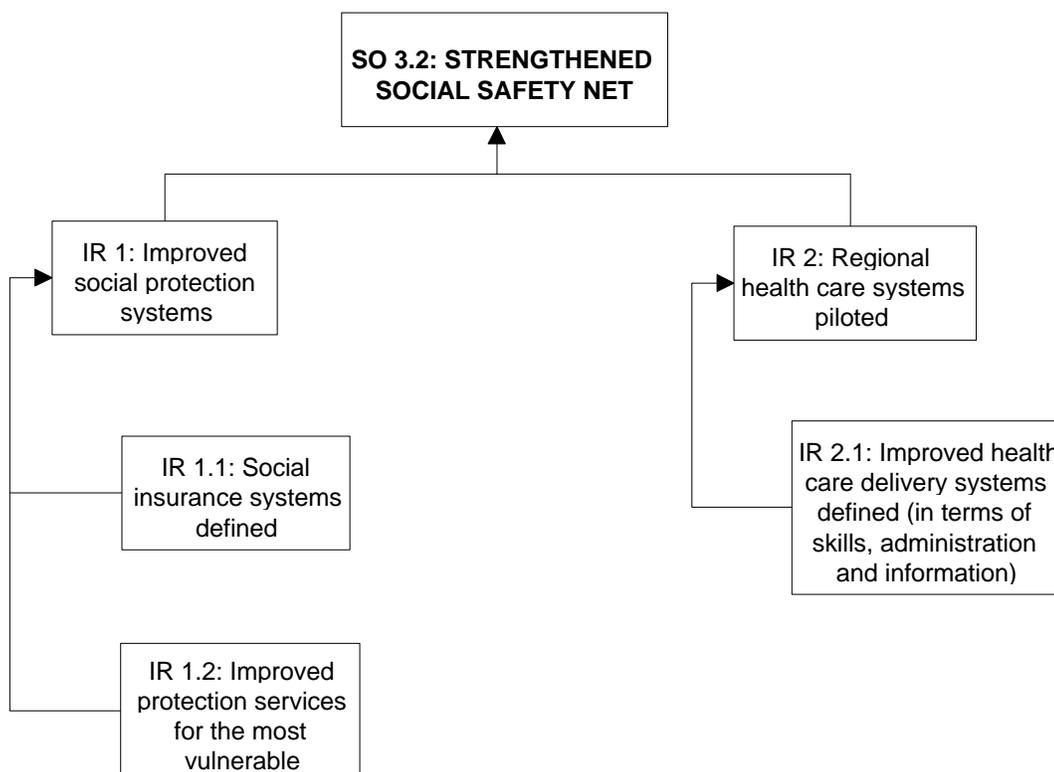
Proposed Program: USAID's social safety net program aims to help Armenia develop sustainable public and private systems to provide social support for the Armenian people. It should be noted that the mission has defined "social safety net" as a combination of (1) insurance, addressing long-term, universal coverage/security needs (specifically pension, health, disability and unemployment); and (2) protection, addressing short-term health, nutrition and shelter needs of the most vulnerable.¹⁶

USAID has identified two intermediate results that are necessary to achieve the strategic objective (see Figure 15):

- ⇒ improved social protection systems
- ⇒ regional health care systems piloted

¹⁶ While education repeatedly was raised as a major problem in the mission's strategy deliberations, it was agreed that: (1) lack of quality education at the moment is not life threatening to the poor in the same way that lack of food, heat and health care are; (2) it is not within USAID's manageable interest at the present time to add another significant aspect to its portfolio; and (3) other donors, most notably the World Bank, are already involved in the education sector.

Figure 15



Improved Social Protection Systems: As noted above, Armenia has been making its own significant efforts to improve its social protection systems. In spite of these GOA efforts, improving social protection systems is a major undertaking and much remains to be done. For example, Armenia at present has no systematic means of identifying its population, their needs and the benefits provided to them. The country's ability to actually plan for, design and administer appropriate services is also weak.

Within the period covered by this strategy, USAID expects to see a social insurance system designed and developed and the administration necessary to research best options and plan an effective social benefits program based on that research put into place. It should be noted that USAID's recent experience in developing and implementing the PAROS system demonstrates that such a system is not only feasible but highly effective in Armenia. However, while the PAROS system focuses only on the most vulnerable in need of immediate humanitarian assistance, USAID is now focusing on the development of sustainable, population-wide systems.

In order to implement an effective social security system (e.g., unemployment insurance, welfare benefits, pensions), the country must first be able to identify and track its population. Such a system will allow Armenia to track contributions made (public/private, employer/individual), identify specific needs (e.g., the elderly) within the broader population, and ensure that benefits are provided appropriately and effectively. EU/TACIS is currently designing such a system, which USAID will actually develop and implement. By the end of the strategy period, it is expected that

each Armenian citizen will have a social security number and card and that the GOA will have the ability to track all social security contributions and benefits made for each individual over time.

In addition, both the GOA and other (NGO, private sector) representatives need to think about what kind of social insurance options might be available to Armenia, what kind of systems might be most appropriate for the country, and how they might be managed. Thus, USAID proposes to work with the World Bank and other donors as well as with the GOA in assessing various social insurance plans and seeking a national vision for the country, including relatively concrete planning for sustainable health insurance schemes, welfare and unemployment benefits systems, and pension plans. Related to this development of a vision for the social insurance system will be a need to identify and address legal and regulatory changes and management and financing improvements. USAID has begun a design effort to determine how best to implement this result. Any activity in this area will need to be linked to the *Laws are Enforced and Adjudicated Impartially* strategic objective.

While systemic, universal social insurance coverage is a desirable and appropriate objective for Armenia, there are still a large number of vulnerable people in need of immediate assistance. While it is expected that these numbers will decline over time as the economic situation improves, it is a fact that a certain portion of the population will always remain vulnerable (e.g., some disabled and elderly), therefore long-term, sustainable means of providing basic assistance to these most vulnerable need to be identified. USAID intends to explore better ways to deliver assistance to the poorest-of-the-poor group, to look for and document what efforts are most effective, in terms of cost and benefits to the vulnerable, and efficient, in terms of numbers reached and management required. Thus, through a series of pilot efforts, USAID will explore various ways in which direct service delivery could be replicated over the long term and by whom. The expectation is that these pilot services will be provided directly to the vulnerable with the goal of identifying and providing "lessons learned" on efficiencies and effectiveness options.

Regional Health Care Systems Piloted¹⁷: As part of health reform efforts, the Ministry of Health (MOH) has de-centralized the Soviet-styled hospital-based health care system, making marz/regions responsible for their populace's health care. There is as yet no comprehensive MOH blueprint for decentralized services and a lack of infrastructure, inadequate equipment, and a shortage of trained staff have weakened Armenia's capacity to respond to public health crises. Regions and districts are without either money or know-how to address the roles and responsibilities they have been handed [24].

The need for new decentralized systems of health delivery on a marz or regional level is apparent. Physical facilities are in disrepair, supplies and equipment are not

¹⁷ USAID has included the health directives portion of its budget as part of the overall budget for achieving the Strengthened Social Safety Net strategic objective on the assumption that all health funds can be made supportive of achievement of this SO. However, should the Mission be asked to accept health sub-directives that cannot be incorporated productively into achieving results against this strategy, we reserve the right to initiate a "special objective" where such funds can be budgeted and expended on other than strictly strategic purposes.

available, professional staff skills are often outdated or inappropriate, and the two-way flow of information between provider and patient is poor at best. The collapse of the socialized system and the creation of a shadow "privatized" system by doctors and other providers that unofficially demand fees for services have made it difficult for the average Armenian to access adequate health care. Nowhere is this more acutely felt than in rural areas where, according to survey findings, the majority of people appear to forego diagnosis at a formal health facility when ill [9].

The Mission seeks to support the MOH's reform efforts, providing assistance in the form of piloted regional health care delivery systems. Obviously, not all problems that plague the country's health care system can be addressed simultaneously. As with the previous intermediate result, USAID intends, through a series of pilot efforts (which, unlike the broader provision of protection services to the most vulnerable in the previous intermediate result, will cover only a portion of the entire population), to explore and compare various means of improving selected functional health care systems in Armenia. Improvement of health care at the local level will be the emphasis, with referrals to the appropriate treatment centers for health problems that cannot be handled locally built into these systems. (Such locally-based care should be especially beneficial to women in providing higher quality services, increased availability of service options and more affordable and accessible services.) The expectation is that, at the end of the strategy period, we will be able to demonstrate greater efficiencies and effectiveness that can be replicated elsewhere in the country on a more widespread basis. Included in the demonstrations will be various sustainability (payment) options (e.g., public coverage for the most vulnerable, fee-for-service, private contributions through NGOs, health insurance). The specific health care systems that USAID has identified as most critical are:

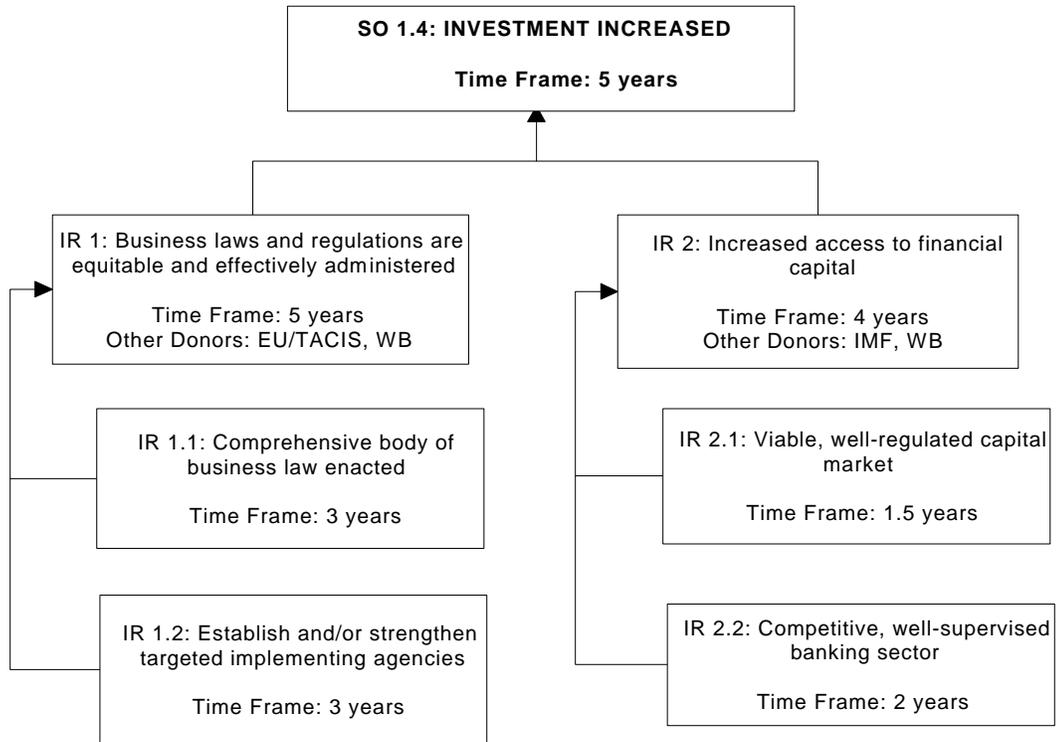
- * improved professional skills
- * strengthened administrative capacity
- * improved information, collection, dissemination, and analysis

These pilot efforts will be undertaken through a variety of mechanisms, including partnerships with U.S. organizations (e.g., community health services) and professional skills training.

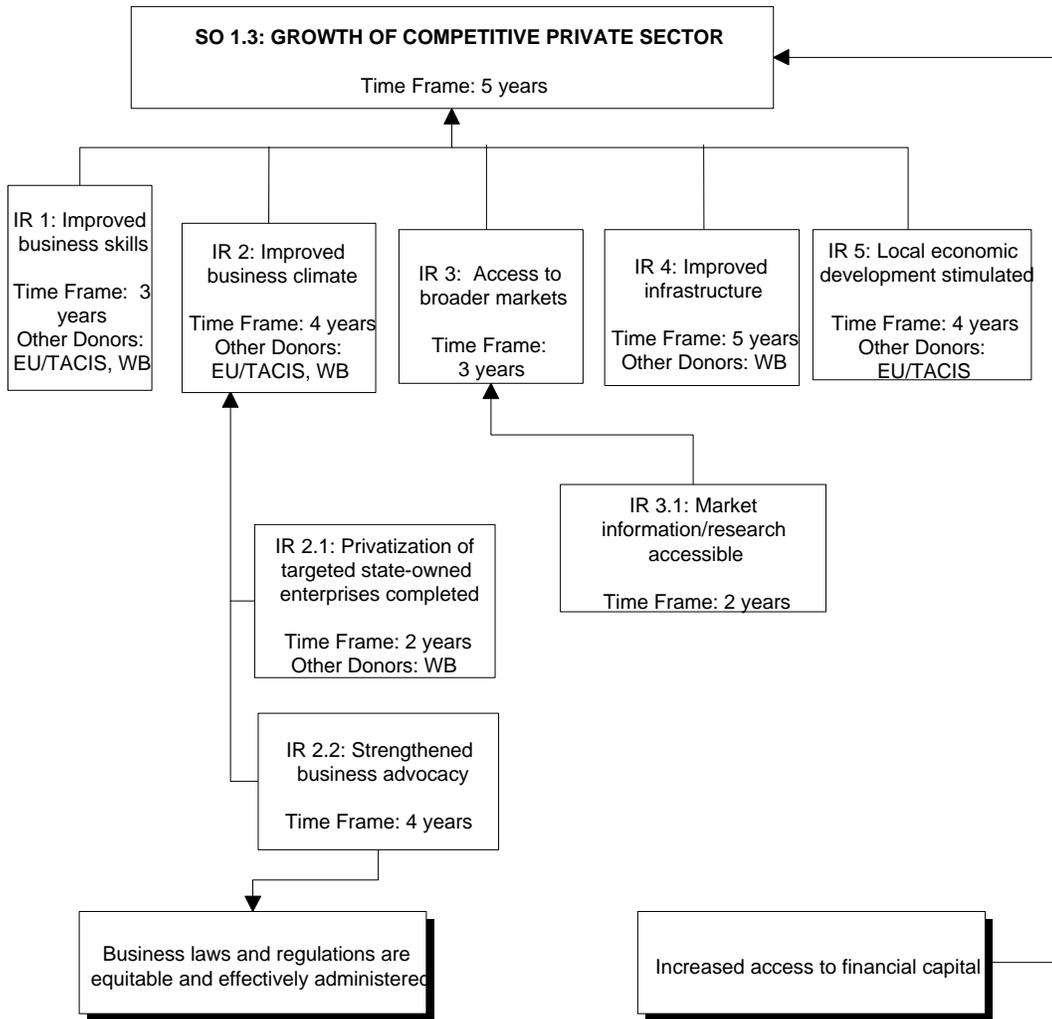
Appendices and Annexes

Appendix A: Expanded Results Frameworks

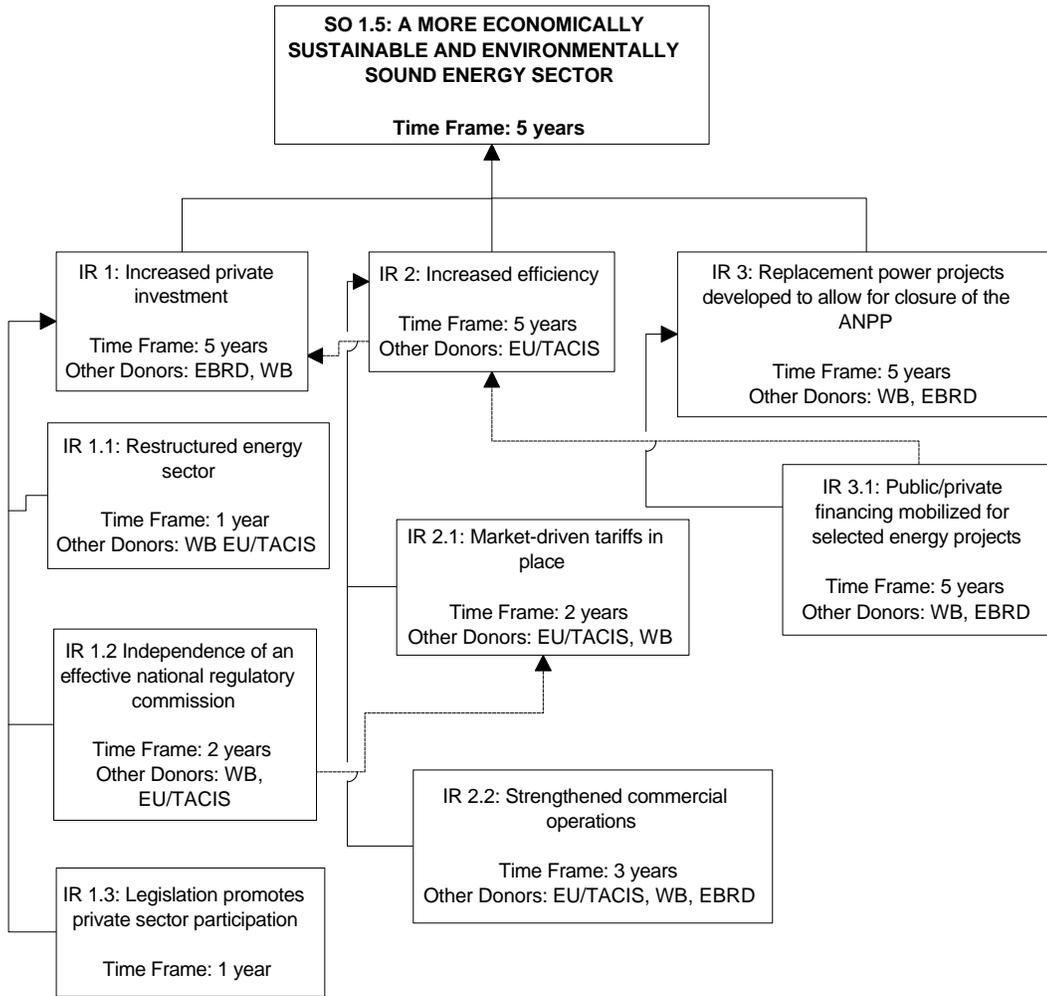
Critical Assumptions:
 -- Stability
 -- Efforts to promote regional integration continue
 -- Educated, trainable, inexpensive workforce



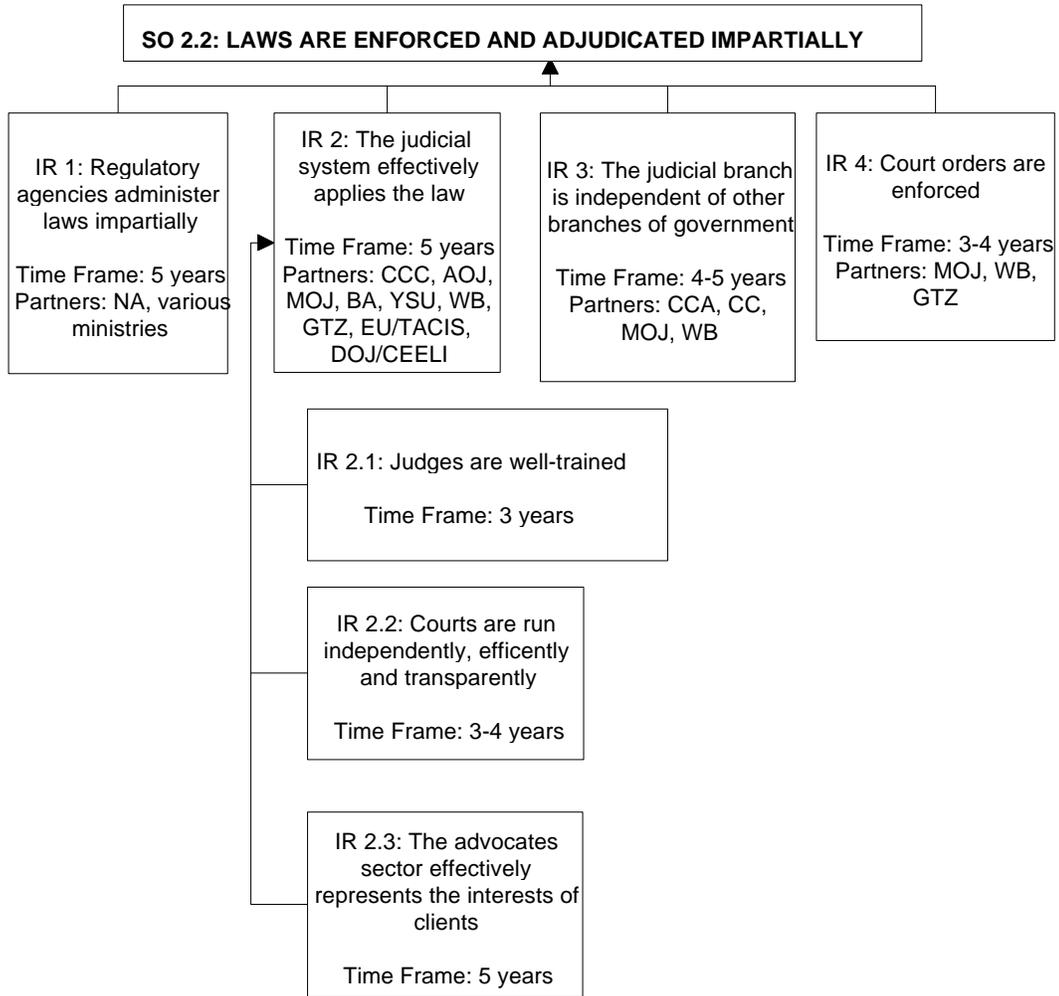
Critical Assumptions:
 -- Stability
 -- Efforts to promote regional integration continue
 -- Educated, trainable, inexpensive workforce



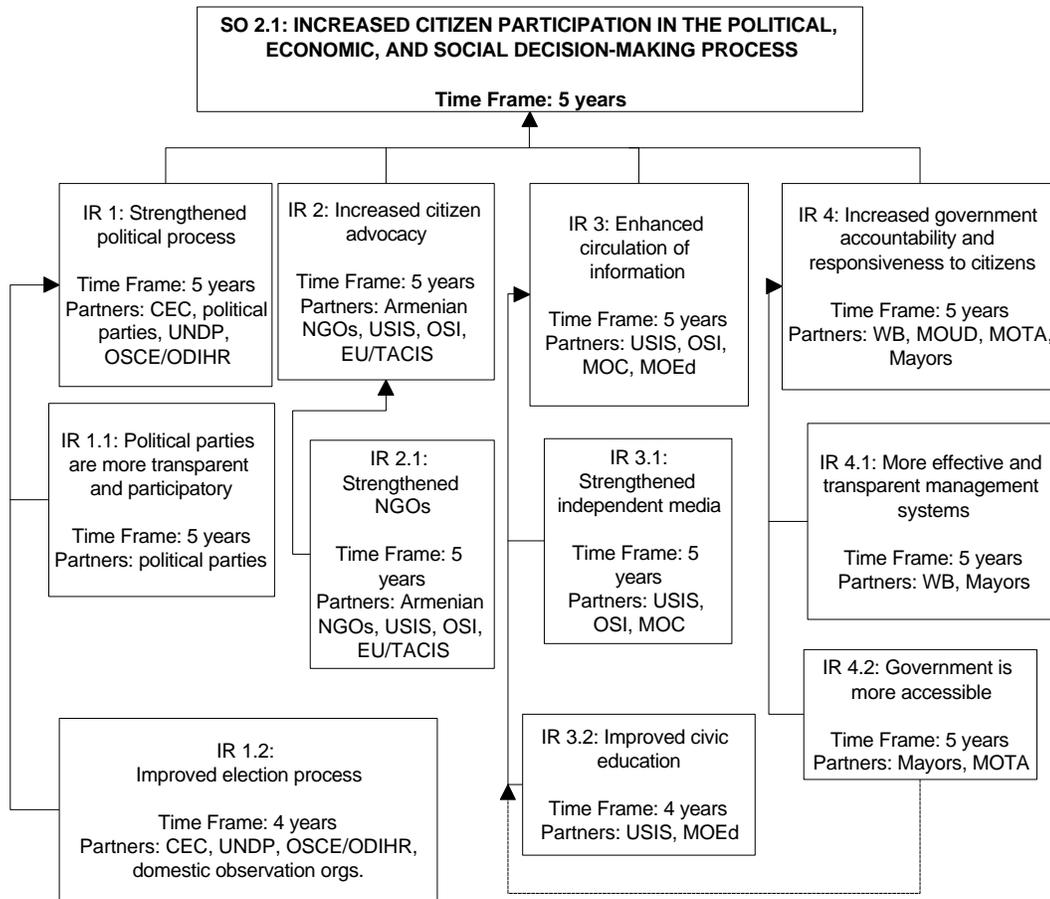
Critical Assumptions
 -- political will
 -- private investment to modernize facilities



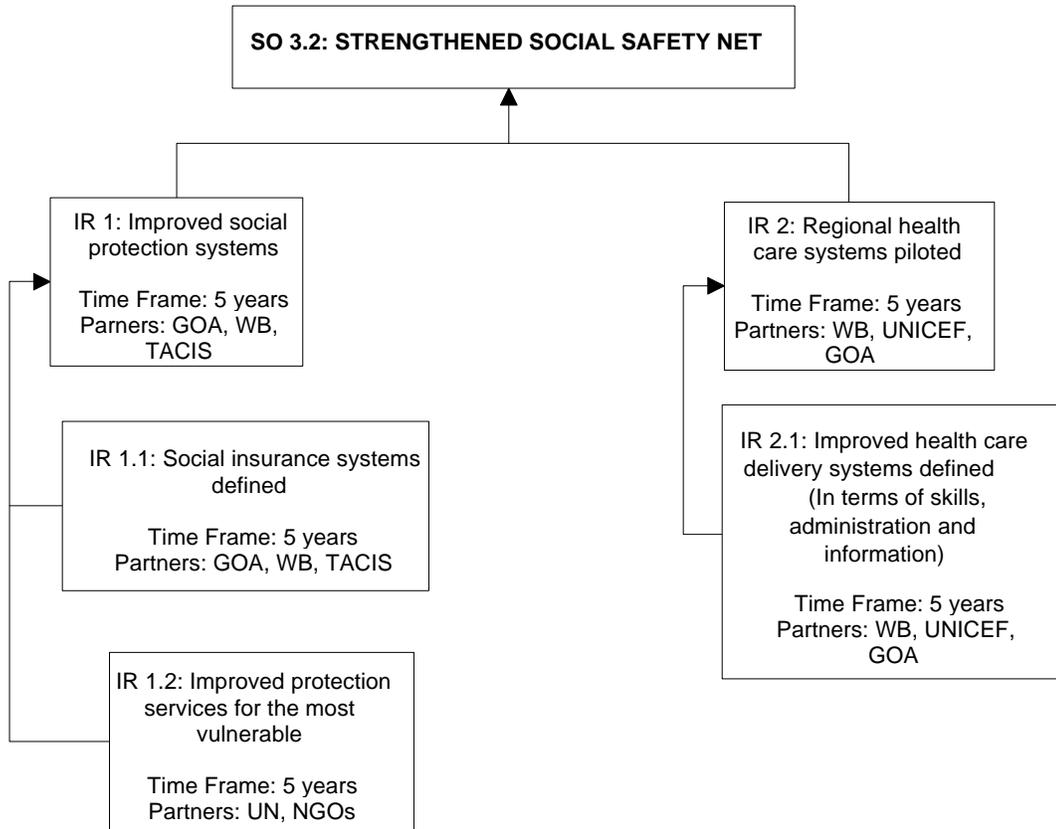
Critical Assumption:
 -- Political will to continue rule of law reform does not significantly diminish



AOJ is the Association of Judges
 BA is the Bar Association
 CC is the Constitutional Court
 CCA is the Committee on Constitutional Amendments
 CCC is the Council of Court Chairmen
 MOJ is the Ministry of Justice
 NA is the National Assembly
 YSU is Yerevan State University - Law School



CEC is the Central Election Commission
 OSI is the Open Society Institute
 MOTA is the Ministry of Territorial Administration
 MOEd is the Ministry of Education
 MOC is the Ministry of Communications
 MOUD is the Ministry of Urban Development



Appendix B: Performance Data Tables

Table I -- Performance Data

SO 1.3 GROWTH OF COMPETITIVE PRIVATE SECTOR

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				Year	Value	Target	Actual								
SO 1.3	Growth of competitive private sector	Private sector share of GDP	Definition: share of private sector in total value added output Unit: % of GDP	1997	60	65		67		69		72		75	
		Private sector share of employment	Definition: share of employed persons employed by private sector firms Unit: % of total employment	1997	56	60		63		65		69		72	
IR 1	Improved business skills ¹	No. of USAID trained business trainers and consultants	Definition: cumulative no. of individuals trained by USAID programs to be trainers of business skills and consultants to business Unit: no. of persons	1998	0	25		40		60		75		90	
IR 2	Improved business climate	Increased investor confidence	Definition: index of economic risk as determined by <u>Euro money</u> magazine (higher # indicates better prospects) Unit: 0-100 scale	1997	31	35		40		45		50		55	
IR 3	Access to broader markets	Volume of exports	Definition: value of total Armenian merchandise exports Unit: \$ million	1997	233	280		310		360		430		500	
IR 4	Improved infrastructure ²														
IR 5	Local economic development stimulated ³	Number of community level jobs created	Definition: jobs created as a result of USAID program Unit: # of jobs	1999	TBD	TBD									
		Change in community level family income	Definition: average annual income change per family as a result of USAID program Unit: \$	1999	TBD	TBD									

NOTES: ¹ Additional indicators are to be determined once the full contingent of business skills trainers are on-board (est. 12/99).
² This IR is unfunded by USAID, at least initially. Thus, USAID will not track results under this program until such time as we have a related program (see also SO 1.5).
³ Targets will be determined with implementing partner as part of the activity design.

Table II -- Performance Data

SO 1.4 INVESTMENT INCREASED

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003			
				Year	Value	Target	Actual										
SO 1.4	Investment increased	Investment as % of GDP	Definition: value of fixed investment as proportion of GDP Unit: % of GDP	1997	10	11		12		13		14		15			
		Foreign direct investment (FDI)	Definition: annual flow of FDI in Armenia as reported in balance of payments statistics Unit: \$ million	1997	51	100		130		140		150		160			
IR 1	Business laws and regulations are equitable and effectively administered	Freedom House microeconomic policy rating	Definition: progress towards economic reforms in terms of microeconomic policy as reported by Freedom House (see Monitoring Country Progress , October 1998 for a more detailed explanation) Unit: 1-7 scale (1 representing the most advanced)	1998	4.25	3.75		3.25		2.75		2.5		2.25			
IR 2	Increased access to financial capital ¹	Annual percent change in the total value of household bank deposits	Definition: change in year-end value of demand, time, and savings deposits in all currencies in deposit-taking institutions, deflated by change in year-end to year-end consumer price index Unit: %	1997	11.5 billion drams	+35		+35		+35		+35		+30			
		Percent change in bank credit to private, non-bank sector	Definition: year-end to year-end change in all bank credit in all currencies to private sector enterprises, except financial institutions Unit: %		TBD												
		Stock market turnover as percent of stock market capitalization	Definition: annual value of all trades divided by total value of stock market capitalization Unit: %		TBD												
		Household asset preference ²	Definition: tabulated responses to periodic household questionnaire on preference for investing or saving in bank accounts, T-bills, stocks vs. property, cash, and jewelry Unit:		TBD												
NOTES: ¹ Additional indicators are under consideration; to date reliable data has been difficult to identify. ² Baseline data expected by April, 1999.																	

Table III -- Performance Data

SO 1.5 A MORE ECONOMICALLY SUSTAINABLE AND ENVIRONMENTALLY SOUND ENERGY SECTOR

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Act.	Tgt.	Act.
SO 1.5 ¹	A more economically sustainable and environmentally sound energy sector	Sector revenues attaining full cost recovery	Definition: sector billed revenues approaching a level adequate to recover full depreciation on revalued assets and to provide for adequate maintenance on property, plant and equipment Unit: % of ideal revenue requirement	1997	27.9	62.4		75.7		TBD		TBD		TBD	
		Energy consumption per unit of GDP	Definition: energy consumption in GWh and other fuel units converted to standard unit of measure (use of biomass and other traditional fuels are excluded) Unit: kilogram of energy use (oil equivalent) per unit of GDP (1987 dollars)	1997	0.64	0.59		0.56		TBD		TBD		TBD	
IR 1	Increased private investment	Amount of electricity utility ownership privately held	Definition: percent of actual ownership shares for each enterprise, not adjusted for the value of the shares Unit: (D) average % of non-state ownership of distribution (weighted by % of sales for each distribution enterprise); (G) average % of non-state ownership of generation (weighted by % of generation for each generation enterprise)	1997	0 (D) 3 (G)	30 (D) 10 (G)		61 (D) 31 (G)		TBD		TBD		TBD	
IR 2	Increased efficiency	Collections from end-users paid to distribution companies	Definition: cash collections based on energy bills to consumers – industrial and residential Unit: % of billed energy collected	1997	66.2	93		100							

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Act.	Tgt.	Act.
IR 3	Replacement power projects developed to allow for closure of the ANPP	Rehabilitation of hydro-electric facilities	Definition: hydro-facilities supplying up to 100 MW Unit: yes/no	1998	no	yes									
		Demand side assessment completed	Definition: verification of available data and develop a comprehensive program Unit: yes/no	1998	no	yes									

NOTES: ¹ Targets for years beyond 2000 anticipated by late March 1999.

Table IV -- Performance Data

SO 2.2 LAWS ARE ENFORCED AND ADJUDICATED IMPARTIALLY

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				Year	Value	Target	Actual								
SO 2.2 ¹	Laws are enforced and adjudicated impartially	Public confidence	Definition: percentage of public that believes that court decisions are rendered fairly and according to the law Unit: % of populace	1999	TBD										
IR 1	Regulatory agencies administer laws impartially	Administrative Procedures Act	Definition: an administrative law is adopted that regulates: 1. agency appeals 2. public hearings 3. agency rulemaking 4. access to courts from agency decisions Unit: yes/no or point by point	1998	no/none			yes							
		Administrative decisions are sound	Definition: percentage of appeals to courts from administrative agencies where the agency decision is overturned by the court in the final decision; final decision means that the decision was made by the Court of Cassation, or no appeal was made from the Court of Appeals Unit: % of cases	1998	TBD										
IR 2	The judicial system effectively applies the law	Ability to find advocate	Definition: percentage of public that believes it is able to find and afford an advocate when needed Unit: % of populace	1999	TBD										
IR 3	The judicial branch is independent of other branches of government	Constitutional amendment	Definition: the Constitution is amended to remove executive branch participants from the Council of Justice	1998	no	yes									

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				Year	Value	Target	Actual								
			Unit: yes/no												
		Independent judicial disciplinary body	Definition: a body independent of executive branch control is responsible for discipline of judges; the body must also be free of case-specific interference by the Council of Court Chairmen Unit: yes/no	1998	no					yes					
		Judicial code of ethics	Definition: a code of professional ethics requiring impartiality and independence applies to judges Unit: yes/no	1998	no			yes							
IR 4	Court orders are enforced	Average time of enforcement	Definition: the average number of days for a court order to be enforced Unit: average number of days	1998	NA										
<p>NOTES: A number of the indicators above will be determined by survey of the public which will be developed in Feb. 1999 and most likely undertaken as an initial (baseline) survey in June 1999, and annually thereafter. Until the first surveys are conducted, and a baseline is determined, no genuine targets can be set for the following years. An additional survey of judges and other judicial staff may also be necessary. This will be discussed and a decision made based upon recommendations from MSI consultants in Feb. 1999. Some other indicators depend on institutions which are new (the full Council of Court Chairmen and the Service for Execution of Court Orders) or not yet in place (the Judicial Training Institute). Baselines and targets for these indicators cannot be determined precisely until the institutions have been in independent operation for some time, and basic issues have been determined. Baseline numbers for two of the above indicators have not yet been determined, but information is being collected. NA means not available</p>															

Table V -- Performance Data

SO 2.1 Increased citizen participation in the political, economic, and decision-making process

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				YEAR	VALUE	Target	Actual								
SO 2.1 ¹	Increased citizen participation in the political, economic, and decision-making process	% of citizens who feel they have some influence on governmental decisions	Definition: Citizens who feel that government is hearing and acting upon their concerns Unit: %	1999	TBD										
IR 1	Strengthened political process	% of people who feel that elections are democratic	Definition: Citizens who feel that the electoral process accurately represents the views of citizens Unit: %	1999	TBD										
IR 2	Increased citizen advocacy	Improved advocacy score from the NGO Sustainability Index	Definition: NGOs are improving and increasing their lobbying activities Unit: Score on the index (scale 1-7)	1998	6	5		5		4		4		3	
IR 3	Enhanced circulation of information	% of population that trusts available news sources	Definition: People who rely on news to provide accurate information Unit: %	1999	TBD										
		% of population that feels that information is readily available	Definition: Citizens who feel that they have the necessary information to make informed choices Unit: %	1999	TBD										
IR 4	Increased government accountability and responsiveness to citizens	% of citizens who feel government is trustworthy	Definition: Citizens believe that elected officials and their appointees take actions for the best interest of Armenia	1999	TBD										

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				YEAR	VALUE	Target	Actual								
		% of citizens in target municipalities who feel local government is addressing their priority concerns	Unit: % Definition: Cities under local government program that are addressing citizens' concerns Unit: %	1999	TBD										

Note: ¹Two consultants from MSI will come to Armenia in mid-February to work with USAID on developing data collection tools for most of the indicators under this SO. For many indicators, this may include annual data gathering from a nationwide survey. The baseline survey most likely would be conducted in June 1999, but final date will be dependent upon the elections which have not yet been called. 1999 data will serve as the baseline data for subsequent years. For political party analysis, this may include an assessment conducted by local experts.

Table VI -- Performance Data

SO 3.2 STRENGTHENED SOCIAL SAFETY NET

RESULT NO.	RESULT STATEMENT	PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		1999		2000		2001		2002		2003	
				Year	Value	Target	Actual								
SO 3.2 ¹	Strengthened social safety net	Percent of GOA budget allocated to social safety net expenditures	Definition: expenditures in the GOA budget line item 6 (social security and social protection) Unit: %	1998	10	12		TBD							
IR 1	Improved social protection systems	Adequacy of the basic benefits package	Definition: value of the basic benefits package compared to standard market basket (calculated as a ratio) Unit: < 1	1998	0.35	TBD									
IR 2	Regional health care systems piloted	Network of health facilities including primary health care services and referrals systematically operating in two regions	Definition: pilots will be developed as community health partnerships; relationships between levels of care (i.e., primary, secondary, tertiary) will be addressed in terms of services, referrals and efficiencies Unit: yes/no	1998	no	no		yes		yes		yes		yes	
		Client usage of locally available health care services (in target regions)	Definition: client numbers will be monitored through clinic rosters and client surveys Unit: TBD	1998	low	low		low		mod		mod		mod/hi	
		Public awareness of and attitude to locally available services (in target regions)	Definition: client surveys and community surveys will be used to gauge attitude and awareness Unit: TBD	1998	low			low		mod		mod		mod/hi	

NOTES: ¹ Indicators and targets are subject to change/refinement once activity design and implementing partners are in place.

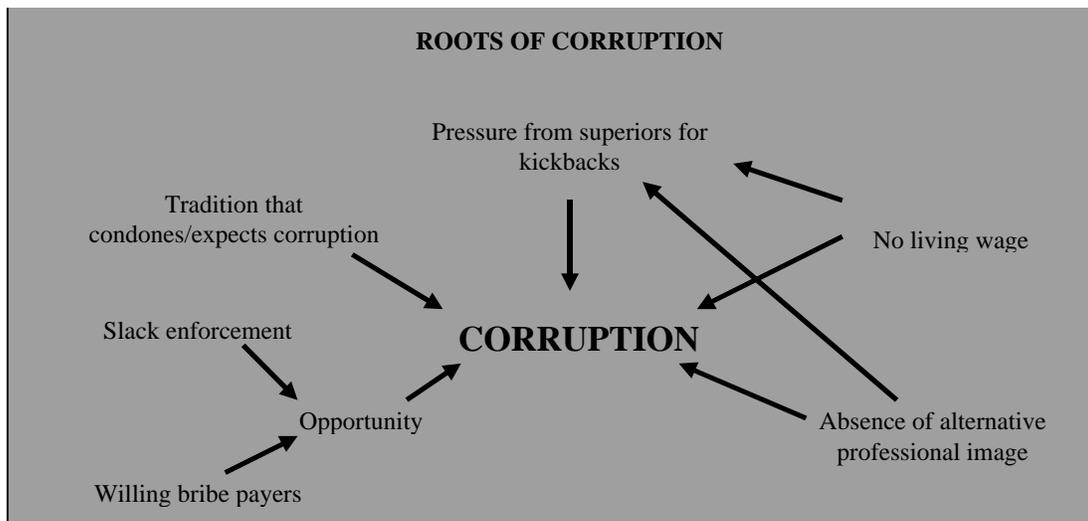
ANNEX 1 - CORRUPTION¹⁸

Armenia, like most of the countries of the former Soviet Union, is characterized by widespread corruption. Clearly, this corruption is a key constraint to Armenia's economic, political and social development as it interferes significantly in: the efficient and effective creation and growth of a free market economy; the transparent and equitable operations of the government; the implementation of free and fair elections; and the efficient and effective creation of equitable provision of social services.

There is widespread agreement among both Armenians and expatriate observers on the main causes of corruption in Armenia:

- tradition
- low wages
- low risk incurred to those engaging in corrupt practices
- weak professional bureaucracy

Figure 16, Adapted from [10]



Tradition: Corruption in contemporary Armenia is very much the immediate legacy of seventy years of Soviet rule. Deeply ingrained coping behaviors from that era find expression in a society that is very tolerant of corrupt practices. Ordinary citizens are for the most part oblivious of the degree to which corruption undermines the transition to a market economy and democracy.

Low Wages: As discussed elsewhere in this strategy document, unemployment and underemployment are both at very high levels in Armenia. Many people have no regular source of income. For most of those who do have a regular salary, it is typically too low to support a family. At the same time, prices have been liberalized

¹⁸ Corruption is defined here as the abuse of public office for private gain.

since Armenia's independence, thereby significantly raising the cost of living for most Armenians. For example, an average, mid-level government employee earns approximately \$15-20 per month; at the same time, an average monthly electricity bill alone can be up to \$100.

Given the relatively high cost of living relative to the wage rate, it is inevitable that many employees will look for any means to supplement their meager incomes -- and often find those means in illegal ventures, such as bribes. Low wages, of course, do not explain all instances of corruption, but they do help to explain its pervasiveness.

Low Risk: Enforcement of laws and regulations in Armenia is weak. Many government agencies are only recently established, do not have a solid legal basis for their operations, and do not have sufficient staff or resources to do their work. There is a lack of political will to enforce laws and regulations against corruption, since many of those requiring the will are themselves practitioners and/or are closely connected to those who are. The end result is that there is little to no perceived punishment for corruption. Few practitioners are exposed for their corrupt actions and, even if exposed, few receive a punishment that could be seen to either change their behavior or serve as a negative example to other potential practitioners.

Weak professional bureaucracy: Even if the salaries of bureaucrats were to rise substantially, incentives for corruption would remain. Reform of the Civil Service needs to be undertaken in order to push through needed reforms and to reduce the potential for political interference in the process. Systems with low corruption levels coincide with personnel whose job motivation reflects a more balanced combination of monetary income and job satisfaction/pride [10].

Given these primary causes of corruption, what can be done to reduce its negative effects? What can and should USAID specifically do in this regard? Actions fall into benefits (or "carrots") and costs (or "sticks") categories:

Benefits: Clearly, if low wages contribute to corruption, then higher wages will be needed to help lessen corruption. Just as clearly, this is not so simple or easy as it may sound. Wages will not rise overnight nor will they rise evenly throughout the economy. Wages for productive new private sector jobs may be reasonably good, but it may take considerably longer to achieve a sufficient rise in government tax receipts and a reduction in the government workforce, to realize meaningful wage increases for government employees who may be most susceptible to corruption at present (e.g., tax inspectors, customs officials). Progress can be made, but it should be recognized from the outset that this is a long-range solution that will require patience and perseverance.

USAID's strategic priorities clearly focus on employment generation, with its clear and very direct connection to wages. Not only will many of the USAID interventions -- e.g., economic reforms, direct assistance to small and medium enterprises -- work to create new job (therefore income) opportunities but also to improve worker productivity with the attendant increase in wages that implies. In addition, USAID assistance in tax administration will help in the collection of government tax receipts

which will gradually help to improve the government's ability to pay reasonable wages to its employees.

Higher wage rates will not come quickly or easily. This should not be seen as a short-term solution. Nonetheless, it is one of the most appropriate and sustainable solutions to the pervasive problem of corruption and must be addressed. There is good reason to believe that some, very modest, progress can be made in this regard -- through both tax reforms and direct and indirect assistance to employment creation -- in the five year strategy period at hand.

Costs: As noted above, enforcement at the moment is generally weak and inequitably applied. Thus, there is little perceived risk of punishment for engaging in corrupt practices in Armenia despite severe penalties on the books. In addition, the broader public, while disgusted by corruption, has come to expect, perhaps even accept, it. It is rare for the population to witness a high level official being exposed for corrupt practices, much less see him/her actually penalized for it. The obvious solution, then, is to increase the penalties involved in corruption so as to deter it.

USAID's strategic focus on enforcement and adjudication directly addresses this need to increase the risks involved in corruption. Strengthened enforcement capabilities in tax and customs administration, energy regulations, accounting practices, and bailiff services will all be addressed through USAID activities.

At the same time, USAID's efforts to ensure increased circulation of information and to encourage and support greater public advocacy will ensure that the public witnesses enforcement and adjudication as they become increasingly impartial. As public confidence in equitable enforcement increases, public apathy and cynicism toward corruption should begin to decline, i.e., people should become less tolerant of -- and more outspoken against -- corrupt practices.

While immediate, dramatic changes in corruption cannot be expected, within the strategy's five year time frame, we should expect to see some inroads in combating corruption in Armenia.

It is important to note that there are a number of Armenian enforcement agencies that, on their own and/or with the help of other donors, are beginning to improve their capabilities and thus their ability to deter corruption. Some agencies are focusing on the media as a means of exposing corruption and ensuring transparency in the investigation process. Other agencies are putting more emphasis on rewarding their staff for honest and effective work ethics, through the use of bonuses. Furthermore, the government is planning to introduce significant changes in the size and structure of public administration. A medium-term civil service reform strategy, developed with World Bank assistance, is to be adopted by the government in 1999.

ANNEX 2 - APPROACH TO REGIONAL PROGRAMS

As noted in Part I of the Strategy, USAID's approach is based on the principle that Armenia's domestic prosperity and stability is the best means to enable it to play a key role in regional stability. However, USAID also recognizes that there are immediate opportunities to enhance or encourage regional integration through various program mechanisms as the political process develops. Although the separation of USAID/Caucasus into two Missions, one in Yerevan, one in Tbilisi, has required a sorting out of programs and staff into country-level organizations, the commitment to regional programs in support of regional integration remains.

The rationale for regional programs in Armenia is closely related to the rationale for economic policies which promote trade and exports: Armenia is too small and geographically isolated by its landlocked location to go it alone. It must search for markets and resources beyond its borders in order to prosper. In the political sphere, Armenia's long term security depends upon its ability to establish and foster cooperative and positive relationships with its neighbors, not only in the Caucasus itself, but also within the broader region which encompasses Turkey, Russia, and even Iran and beyond to the Gulf States.

Although the current blockade is extremely damaging to Armenia's ability to develop, and U.S. policy is to encourage the countries involved to reach an amicable resolution of the political stalemate, Embassy and USAID believe that we should seize opportunities for creating and exploiting even small openings within the current environment to enhance regional cooperation. In this way, immediate benefits can result from the activity which can make longer term resolution of the larger political issues more feasible.

USAID will seek to identify such opportunities as they may exist in the strategic sectors in which our program operates. They would only be pursued after full consultation and coordination with USAID/Caucasus and the respective Embassies.

USAID/Armenia's approach is on two levels:

- identifying those strictly bilateral programs that operate in parallel in the Caucasus countries and looking for opportunities to increase impact, save funds, or promote productive contact and shared lessons learned by joint activities such as seminars and training; and
- undertaking truly regional programs that extend across borders and depend upon two- or three- country cooperation in order to succeed.

Examples of the first category would be training in common disciplines, joint conferences and seminars on common topics, joint study tours, etc. Eurasia Foundation's Synergy Program represents this approach in a well-developed fashion. These parallel activities are likely to be relatively inexpensive and require relatively little USAID management and/or technical time. Outcomes may be largely attitudinal

in some cases, and therefore difficult to measure, but highly valuable in terms of fostering good will and greater willingness to work together over time.

The second category would be much more limited because cross-border activities are likely to be more expensive and complex to implement. An example, however, is currently on the table: Armenia and Georgia are considering proposals to undertake cross-border rail and roadway improvements, with associated customs and trade regime reforms, to enhance regional trade and other linkages through better transport services. USAID's role in advancing and implementing such projects is likely to be limited because of the large capital investments required, but supportive technical assistance and policy reforms could be a valuable contribution. The proposed work is also a good example of the kinds of regional activities that can contribute to longer term resolution of obstacles to integration: although the blockade has thus far prevented studies of upgrading rail and road links between Armenia and neighboring Turkey and Azerbaijan, undertaking an upgrade of the Armenia/Georgia connections could both improve trade and contacts between the two countries and serve as the first stage for the more extensive improvements that could bring Armenia into the TRACECA network and make more feasible an ultimate political solution within the region.

A subset of the second category would be supporting the development of Armenian institutions which could serve a broader regional market, such as hospitals and universities, some of which already draw students from beyond Armenia but which could increase such activity. Conversely, looking for opportunities to utilize institutions in neighboring countries in cooperative ways could also be promoted, as could partnership relationships among institutions in the region.

The energy sector also offers opportunities for regional approaches, such as Armenia's sale of power to Georgia. During the strategy period, regional energy undertakings will be explored.

ANNEX 3 - CUSTOMER APPRAISAL RESULTS

From October 17 to October 31, 1997, three USAID/Yerevan Armenian staff members (two women and one man) interviewed approximately 200 Armenians, both in groups and individually, throughout the country. The interview respondents were selected randomly, using rapid appraisal methodology. Only three basic questions were asked, i.e., (1) what are the problems in your community?; (2) what do you think the solutions to these problems should be?; (3) who do you think should be responsible for these solutions? In addition to these questions, if/where necessary, the interviewers asked follow-up questions to try to draw respondents out on the underlying nature of the problems mentioned, possible interrelationships between and among problems and possible interrelationships between and among solutions. Interviews were conducted in both urban and rural settings. One day was spent interviewing in the area of Yerevan, the capital city (though no interviews were held in the actual city itself). Four days were spent interviewing in the northern part of the country (one team went northeast in the Lake Sevan region; one went northwest to Gyumri and surrounding regions); four days were spent interviewing in the south, between Yerevan and the Iranian border. Interviewers also made an effort to ensure that they interviewed a variety of people, i.e., not all one gender, age group, income level, professional category.

Findings

The most common problem people note, particularly in urban areas, is unemployment. This problem is directly and specifically related to factory closings at the time of the collapse of the Soviet Union and then subsequent privatization efforts. People say that when formerly public factories were sold to private individuals, the movable assets were sold, thereby permanently throwing the workers out of their jobs (previously there had been hopes that these factories might reopen). People appear to recognize that there is a difference between privatization as it has been practiced in Armenia and privatization in theory and do not speak against the latter. Instead, they speak against what they perceive as corruption, where individuals have bought factories at a small fraction of their actual worth and then have made a profit from selling the factories' assets without concern for the employees' welfare or interests.

While unemployment is largely an urban problem, the inability to sell agricultural products is the main problem noted in rural areas. People in rural areas frequently mention their lack of transportation and marketing services as well as corruption (e.g., barriers to market access by a monopoly middleman). In addition, in both rural and urban areas, people note that wages and pensions are very low.

Both urban unemployment and rural inability to sell agricultural products leads to lack of access to cash. Respondents in both rural and urban areas express an understanding of the need to pay for public services (e.g., electricity, water) and taxes and a willingness to pay. However, they also express a frustration with their inability to get the money required to pay. This problem relates to internal private sector dealings as well as payment for public services; for example, farmers are unable to get the cash they need to pay for farming inputs (seeds, fertilizers) at the beginning of the

crop season or for harvesting costs (e.g., to pay the owner of farm equipment such as a combine or to buy the fuel to run this equipment). The lack of cash also leads to a lack of availability of inputs in many areas, i.e., because farmers have not had the cash to buy fertilizers or seeds, merchants to provide these inputs are often not available in rural areas -- meaning that farmers often can't buy the inputs they need even if/when they do have the cash.

In rural areas, one of the most commonly mentioned solutions to the closely related problems of lack of market access and lack of cash is to reestablish a system of market points for agricultural inputs and products. This does not necessarily mean a return to public sector mechanisms; instead people are asking for predictable and workable systems that will allow them to earn an adequate income.

Another very commonly mentioned solution -- in both rural and urban areas -- to the problem of lack of access to cash is loans. There is nearly universal demand for loans -- and universal distrust of the formal banking sector as an acceptable means of accessing loans. (One commercial banker interviewed even recommended that people should not access donor loans through commercial banks.) Many people express concern about collateral requirements, i.e., they are not willing to risk what little they have (in most cases, their homes) for what they perceive as high interest, short term loans, where their perceived chances for success (i.e., in repaying the loan and still having anything left to remain in business) are seen as very low. As a result, there is a demand for "independent controls" (i.e., protection) to accompany any loans which may be made available. This protection is viewed as two fold: first, respondents see a need for borrowers' protection from the "government" (in which they include commercial banks) against unfair collateral and other lending requirements; second, respondents also see a need for protection for lenders (i.e., non-government, donor) so that borrowers do not take unfair advantage of more favorable lending conditions.

In addition to the demand for cash through loans, there is -- to a lesser extent -- a demand for some training (in business management, for example) to accompany the loans. There is also a perceived need for information about loans.

In addition to loan protection, there is a demand, particularly in rural areas, for other types of insurance or government guarantees. Specifically, the need for "crop insurance" was frequently raised. (It should be noted in this context that there may have been some misunderstanding on the part of some respondents of what crop insurance would entail, e.g., non-refundable premiums.) Farmers note that they face a number of uncertainties (in particular, weather damage) that potentially could wipe out their incomes in any given year. In addition, a number of farmers perceive that there is an unfair distribution of government resources which are provided in the aftermath of a crop loss.

Closely related to the problem of lack of cash (but not apparently related to the demand for loans) is the common complaint about the high cost of health care. Repeatedly people note that they cannot afford health care and often are forced to avoid seeking medical assistance due to their inability to pay what is asked by the providers. In particular, there is a high degree of dissatisfaction with the perceived need to pay twice for health care (one official payment based on posted rates for services as well as a series of unofficial payments to individual doctors, nurses, and

other providers). Most respondents express general satisfaction with the quality of health care services (although, with some probing, there were some questions and concerns about quality as well). However, there are some clear instances where inability to pay has affected the provision of services. For example, one respondent noted that his daughter-in-law was refused medical care unless payment was made either in U.S. dollars (not dram) or with her wedding ring. In another area, respondents noted the absurdity of a local hospital advertising that children under two could have their teeth pulled for free.

Less frequently and/or less forcibly noted problems include the cost of "public" education (e.g., frequent requests from the school or teacher for money for books and/or other school supplies and/or for in kind contributions of heating fuel) and the need for physical infrastructure, such as roads (needed for marketing agricultural produce), irrigation systems, drinking water and (at least in the far south of the country) the availability of diesel (to run farm equipment).

Several people offer that humanitarian aid should be stopped since it may be fostering dependency (at least one respondent said humanitarian assistance is "like a drug"). Several respondents express a desire for assistance to be used for more productive (e.g., self-help) purposes.

A common theme throughout the interviews is a high degree of mistrust of what is perceived to be "government" (including the formal banking sector). People openly talk about corruption and perceive that "the government" is responsible, for example, for factories continuing to be closed (at least indirectly by allowing privatization to be mishandled), for loans being unavailable on accessible terms, and for resources being unfairly distributed. While there is a high degree of awareness of the problem of corruption, very few suggestions are offered for how to solve the problem (other than "change the government" -- but, even here, there does not seem to be a sense that this is within the control of the respondents). Even where corruption is directly related to locally elected government officials, there is not a sense of individual or community control. While, in general, respondents in rural areas express more sense of self-control and more of a willingness and ability to fight corruption than their urban counterparts, there is a relatively widespread sense of distrust of and discouragement with government and a general equation of government at all levels with corruption.

Respondents in southern Armenia (in areas close to the Azerbaijan border and near Nagorno-Karabakh) do not express any particular anxiety or animosity as a result of war. To the contrary, people in this southern region express an interest in having the blockade by Azerbaijan lifted so that trade could be resumed. Nonetheless, throughout the country, people are afraid of a return to war and of the resultant costs (both in terms of lives and money). While those nearest the border would like to regain the benefits of trade with Azerbaijan, they do not want to see the occupied territories returned to Azerbaijan for fear of the loss of their "buffer zone" from any potential future fighting.

ANNEX 4 - NAGORNO-KARABAKH

Beginning in 1988, ethnic Armenians residing in the Soviet republic of Azerbaijan in a region known as Nagorno-Karabakh (NK) began to request greater autonomy and closer links to their ethnic relations in the Soviet republic of Armenia. With the collapse of the Soviet Union in 1991 and the resultant independence of both Armenia and Azerbaijan, this quest for autonomy turned into full scale war. The conflict continues unresolved today, albeit under cease-fire conditions. As a result, an economic blockade has been imposed on Armenia by both Turkey and Azerbaijan.

The lack of a peaceful and final resolution regarding the status of NK, which is located entirely within the borders of Azerbaijan but is populated exclusively by ethnic Armenians, leaves this area in a continuous state of political limbo. The "autonomous region" of NK is neither an independent country nor a fully accepted and recognized part of any other country. The United States Government officially recognizes NK as part of Azerbaijan and actively participates in "Minsk Group" discussions to help identify and implement a peaceful resolution to the current standoff.

Since NK is not a part of Armenia and since its status as part of Azerbaijan is subject to dispute, the "autonomous region" receives no development or humanitarian assistance from the U.S. Government as part of either of these two countries' programs. Instead, in FY 1998, the U.S. Congress made provision for separate funds for "victims of the conflict" in NK, i.e., both ethnic Armenian residents in NK and Azeris (and others) displaced by the conflict to areas outside NK.

USAID/Armenia has management responsibility for the funding provided to "victims" resident in NK itself (while USAID/Caucasus is responsible for the "victims" on the Azerbaijan side of the conflict). This responsibility is to ensure humanitarian and limited developmental assistance to the approximately 130,000 residents of NK. While it is widely agreed that there is no acute humanitarian crisis in NK (people throughout the Caucasus, including NK, are experiencing economic difficulties), there are approximately 4,000 especially vulnerable residents, including those who live in seriously damaged conflict areas as well as those injured in the conflict and those whose primary source of income has been lost as a result of the war.

USAID/Armenia's assistance to NK is targeted to meeting the humanitarian needs of this war affected target group. By May 2000, it is expected that this targeted group will have at least some of its basic shelter needs met, have improved access to primary health care, and be able to increase family incomes.

Until a permanent peace settlement is reached, therefore the political status of NK is resolved to all parties' satisfaction, it will not be possible to assist the residents of this area beyond this relatively short-term humanitarian assistance. At this time, USAID/Armenia does not anticipate activities in NK, humanitarian or longer-term developmental, beyond the May 2000 end date of the current assistance program. Should circumstances change (e.g., a peaceful resolution be reached, additional funds

be allocated), USAID/Armenia stands ready to address the priority needs of the people of NK.

ANNEX 5 - GENDER

In November 1998, USAID commissioned a locally available, expatriate consultant to undertake a gender assessment as part of our preparations for this strategic plan. This assessment was based on an examination of existing studies and data and through interviews with various individuals (both formal interviews with national and local leaders and informal discussions with a variety of individuals, i.e., “man and woman on the street”). In addition, we have recently been involved in a number of gender-related discussions with other donors regarding the nature of gender relations in Armenia and the role of gender in this country’s development. This strategic annex is taken from the assessment report, and its basic contents subsequently have been confirmed with a number of other donors working in Armenia.

Armenia’s history has been dominated by despotic external (non-Armenian) rule (Russia, Ottoman, Iranian, etc.). What has allowed Armenians to survive as a culture -- in fact, what has defined Armenians as a culture -- has been the family unit. In fact, in the face of frequent foreign domination, Armenia has, for much of its history, existed only at the level of families and small, relatively unconnected communities. Thus, the family unit has been the main guarantor of Armenian culture for hundreds of years. It is in this historical context that gender in Armenia must be viewed: gender is closely tied to the family unit which, in turn, is strongly tied to the Armenian social system and ethnic survival. This historical background is critical in explaining the Armenian approach to gender: even a relatively benign attempt to change gender roles is seen as an attack on the family and thus on the system of Armenian cultural preservation.

In the Armenian view of gender linked to family linked to social preservation, the men are traditionally the primary breadwinners and decision-makers and the women are traditionally the primary childcare providers and homemakers. This having been said, however, it is a mistake to assume that women are (or, historically, have been) blatantly oppressed by men. Concurrent with domestic subordination, Armenian women traditionally seem to have had a streak of strength and stubbornness. While men are seen as the head of the family and the breadwinners, women are also strong in how the family is presented to the outside world (which has brought, among other things, an emphasis on women’s education as bringing status to the family).

While the Soviet period (with its ideology of formal gender equality) did have some impact on traditional Armenian gender roles (e.g., bringing more women into the urban workplace, although, typically, in the more “feminized” sectors such as health, education, and the arts), it is clear the Soviet rhetoric on gender equality sometimes remained only that and did not translate into a change in more traditional mentalities. Thus, with independence, it is equally clear that more traditional gender relations have continued to drive society rather than the Soviet ideal of gender equality. Consciously and unconsciously, these traditional gender structures, which were incompatible with the Soviet model of gender relations, have re-emerged with independence. Given the uncertainties of the post-Soviet period, one could argue that this re-emergence of traditional gender roles and relationships has been a social self-defense mechanism, i.e., the traditional has emerged to fill the vacuum left by the collapse of the Soviet

system. It is also possible that abiding by gender traditions is a way of asserting ethnicity and nationalism in a culture which has often felt its very survival threatened.

Although the family, with its traditional gender roles, has provided social stability during the economic difficulties since independence, the inability of many male heads of household to retain the role as the main breadwinner in the face of high unemployment and underemployment has added to the already difficult economic circumstances of many families, i.e., many men have had difficulty coping with their inability to fulfill their traditional family role. Migration of men in search of work abroad has been one method of adaptation, thereby leaving a number of female-headed families. Many men who have remained in Armenia are unemployed. Women have helped to meet the increased financial needs of the family through increased participation in economic life, typically in relatively low-wage jobs, while also continuing to do household work and maintaining a traditional domestic division of labor along gender lines. While increased economic participation by women, even in lower wage jobs, has helped families to survive economically during the transition, it (coupled with the inability of men to fulfill their traditional roles) may have had some destabilizing effects on the Armenian family (e.g., an increased rate of divorce).

There has been a general reassertion of traditional Armenian gender divisions of political power since independence. The new organizations that have come to dominate political life after the collapse of the Soviet Union have not actively sought female participation; at the same time, women have not, for the most part, tried to push their way in. Anecdotal evidence suggests that there is greater female involvement in local political and social institutions such as educational boards, electoral commissions, and NGOs. As noted throughout the strategic plan, Armenians as a whole, both male and female, are largely alienated and perceive themselves to be powerless. Until representatives are more accountable to their constituencies, until the electoral process improves, until the influence of patriarchal clans is reduced, and until the democratic process itself becomes stronger, women will continue to be underrepresented.

There is no compelling evidence to suggest that gender is a determinant of poverty. However, refugee women and women whose husbands are abroad as migrant workers do form an important at-risk poverty subset. There is increasing anecdotal evidence of a spreading phenomenon of the establishment of “parallel families” by migrant male workers in their new locations, resulting in the effective abandonment of wives and children left in Armenia, leaving them even more at risk. While overall health indicators (such as life-expectancy) for both men and women have declined during the transition period, women's health has been especially affected, largely as a result of the high costs of health care (e.g., an increase in home childbirth and a decrease in prenatal care to save money have resulted in increased maternal mortality). In education, women continue to graduate at higher rates than men from both secondary school and university and have lower dropout rates than boys.

Given the historical context in which Armenians view gender (particularly as it is intimately related to family and culture), it is clear that USAID needs to proceed with sensitivity on gender issues. The potential gains of gender-specific programs (e.g., in increasing women's economic opportunities) could potentially be offset by a negative impact on an Armenian social structure (e.g., in further discouraging men in their

traditional role as breadwinner, thereby destabilizing families through possible divorce, increased alcohol consumption, etc.) that is already frayed. In addition, there is often open hostility among both men and women toward anything that is perceived to disproportionately favor women, thereby potentially destabilizing the family; as a result, USAID needs to ensure that it "does no harm" in overemphasizing gender issues that could potentially reinforce this hostility.

Since many of the problems facing women -- unemployment, poverty, powerlessness in the political sphere, declining health indicators -- are also faced by men, the USAID strategy as outlined will primarily focus on ensuring gender equity rather than on advancing the interests of one gender over those of another (which, in the Armenian context, could be viewed as potentially destabilizing) while working more quietly to heighten awareness of gender issues and support a domestic dialogue on the issue. Given the very deep-seated gender traditions and the strong emotions attached to them, a radical and rapid change in gender attitudes should not be expected; instead a gradual shifting of ideas can and should be supported, as Armenians feel more economically secure and as they become more interconnected internationally.

In light of the above, the mission will look for opportunities throughout the program to ensure that men and women interact on an equal footing and have the opportunity to discuss gender within a broader sectoral context. For example, USAID is planning to undertake a number of study tours to Eastern Europe and other FSU countries (as well, possibly, as to the U.S.) as part of its emerging social and employment portfolios; such study tours can and should ensure that both men and women are included and that they interact both with one another and with receiving country nationals of both genders in such a way that demonstrates gender equality supportive of rather than threatening to social and ethnic security. In the same way, training opportunities should not only ensure gender equity among participants but should look for opportunities to expose trainees to new ways of viewing gender, e.g., by ensuring that training programs incorporate gender examples and/or issues relevant to the course.

On a sector-specific basis, the mission will reinforce this cross-cutting attempt to introduce Armenians to alternative gender approaches. For example, the mission's employment strategy will ensure that direct private sector assistance (i.e., SO 1.3) does not disadvantage women in employment opportunities. It should be noted that the current legal environment does not disfavor women; however, to the extent that enforcement, adjudication, and/or practice (e.g., in securing a loan from a bank) are inequitably applied by gender, USAID will certainly work to ensure that such disparities are corrected.

In the political realm, USAID will ensure that both women and men are given every opportunity and encouragement to participate actively at the local and national levels and in both public and non-governmental fora. Access to information will be available to both men and women, both will be encouraged to participate in NGOs, and both will be encouraged to inform the political process through involvement in political parties, local government activities (e.g., town meetings) and elections. Use of NGOs and the media to initiate a national dialogue on gender issues -- particularly as they relate to specific sectoral issues -- may be considered; given the sensitivity of

this issue among Armenians, however, such an approach deserves considerable thought and customer information gathering first.

USAID's new emphasis on a stronger social safety net will benefit both men and women as sustainable mechanisms are sought to ensure that, over the long term, all Armenians will have some form of insurance to protect them against unemployment, sickness, disability and old age. To the extent that some women (e.g., refugees, those whose husbands are abroad and single pensioners) are especially vulnerable, USAID activities will ensure that they receive particular attention. A focus on primary health care at the local level should improve accessibility for women in particular.

Reproductive health activities will directly improve women's health through: decreasing the rate of abortion (therefore the risk of longer-term complications such as infertility); offering safer alternatives in family planning; providing improved pre- and post-natal care to mothers; and increased awareness and appropriate treatment of sexually transmitted diseases.

ANNEX 6 - ENVIRONMENT

Armenia, like many of the countries of the former Soviet Union, is characterized by a poor environmental profile. Competing demands for scarce financial resources, a still limited environmental consciousness among both the general population and national (public and private) leadership, and a reviving economy will challenge the country to reduce pollution emissions and ambient levels, many of which substantially exceed U.S. and European Union levels. It will probably take a decade or more for policy improvements, market-based incentives and improved finances to reach a level of sustainability. Nevertheless the government is taking action, changes are taking place, and progress is being made. For example, Armenia's draft National Environmental Action Plan, produced with the support from the World Bank, focuses attention on two priorities: improved water supply and utilization; and phasing out lead in gasoline and mitigating exposure to lead, especially among young children.

An August 1998 environmental assessment outlined a number of serious environmental problems in Armenia which could benefit from donor attention. Among them:

- incomplete legislation and lack of enforcement;
- lack of public and institutional awareness of environmental issues and their intersection with economic recovery;
- contamination of drinking water distribution systems;
- poor wastewater treatment facilities and procedures;
- over-extraction of water from Lake Sevan for hydropower and irrigation;
- air pollution from unleaded gasoline;
- lack of farmer awareness of safe pesticide practices and the resultant passing of pesticides through the food chain;
- water logging and salinization in agricultural areas;
- heavy metals contamination of agricultural soils;
- nuclear safety from the Armenian Nuclear Power Plant;
- lack of separation of domestic and industrial waste.

All of these problems (and more) are serious and require attention. However, the mission does not see the environment as a separate and distinct portion of the strategy; instead it is clearly and closely interrelated with almost all aspects of the strategy. Environmental solutions therefore need to be integrated into the rest of the program. As a result, we do not have a specific environmental strategic objective or intermediate result. As should be clear from the narrative in Part II of the strategic plan, environmental efforts appear throughout.

Given the lack of public and institutional awareness of environmental issues at present in Armenia, USAID/Armenia proposes to focus its environmental attention primarily in this area at least for the initial portion of the five year strategy period. Public awareness will be addressed through at least two primary mechanisms:

- encouraging media coverage of priority environmental issues; and

- supporting environmental NGOs in their efforts to promote environmental awareness.

While many of the problems listed above require more than simply public awareness, this is seen as an important starting point. For example, in order to ensure that the GOA's commitment to phasing out lead in gasoline by 2008 is achieved, there will need to be significant attention given to raising the public's awareness of and support for this initiative.

While the mission's primary focus will be on increasing public awareness, there are plans for possible additional environmental efforts. For example, the mission is looking into increasing institutional awareness through environment-related training for:

- judges as part of a larger judicial training effort;
- Ministry of Environmental Protection inspectors and others;
- reporters and others in the media; and possibly
- the National Assembly.

Current mission activities through the Environmental Public Advocacy Center (EPAC) will continue to assess and provide advice on environmental laws, in addition to their public awareness and training efforts noted above.

There may be other opportunities for environmental awareness and even more proactive activity that the mission will pursue as the strategy progresses. For example, some local economic opportunities may include environmental benefits, such as community re-forestation for fruit production and/or sustainable fuel wood production. In demonstrating improved efficiencies in local government management and budgeting, more efficient water delivery and/or waste disposal systems may be developed. As activity designs progress, the mission will look for ways to include environmental awareness and improvements as effectively as possible. As the economic reform process continues, USAID may want to include legislation related to the environmental protection and/or liability of privatizing industries.

ANNEX 7 - SELECTED ECONOMIC INDICATORS

GDP (\$ millions, 1997)	\$1,600
Growth Rate '98	5.5% (est.)
Investment as percent GDP (1997)	10%
Private Sector Share of GDP	60%
Laborforce:	1,380,000
Private Sector Share of Employment	56%
Per Capita GDP at PPP (1997)	\$2,280
% of Pop. Below Poverty Food Line	28%
Unemployment Rate	30+%
Exports (\$ millions, 1997)	\$233
(CIS 41%, EU 29%, Iran 18%)	
Imports (\$ millions, 1997)	\$892
External Debt (\$ millions, 1997)	\$786
Debt Service as % Exports Goods & Services	15%
Gross Int'l Reserves (\$ millions, 1997)	\$247
Remittances:	pvt.: \$120 mil. off.: \$150 mil.
Tax Revenue as % GDP	13.5% (1997)
Gov. Deficit as % GDP	5-6% (1997 & 1998)
Inflation:	8.7% (1998)
Total Bank Deposits to GDP (1997)	4%
Total Bank Loans (ex to gov) (1997)	\$75 mill.
Total Bank Capitalization (1997)	\$32 mill.
Capitalization of YSE:	AD 8 billion (\$15 mil)
{ approx. 60 companies }	
Trading at YSE:	AD 1.4 billion (\$3 million) yearly
Net T-bills Outstanding:	AD 12 billion (\$24 mil)
Remaining Medium & Large SOEs to be Privatized/Liquidated:	2,860

Sources: IMF Standby Reports; IBRD country, project reports; EBRD, Transition Report, 1997; Armenia Economic Trends, Nov. 1998; Central Bank Republic of Armenia, Annual Report, 1997; Graber, E., Memo on Financial Sector, IRIS, 1998.

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