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USAID/ARMENIA

Strategy for 2004-2008

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Additional information on the attached can be obtained from
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Yerevan, Armenia

September 22, 2003

Dr. Kent R. Hill
Assistant Administrator
Bureau for Europe and Eurasia
U.S. Agency for International Development
Washington, DC

Dear Dr. Hill:

I am very pleased to endorse the new five-year USAID Strategic Plan for Armenia. The USAID program continues to provide critical assistance to Armenia as it moves toward a market-oriented democracy. The Post-Soviet collapse in manufacturing and disruption of trade relations, as well as the political and social isolation resulting from imposed border closures to the east and west, continue to take a heavy toll on the country's economy and social structure; Armenia remains in need of assistance. The receptivity of our counterparts and civil society to this assistance has been an important element of our success to date, and will contribute substantially to the depth and durability of our future achievements.

The strategy presented in this document supports areas of vital interest to the United States Government. A strong economy and an accountable democracy are critical for Armenia's stability as well as its integration into the community of nations. The strategy correctly emphasizes employment generation and poverty reduction as central themes. In addition, the emphasis on human and institutional capacity development will ensure that our programs properly focus on what we leave behind as well as how we get there.

Despite the comparably generous assistance levels for Armenia, we nonetheless had to make some difficult choices in selecting areas to assist. We have utilized our strong existing coordination and cooperation with other donors, counterparts and civil society to develop this strategy. I strongly support its programs and am confident that USAID will be able to successfully implement them to move Armenia toward the democracy and market economy that its people so richly deserve.

Sincerely,

John Ordway
Ambassador

PART I: ANALYSIS OF THE ASSISTANCE ENVIRONMENT AND RATIONALE FOR STRATEGIC CHOICES

U.S. Foreign Policy Interests in Armenia

"…the long-term guarantors of Armenia's stability are Armenians with the capabilities and commitment to strengthen their market economy and democratic political system, and to resolve regional conflicts. The U.S. has a clear national interest in helping Armenians facilitate this transition and resolve their conflicts..."[1]

Since its independence, Armenia has emerged as a strategically important country in the Caucasus. Its progress towards becoming a stable, European-oriented and democratic country with a transparent, market-based economy is important to U.S. security and economic interests in the region. U.S. national interests in Armenia, and in the larger Caucasus region, revolve around security, conflict resolution, internal reform and energy security.[2] A settlement of the ongoing conflict with Azerbaijan over the predominantly ethnic Armenian-populated enclave of Nagorno-Karabakh, and a rapprochement between Armenia and Turkey are both important U.S. foreign policy goals.

Armenia is a partner in reducing threats to the U.S. and international security from proliferation of weapons of mass destruction, weapons technology and expertise.[3] Additionally, U.S. ties to Armenia are many and varied, from the cultural bond of the large Armenian-American Diaspora community to diverse personal connections, commercial interests, and broader political relationships.

Country Conditions

Low Risk of Conflict

In spite of features that suggest relatively high social, political and economic risks of conflict, Armenia is actually a relatively stable country with low conflict vulnerability. Observed irregularities in the 2003 presidential elections, and relatively large demonstrations protesting the results, suggest that there is some potential for instability. Nonetheless, it appears that USAID and the United States Government (USG) can strongly encourage fundamental reforms, to produce competition in the political and economic system, with little fear that destabilization might lead to violence in the short term.

[1] Draft Summary of Findings from December 2002 Review of U.S. Assistance to Armenia by the Office of the Coordinator of U.S. Assistance to Europe and Eurasia (EUR/ACE) (hereinafter "EUR/ACE Assistance Review").
[2] EUR/ACE Assistance Review.
[3] EUR/ACE Assistance Review.

High Educational Potential

Virtually all Armenians are literate, with approximately 80% having completed high school. School attendance among primary to middle school-aged children is high in both urban and rural areas and there are no significant differences by gender. As students reach secondary school (15-16 years of age), attendance declines, particularly among males and among the poor, due to problems of cost and access. However, completion rates remain high. Many institutes of higher education exist in Armenia, resulting in some 26% of urban women and 29% of urban men having a university education.

While literacy rates are impressive, the quality of education received and its relevance to Armenia's current economic and political development is a serious issue. Many members of the labor force, trained during Soviet times, have obsolete skills and inflexible attitudes. Others have received strong theoretical training, frequently in narrowly defined, highly specialized fields, but have less skill in practical problem-solving techniques that would help them survive in a competitive marketplace.

Since the transition, Armenian schools have undertaken some reforms, but basic approaches to teaching and learning have not changed substantially. As a result, Armenia's education facilities are still not adequately providing young people with the education and skills required to succeed in a market economy and participate in a democratic form of governance.[4]

To capitalize on Armenia's educated population, widespread skill building, retraining and retooling are needed that will enable Armenians to meet the changing demands of the labor market and fully participate in nation building.

Diaspora Eager to Invest

The estimated five million Armenians living outside of Armenia are an important source of investment and income for the country. Assistance from this group has included everything from cash transfers, (mainly to family members) to the provision of food and clothing, to the construction of a cathedral marking the 1700th anniversary of the adoption of Christianity.

At independence, many wealthy overseas Armenians began to invest in businesses, real estate, and other commercial operations in Armenia. In addition, the U.S. Diaspora began to finance a number of public projects. One particularly important current program is the massive public works activity funded by a wealthy Armenian-American. His grant of $145 million (equivalent to seven percent of GDP) to rebuild Armenia's infrastructure has put thousands of Armenians to work, albeit temporarily.

There is currently concern, however, that the Diaspora has become disillusioned with the corruption, lack of enforcement of contracts and slow pace of reform, and is not continuing the rate of new investment in the country. It appears that this group is now more willing to send funding for charity than for investment. There is confidence, however, that should the investment environment improve, investments by the Diaspora would increase.

In addition to their direct investments in Armenia, overseas Armenians (particularly those in Europe and other parts of the former Soviet Union) are an important source of income for

[4] This issue is complex. While young people need to receive a good education and training, clearly there must be jobs available for them to be able to use their skills. Currently, the lack of employment opportunities in Armenia results in many highly skilled specialists and well-educated people being unable to find employment using their skills and specialties. They therefore frequently either work as unskilled laborers or, especially men, emigrate.

Armenian households. Indeed, observers estimate that net annual transfers (mostly comprised of remittances from the Diaspora) total $110 million[5] or 4.6 % of GDP per annum. These remittances not only help families to survive, but also provide them with funds for starting small businesses, buying property or otherwise investing in the country.

Macroeconomic Stability and a Growing Economy

Between 1991 and 1993, Armenia suffered a series of economic blows that caused real GDP to contract by 60%. Following major economic reforms in the early 1990s, the composition of output changed drastically, as unproductive sectors, particularly manufacturing, contracted mainly due to the collapse of regional trade and payments agreements with the Baltic countries, Russia and other countries of the former Soviet Union. As agriculture gained workers released by industry, the average level of labor productivity in the economy declined after the mid-1990s, because more workers were concentrated in lower value-added activities. Since 1993, a sound monetary policy has contained previously high inflation. Meanwhile, average real GDP growth of around 6% per year has been the norm. In 2002, real GDP growth reached 12.9%. The Heritage Foundation ranks the economy as the most open of the Commonwealth of Independent States (CIS). In spite of these positive aspects, the country is not yet showing broad-based growth patterns. The relatively high average real GDP per capita growth in Armenia is explained partly by the catching-up process after the sharp fall in output in the early 1990s. To date, most of these increases have primarily benefited workers in a few relatively small sectors of the economy that employ a small proportion of the labor force.

Major Constraints to Development

Isolation

The Nagorno-Karabakh (NK) conflict resulted in Azerbaijan and Turkey maintaining an economic blockade against Armenia. While some highway and rail traffic continues across the Iranian and Georgian borders (and a small amount continues with Turkey through Georgia), the blockade has a large negative impact on Armenia's economy and its prospects for growth. The fact that the country cannot access the larger economic zone within which it operated during the Soviet era reduces access to imports (including inputs needed for industry) and makes exports more costly. It also cost the Armenians significant potential revenues from the oil pipeline from Azerbaijan to Turkey, which bypasses Armenia and instead travels through Georgia.

Small Internal Market

It is critical for Armenia to develop a vibrant internal market, especially given the difficulty in export. Unfortunately, pervasive poverty coupled with the small size of the country severely limits the possibilities for such an internal market.

Overly Strong Executive Branch and a Lack of Citizen Participation

The dominance of the Executive branch of government (e.g., the President and Minister of Justice have substantial authority over the judiciary) has reduced competition in Armenia's political and economic spheres. As a result, rule of law is problematic, political parties are weak

[5] This figure, as well as all other macroeconomic indicators in this document, was excerpted from the IMF Country Report #03-93, March 14, 2003.

and the media are not truly independent. This situation allows national-level leaders to focus on their personal interests at the expense of citizens' political, economic and social interests.

A declining standard of living, coupled with rampant corruption and generally unresponsive government, discourages political participation and reinforces citizens' disillusionment with their government. Many Armenians do not believe that civic activism can help resolve their problems. Similarly, economic participation is constrained by the heavy hand of the executive, the weakness of the rule of law, and the need for government connections in order to succeed. Government is seen as an impediment in areas such as customs and tax services. Business people tend to turn to the President or Prime Minister rather than administrative or judicial bodies to resolve business-related problems.

Of particular concern is the lack of sufficient institutionalized mechanisms for citizen involvement in the decision-making process. While there are a few examples to the contrary, frequently there is little participation. Policy tends to be formed to benefit the elite, rather than the public. Inappropriate (and even contradictory) laws and regulations frequently do not support Armenia's political and economic reform process. Further, the laws are inconsistently enforced, further diminishing respect for the law.

Corruption

Corruption is undermining Armenia's economic, political and social reform process, and is one of the cross-cutting themes of this Strategy, discussed below. Both "grand" corruption (misuse of political power for private gain) and "petty" (administrative) corruption are common. Corruption is seen in the form of bribes, theft/illegitimate acquisition of assets, clientelism, political corruption and conflict of interest. Causes of corruption include the fusion of political and economic power and the lack of separation between the public and private sectors. Grand corruption is facilitated by lack of understanding of the role and tasks of the state; the lack of meaningful separation of power among the executive, legislative and judiciary branches of government; ineffective public administration; imperfect implementation of monetary, credit and tax policy; and general weaknesses in the institutions of democracy, including civil society. Tradition, low wages, low tolerance for risk and a weak professional bureaucracy fuel petty corruption.

Fighting corruption will not be an easy task. A World Bank-GOAM expert group developed a draft anti-corruption strategy that was generally viewed as a comprehensive assessment and an ambitious framework for attacking corruption across all sectors. The GOAM later presented its first draft of the Republic of Armenia anti-corruption strategy and action plan. The GOAM draft was a considerably scaled-down version of the original strategy presented by the expert group. Much of the substance and analysis in the original strategy was removed, leaving an unclear, disjointed and fragmented list of mainly legislative interventions. The GOAM has committed to a finalized anti-corruption strategy by the end of calendar year 2003.

Poverty

Despite high rates of economic growth, poverty in Armenia has been persistent. Basic poverty indicators demonstrate little progress during the last few years. The poor were 50.9% of the total population in 2001, with the extremely poor constituting 16%. In 1996, the rates were 55% and 23%, respectively. Continuing high rates of poverty during rapid growth highlights a need for an explicit role for poverty reduction in evaluating development efforts.

There are significant differences in the territorial dimensions of poverty. The 2001 Household Income and Expenditure Survey, conducted by the National Statistical Service with assistance from the World Bank, shows that small- and medium-sized towns are the worst in terms of poverty. Regional peculiarities of poverty also clearly demonstrate that the population of the Earthquake Zone, those at high altitudes, and those near the border are more exposed to poverty.

Recognizing the magnitude of the problem, both state and civil society proposed a national strategy to reduce poverty. Independent experts were hired to draft a Poverty Reduction Strategy Paper (PRSP), viewed by the Government of Armenia as an overarching strategy for national development. The GOAM approved the PRSP in August 2003. The paper identifies the following main priorities: (i) pro-poor economic growth; (ii) public administration reform and anti-corruption; and (iii) human development, which focuses on addressing issues such as social, education, health, and infrastructure development. Employment generation is viewed as an overarching theme in the PRSP as a means to reduce poverty. At the same time, the PRSP places special emphasis on targeted programs for the most vulnerable population. USAID/Armenia closely monitors the PRSP development process and links assistance under this strategy to key PRSP priorities.

Energy Dependency

Armenia is poorly endowed with energy resources. In late 1991, Azerbaijan shut the main pipeline transporting Russian gas to Armenia. Since then, a smaller pipeline through Georgia, which is at times subject to disruption, remains the only source of natural gas supply for electricity generation and heating. This situation led to the re-opening of the Metzamor Nuclear Power Plant in November 1995. International nuclear regulatory agencies regard the plant as inherently unsafe, despite extensive safety improvements made in recent years. As a result, it potentially endangers the health of all those living within its range, as well as the environment.

While Armenia has significant installed capacity and potential for hydroelectric power generation, increased output from this source during the energy crisis years caused the water level in Lake Sevan to decline to an ecologically dangerous level. Such potential for continued overuse places a limit on production.

Underdeveloped Infrastructure

Armenia's infrastructure, including water, energy, transport and communication, are outmoded and in poor condition. Lack of adequate transportation and the high cost of transportation have been identified as key impediments to the development of a thriving and efficient agricultural sector. Uncertain supplies of energy prohibit industrial output. Poor communications limit business opportunities.

Dysfunctional Labor Market

Armenia’s labor market is plagued with numerous problems, many stemming from the Soviet legacy. In addition, high levels of unemployment remain unaffected by annual high economic growth. Few workers accustomed to the Soviet workplace display initiative and entrepreneurship, two important elements in job creation. Workers also are not receiving education or training useful in the current job market, to a large degree due to a lack of transparency and information in that market. There are some job placement centers operating throughout Armenia, but with limited success. The outlook is also dimmed by the likelihood that

the government will have to lay off large numbers of workers, and by the lack of progress in lifting the economic blockade of Armenia by two of its neighbors. The bright spots today are increasing Diaspora investments in high-tech, electronics, and production, a highly educated workforce, some new training/certification programs, and a new generation entering the job market with a new attitude.

Unequal Enforcement of the Law

Inconsistent enforcement of the law is closely linked to corruption, and is one of the most acute problems in Armenia. Irregularities in the rule of law seriously constrain the business and investment climate. For example, laws related to fair business competition are unfairly enforced, contracts are not consistently enforced, and bureaucratic requirements can be used selectively to harass disfavored businesses.

Within the judicial system, corruption and the strong influence of the Executive undermine the impartiality of the courts. Courts do not follow a standard set of procedures, resulting in inconsistent judgments and a lack of confidence in the judicial process.

Lack of Objective Information and Public Awareness

While there is basic freedom of expression in Armenia and opinions are openly stated, political sponsorship drives reporting and clouds objectivity. The Armenian public has a low level of understanding of the law and lacks familiarity with individual rights. The public cannot be expected to exert its rights, demand accountability from public officials or advocate for reforms and change without a broader awareness of individual rights and mechanisms to assert them.

Pessimism and Public Disillusionment

Years of economic decline, increasing corruption, and exclusion from decision making, among a myriad of other factors, have contributed to widespread frustration and lack of hope for the future among the general population. The high rate of out-migration (the population has decreased from 3.8 million in 1989 to 3.2 million in 2001 – this official GOAM figure includes residents who have left Armenia in the last 12 months) is one expression of this pessimism. Lack of civic involvement, lack of confidence in the judicial system, an unwillingness to invest in Armenia, and the growth of the shadow economy are others. While improved living conditions and continuing reform should help overcome the disillusionment, economic and political progress are more difficult without active support and optimism from the public.

Gender Disparities

Patriarchal traditions and gender norms are still common in Armenia, even though both women and men achieve high levels of education and have extensive work experience. Men rarely take on any household work or child-rearing responsibilities, and their sense of worth often depends on employment. For a variety of reasons, Armenian men are more likely to respond to economic difficulties by emigrating, even to take menial employment that would be available at home. Gender traditions feed into the decision to emigrate through rigid expectations of the man as a breadwinner who should have a “respectable” profession.

This out-migration increases the pressure on women and families left behind, who are sometimes abandoned when the man decides to make a new life abroad. The women who remain carry the double burden of physically and financially caring for children and elderly parents.

Women are more likely to be unemployed, paid substantially less, and discriminated against in the workplace. With female-headed households more numerous, poor families are more likely to be headed by women. Women are lagging behind in business ownership, except at the micro level. Few women can be found in elected office or in leadership positions in the private or public sector. Even in an NGO sector dominated by women, men comprise the majority of NGO leaders.[6]

The result of these gender disparities is not only a human rights issue, but also an under-utilization of human capacity critical to successful development.[7]

USAID Experience in Armenia and Prospects for Transition

USAID/Armenia's partnership with the Armenian public and private sectors has been fruitful and helped lay the groundwork for the opportunities that now exist. Since 1992, USAID, in coordination with other donors, has been instrumental in reforms in all economic and social sectors. This assistance helped to build a new economic system from the ashes of the post-Soviet economic collapse, contribute to the development of social services that are more equitable, and build a more representative, responsive government.

USAID's relations with the Government of Armenia (GOAM) matured substantially during the past 10 years. The GOAM has evolved from a passive recipient of assistance into a more demanding and responsible partner that works to coordinate and influence donor efforts. The GOAM now emphasizes development assistance, and has developed its PRSP, into which it fits donor activities.

To date, USAID/Armenia's *Private Sector Program* has focused on accelerating the systemic restructuring of the economy toward a market orientation. USAID assistance concentrated on commercial legal and regulatory reform, tax/fiscal/customs reform, capital/financial markets development, accounting reform, information technology, and improved banking supervision. In addition to these efforts to create an improved environment for private sector activity, USAID directly assisted Armenian businesses and business associations, specifically in the form of credit, technical assistance, and training to micro, small-, and medium-sized enterprises in the areas of agribusiness, tourism, information technology, and jewelry. USAID also supported several activities providing micro loans to small-scale entrepreneurs, including economically active women living below the poverty line in under-served areas.

The Mission's *Democracy Program* assisted in developing more transparent, accountable, and responsive democratic governance in Armenia. To meet this goal, the program worked with both governmental and non-governmental actors to strengthen democratic institutions and organizations and to increase citizen confidence in them. In order to strengthen government institutions, USAID worked with local governments to strengthen their capacity to manage resources and respond to citizens' concerns. USAID initiated a program to work with the National Assembly to improve its internal management and increase citizen access to the legislative process and their representatives. USAID also worked with legal professionals to help develop a more transparent and effective legal system. To strengthen non-governmental

[6] Somach, Susan D., "USAID/Armenia Gender Assessment Report & Action Plan" (hereinafter Gender Assessment), March 2003.
[7] Gender Assessment.

actors, USAID worked with NGOs and communities to increase citizens' participation in public policy development and the oversight of government. Finally, USAID worked to strengthen independent media as a reliable source of objective information.
USAID/Armenia also implemented a comprehensive program to mitigate the short-term adverse effects of the transition to a market economy. The *Social Transition Program* focused on strengthening and making sustainable key social and primary healthcare systems while providing urgently needed services to the most vulnerable populations. USAID programs helped establish the legal and institutional foundation for sustainable social insurance systems and helped make the provision of social assistance and primary healthcare more efficient and effective. Other programs assisted the NGO and private sectors in developing capacity to provide urgent social services – focusing on nutrition and shelter – and primary health care. Small-scale community infrastructure projects helped increase citizens' capacity to meet their own needs.

USAID/Armenia's *Energy Sector Program* supported the efforts of the GOAM to privatize state-owned enterprises in the energy sector, to promote economic and environmental efficiency, and to diversify energy sources. Specific USAID interventions included a broad array of technical assistance, human and institutional capacity development, and equipment provision. These resources were designed to improve commercial operations, revise tariff methodologies, initiate legislative and regulatory reform, develop demand-side management and other energy saving measures, encourage innovative energy technologies and rehabilitation of existing technologies, and rationalize regional energy trade. USAID provided assistance to improve Armenia's energy security, contributing to the USG goal of closure of the unsafe Armenian Nuclear Power Plant at Metzamor.

The *Water Management Program* was a limited effort designed to complement ongoing USAID activities and lay the groundwork for possible future collaboration in water management. The program sought to improve the national policy/legislative/institutional framework for water quantity and quality monitoring, including the rehabilitation of monitoring systems. It also supported local-level efforts to develop and implement market-based approaches to improving water quality, and strengthened the institutional and financial sustainability and operational efficiency of selected Armenian water supply entities. Similarly, the Mission's *Earthquake Zone Recovery Program* was part of a broad range of activities supported by USAID to help the recovery of the regions affected by the devastating 1988 earthquake. Under this program, some 4,000 families who lost homes found permanent, adequate homes.

Under its FY1999-2003 strategic plan, USAID/Armenia continued to emphasize macro-level reforms – an emphasis that began in 1995 as the humanitarian crisis in the country began to lessen. The FY99-03 strategy, however, also added a new, balancing "bottom-up" approach through more direct attention to expanding grassroots assistance. This new emphasis was added in response to USAID's concern that widespread poverty potentially could lead to unrest, and in recognition of the fact that successful economic and political reforms require public understanding, participation, and support.

Over the FY1999-2003 strategic period, USAID's short-term interventions successfully reached targeted vulnerable groups. Longer-term interventions also produced significant results, particularly in promulgating legal and regulatory frameworks across all sectors. With only a few exceptions, Armenia now has laws and regulations on the books consistent with a free market economy and a democratic political system. A reflection of progress in development of a

commercial framework is Armenia's accession to the World Trade Organization in February, 2003.

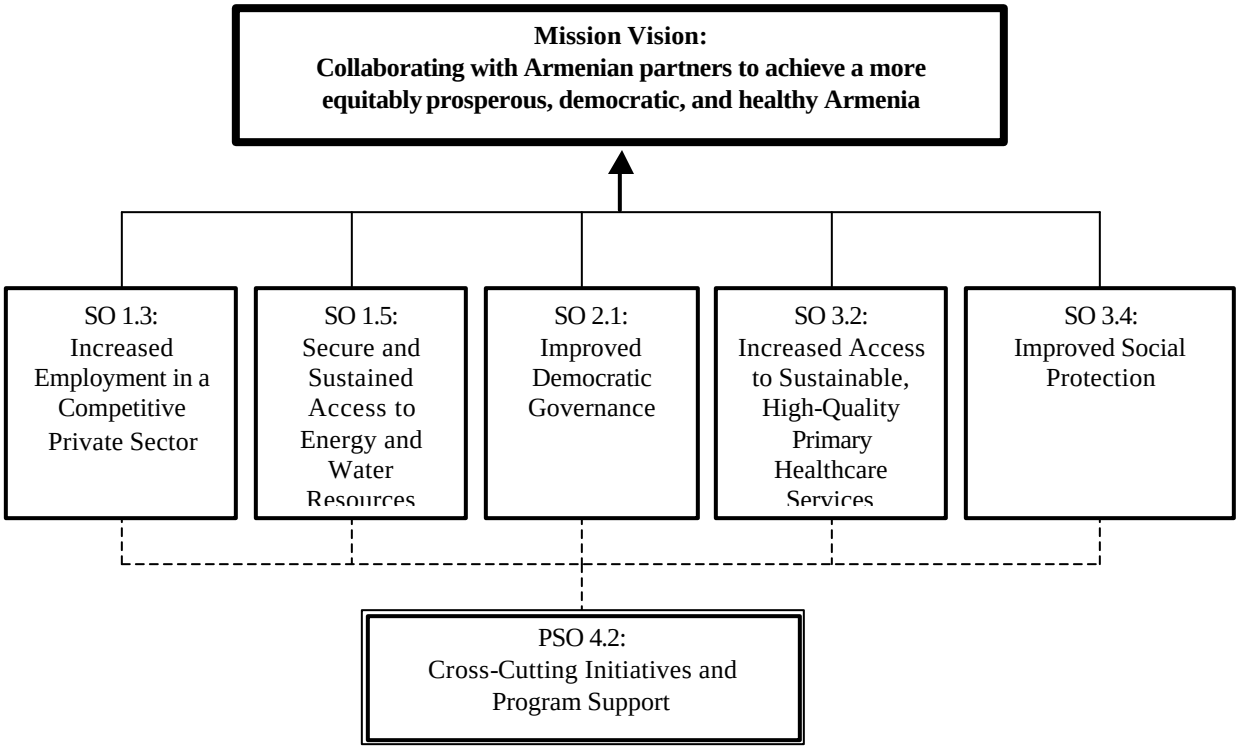
There was less progress, however, in implementing and enforcing this legal framework, and in creating the human and institutional capacity necessary for this implementation. Council of Europe expectations for critical constitutional reforms were not realized. While achievements were noteworthy, the high rates of GDP growth did not materially improve the general standard of living in Armenia during the FY99-03 period. This indicates that the benefits of long-term reforms are not yet reaching the broad populace – and the poor in particular – and that there is a continuing need for interventions with tangible impacts.

A Framework for USAID Assistance 2004-2008

The vision for USAID's Mission to Armenia is "Collaborating with Armenian partners to achieve a more equitably prosperous, democratic and healthy Armenia."

USAID/Armenia developed five strategic objectives and one program support objective to fulfill its vision:

1. **SO 1.3 - Increased Employment in a Competitive Private Sector:** Creating the economic conditions necessary to provide Armenians with the opportunity to find sustainable employment is critical to the country's long-term success.
2. **SO 1.5 – Secure and Sustained Access to Energy and Water Resources:** Proper and efficient management of Armenia's physical resources, particularly water and energy, are critical components of the country's economic growth and sustainable development.
3. **SO 2.1 - Improved Democratic Governance**: Increased participation in civic life and more open governance institutions through which to channel participation are necessary to stimulate the demand side for improved governance and to hold government institutions accountable through the democratic process.
4. **SO 3.2 - Increased Access to Sustainable, High-Quality Primary Healthcare Services**: Good health and nutrition, and a well-functioning health system that ensures access to high quality services, are critical if Armenia is to break out of the vicious cycle of poverty, poor health, and low economic growth.
5. **SO 3.4 – Improved Social Protection:** An effective and sustainable benefits system, in addition to targeted vocational training and work experience, is necessary to meet long-term universal coverage commitments for the disabled and the elderly, as well as the short-term needs of the unemployed and the poor.
6. **PSO 4.2 - Cross-Cutting Initiatives and Program Support:** Activities that are broad in nature, which contribute to the achievement of all of the Mission's Strategic Objectives, are a necessary component of an integrated strategy.



With Armenia now in its second decade of post-Soviet independence, the challenges of the transition to democratic values and institutions and a market-based economy are now more nuanced. While the effects of the Soviet system linger, the current choices Armenia must make in its future development are more the product of broader political and economic forces abroad and emerging asymmetries at home. Principal among these challenges are high rates of poverty and unemployment, which have been little affected by recent GDP growth. GDP growth has been fueled by import substitution and internal consumption, but this stimulus is likely to abate. High flows of external assistance and investment, principally from official donors and the Armenian Diaspora, may not be a sufficient or reliable basis for long term growth in the 7-8% range required for a serious dent in poverty. Rather, a sustainable basis for future growth seems to lie in increased public and private investment impacting the broad economic, demographic, and geographic landscape of Armenia.[8] Armenia needs to take a more aggressive stance fiscally and legislatively to ensure such investments take place and human and financial capital is deployed equitably and efficiently.

The FY2004-2008 USAID strategy for Armenia therefore hinges on (a) robust growth in micro and small/medium enterprises (MSMEs) – the economic segment most likely in the near term to create jobs, (b) companion public investment in a healthy and productive society, (c) a climate of governance conducive to those public and private investments, and (d) the presence of transparent, accountable institutions that respond to the needs and demands of a vigorous, informed and healthy Armenian society. This narrowing of USAID/Armenia's strategic attention and engagement to people-level and enterprise-level impact has been made possible by the generally conducive development environment now in place: relative political stability, more

[8] "Sustainable Economic Development Policy for Armenia". UNDP/MTED. 2002

or less the right set of macroeconomic policies, and a strong combination of formal and informal external financial flows that can couple with domestic savings for early results. Indeed, it is this political-economic setting, and the performance that created it, which is the reason that Armenia currently qualifies for consideration[9] under the Millennium Challenge Account (MCA) – a reflection of past achievement and prospects for future success.

A finer sieve for program choices means that some broader structural reform or institutional strengthening activities from the FY1999-2003 strategy will be wrapped up or recalibrated over the next couple of years. Financial and capital market development will concentrate more on promoting affordable and equitable access to investment credit and on financial products such as leasing finance and services such as credit bureaus of special relevance to SMEs. Strengthening of social services will focus less on general social insurance or benefits administration and more on ensuring that the system targets assistance to the most needy and vulnerable and, whenever possible, channels clients into productive employment. The health program will work to ensure quality care for all that is accessible, affordable, and financially solvent. The energy and water programs will aim more directly at how the GOAM can make real commitment to ending theft and corruption in the sector, and be rewarded for such performance, as Armenia works out practical technical and financial solutions to bring heat, power, and potable water to the poor.

Crosscutting Objectives and Themes

In reviewing USAID's previous strategy period programs in terms of the development challenges articulated in recently completed assessments (see Appendix VI), some programmatic gaps were exposed. One – civil service reform – is being adequately addressed through other donor programs. Three others –

- a weakened and often obsolete education system,
- ill-prepared and unengaged youth, and
- a dysfunctional labor market

– are closely related under the dimension of "human capacity". Another element in the human resources dimension, gender-related problems, was seen as needing special attention at this juncture in Armenia's development. Additionally, three other troubling social phenomena constrain development in Armenia and, indeed, throughout most of the FSU:

- pervasive and corrosive corruption;
- old values and mindsets inherited from 70 years of Soviet behavior; and
- weak participation by citizens and civil society in the governance of their nation.

Tackling these seven problems will be a challenge for virtually all SO teams, working alone on some issues and interactively on many of them. There is reason for optimism. The Armenian public is becoming awakened and more vocal about the excesses of centralized power, and demonstrated against irregularities in the Presidential election of 2003. The Mission has found receptivity to new legal ethics and professionalism, and promoting self-help and cooperation

[9] Armenia qualifies for the MCA in the first year of implementation on the basis of an application of MCA methodology using the most recent (early 2003) available data. Source: S. Radelet, Center for Global Development, May 2003.

among citizens. Young people born after independence are now entering adolescence; selected USAID efforts in NGO strengthening, independent media, education reform, entrepreneurship, and environmental stewardship can collectively influence their values, attitudes, and behavior. Community-based organizations are beginning to challenge the old values that the citizenry must passively await top down central government decisions. Constituents and governments are learning that effective governance is a two-way street with responsibility and accountability by both parties.

The Armenian Diaspora, embracing enormous energy, talent, and love of its homeland, can play a leading role in advancing both its goals and the vision of the USAID strategy. The Diaspora has wearied of a sometimes recalcitrant GOAM bureaucracy, and is unlikely to support government programs. Great potential exists, however, for Diaspora support for non-governmental solutions that USAID/Armenia believes are important for the country, including: targeted humanitarian assistance in fields such as medicine, housing, and schools; support of domestic capital markets development through the purchase of debt instruments of the first-ever Armenian trade finance company; and potentially many others. This Strategic Plan will be broadly shared with the American-Armenian community; the Mission desires that the joint leveraging of resources – ideally, under the aegis of the Global Development Alliance (GDA) – will result in markedly better cost/benefit ratios for our mutual investments. Many Diaspora organizations can raise funding privately for programs in Armenia, but lack the in-country resources to manage and monitor these funds effectively. USAID/Armenia is working to leverage these funds into existing or future programs by demonstrating that it can identify, manage, evaluate and report on activities and viable implementing partners of common interest to USAID and the Diaspora.

To track and monitor the management of USAID activities relevant to the cross-cutting strategic themes, and to ensure adequate budgeting for them, the Mission has established a Program Support Objective (PSO) and a companion inter-SO and interoffice team. The PSO team will also facilitate operational coordination of cross-cutting themes.

Required Resources

Armenia receives an annual earmark from Congress within the total budget provided to the New Independent States under the Freedom Support Act (FSA). Given congressional interest, Armenia's funding level over the last several years remained almost constant.

At these levels, significant progress can be achieved over the strategy period toward the establishment of a vibrant market economy, effective democratic governance and social protection for Armenians. No significant cuts in planned future programs would be necessary, and planned completions of some ongoing programs during the strategic period – such as hand-over of the social security card system – would proceed as scheduled. At lower levels, the paring of programs would have to be drastic:

- the water supply development program under SO 1.5 would not be implemented, and energy activities would be sharply limited to critical system efficiency and energy conservation efforts directly causal to the earliest possible closure of the unsafe Metzamor nuclear plant;
- future financial sector work under SO 1.3 would be limited to the essential legislative and regulatory requirements to facilitate non-financial banking institution (NBFI) and

microfinance institution formation, at the expense financial and banking system regulation and oversight unrelated to NBFI/microfinance oversight, general dialogue and assistance on tax and other fiscal policy reform, and creating more MSME-friendly environments in the commercial banking industry;

- social insurance system management assistance under SO 3.4 would be curtailed early and/or final program development handed over fully to other major donors in the sector;
- the number of present and planned partners in the SO 3.2 health program would be significantly reduced, thereby diminishing the scope and depth of the overall health initiative; and
- no initiatives in the formal education sector would be pursued.

Strategic Objectives Start and End Dates
USAID/Armenia will implement, monitor and report on the activities under all five of its strategic objectives during the full five-year duration of the strategy period through the end of FY 2008.

Millennium Challenge Account
According to the latest data available (mid 2003), utilizing the still-draft qualification criteria for the MCA, Armenia would be a Year 1 qualifier – the only part of the former Soviet Union to meet this standard.[10] Armenia exceeds the median score for qualifying factors with the important exceptions of "civil liberties and political rights" and "public primary education spending as a percentage of GDP." Armenia's 3-year budget deficit average also exceeds the median score. These missed qualifiers will be the subject of USAID dialogue and possible technical interventions over the course of the Strategic Plan. As noted, a key component of the strategy will be expanding Armenian civil and political rights. USAID/Armenia is also concerned with poor GOAM performance in social sector funding, which seems especially shortsighted given the high importance of Armenia's "human capital" relative to the country's other resource endowments. A greater level of social funding, coupled with a breakthrough in job creating economic growth, are essential ingredients for a paradigm shift in Armenia's future prospects. Better targeted and more robust spending may indeed threaten a prolongation of the government budget deficit, but a somewhat higher level of federal spending can be viewed as a responsible long-term investment. USAID assistance programs – either in conjunction with MCA program funding or in anticipation of it – will leverage other donor and possibly Diaspora contributions to improve performance in these key qualifying areas.

Graduation
USAID experience elsewhere and present conditions in Armenia suggest that graduation from U.S. bilateral assistance is likely not obtainable until seven to ten years after presidential and parliamentary elections that produce reasonably high prospects of transparent, accountable and effective government. The objective measure of graduation status would be attainment of USAID/Armenia's goal of a "more prosperous, democratic and healthy Armenia" at performance levels equivalent to those of the Central European and Baltic States at the time of their accession to the European Union. Armenia will need to have achieved a self-generating development

[10] At the time of preparation of this Strategic Plan, there was no official U.S. Government MCA list.

momentum not dependent upon stimulus from the donor community or the Armenian Diaspora. Already, Armenia has been sufficiently exposed to the fundamentals of good macroeconomic, fiscal, and democratic practices; the next major step toward graduation readiness is serious GOAM political commitment to applying those principles, under girded by public expectations and civic activism.

Formulation of the Strategic Plan

USAID/Armenia approached its strategy design process differently than it has done in the past. Particular emphasis was placed on increasing the level of participation of USAID FSNs and, subsequently, promoting their ownership of the strategy. To promote more critical evaluation and independent thinking, most of the strategy design teams were headed by FSNs. The design of the strategy was founded on input obtained from USAID stakeholders and results of 20 evaluations and assessments conducted by the Mission. In developing the new Strategy, USAID/Armenia sought input from a broad spectrum of stakeholders, including GOAM counterparts, implementing partners, non-governmental entities, USAID/Washington, the State Department and other donors. As a result, there is a broad and strong sense of ownership throughout the Mission and among stakeholders of this strategy.

The result of this more comprehensive approach to developing the Mission's 2004-2008 strategy has been an unquestionable success. Engaging myriad stakeholders has strengthened the strategic plan. Perhaps as significant, this engagement has improved communication that will enhance implementation of the strategy, and that will enrich development beyond USAID activities.

Washington Guidance

EUR/ACE Assistance Review

In December 2002, EUR/ACE reviewed all USG assistance to Armenia, setting strategic goals for further assistance. During the formation of this five-year strategy, the furtherance of these goals was considered. The strategy's six objectives continually reinforce those programs that would contribute to these goals. Expanding the economy and job market, mitigating the social effects of this economic transition, partnering with the Armenian-American Diaspora, achieving energy security, and encouraging necessary reforms in the spheres of corruption, the judiciary, and financial markets are all taken into account. Progress in these important areas would also assist Armenia to qualify for Millennium Challenge Account funding. By implementing these six objectives, our activities will be supporting identifiable U.S. national interests.

E&E Bureau Parameters Message

The May 2003 message referred to the results of the EUR/ACE assistance review and added several topics that AID/W wished to see addressed in the strategy. Additional cross-cutting areas of concern included gender, youth, and institution-building to enable implementation of reform legislation. Trafficking in persons also was noted as an important problem in Armenia. The parameters message made SO-level recommendations on various topics for the Mission to pursue: in Economic Transition, improving the business and investment climate to create jobs and stimulate GDP growth, addressing issues such as access to credit, targeting petty corruption, and lessening obstacles to enterprise start-up; in Energy Security, prioritizing restructuring

issues, including regulatory strengthening, and clarifying objectives with regard to alternative energy sources, energy efficiency, subsidizing poor consumers, and decommissioning the Metzamor nuclear plant; in Democratic Transition, addressing the over concentration of executive branch power, especially utilizing media and civil society to mobilize local political activism and citizen participation, and reviewing prospects for enhanced legal education and court administration reform; in Social Transition, focusing on lack of access by the poor majority to basic social services, improving income transfer targeting, promoting vocational training and job-creation strategies in a labor market context, and expanding direct, community-based assistance; and in Health Transition, implementing reforms improving service delivery and addressing sustainability issues, including health care finance, service/facility rationalization, and management and procurement reform. The Mission was asked to consider a more common strategic focus for its portfolio of education-related activities. The Mission has addressed all topics and issues raised in the EUR/ACE and AID/W reviews in the strategic plan.

Assessments and Evaluations

USAID/Armenia commissioned 20 assessments and evaluations (see Appendix VI) to review its current portfolio, recognize programmatic gaps, prioritize strategic issues and identify emerging opportunities as well as better focus on cross-cutting themes and potential synergies. During strategic planning, Mission staff drew on the findings and recommendations of these documents as the analytical foundation for strategic development and a framework within which the identified strategic areas and objectives were considered. The evaluations and assessments were also valuable as a tool for soliciting counterpart and other donor input into the strategic process. In addition, studies and analyses by other donors and organizations were used to supplement, verify and complement USAID investigations.

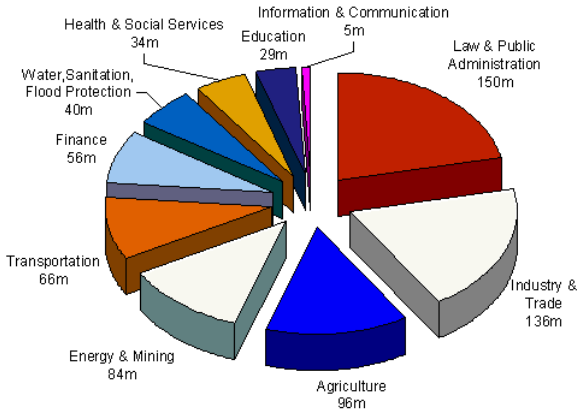
Stakeholder Consultations

This strategy was developed over the course of three months. Most of the strategy design teams were led by FSNs, with USDHs playing the role of coaches and technical sounding boards. This arrangement was chosen to enhance independent thinking and critical evaluation of program successes, failures, and future direction. In addition to greater internal participation, the Mission actively sought the input of its implementing partners and counterparts.

Consultations with government counterparts included the Ministry of Trade and Economic Development (MTED), Ministry of Health (MOH), Ministry of Social Security (MOSS), the Armenian Development Agency (ADA), the Central Bank of the Republic of Armenia (CBA), the State Revenue Service (SRS), The State Customs Service (SCS), Ministry of Finance and Economy (MFE), Ministry of Justice (MOJ), the Securities Commission, the Central Depository, Armenia Energy Regulatory Commission (AERC), State Water Committee, the Constitutional Court, the Economic Court, the Court of Cassation, the National Assembly, mayors and key personnel of municipalities, Ministry of Urban Development, Ministry of Nature Protection, Ministry of Energy, State Commission for Protection of Economic Competition and the National Commission on Television and Radio. Non-state entities consulted included a wide variety of NGO associations, as well as student and media representatives. Donor consultations were conducted with the World Bank (WB), European Union, IMF, IFC, EBRD, CoE, UNDP, UNHCR, OSCE, GTZ, TACIS, Open Society Institute, and Embassies of the United Kingdom, Germany, France and the Netherlands.

Development Partner Activities

The United States is the largest bilateral donor in Armenia. The second largest bilateral donor is Germany (private sector, SME development, export promotion, infrastructure development, public administration, and education). Other bilateral donors include France (education, health sector, and culture), United Kingdom (public sector reform, civil society, and support for the national census), the Netherlands (agribusiness), Japan (private sector development and technical assistance), Sweden (social and health sectors, poverty reduction, environment, governance and civil society, and education), Switzerland (housing, social sector, health, and elections), Belgium (health) and Italy (health and culture).



World Bank lending portfolio in Armenia: FY 1991 to 2002
Source: World Bank

The largest multilateral donor in Armenia is the World Bank (natural resource management and poverty reduction, foreign investment and export promotion, information technologies, infrastructure, education, health, social sector, agricultural reform, municipal development, transport, and judicial reform). Armenia joined the World Bank in 1992 and the International Development Association (IDA) in 1993. IDA lending has helped finance infrastructure rehabilitation, including support for earthquake reconstruction, irrigation, power, road maintenance, and municipal water. IDA credits supporting the social safety net and improving access to services have included operations in health, education, and a social investment fund aimed at improving basic social and economic infrastructure. WB and USAID activities complement each other's efforts in most sectors, particularly social, health, and information technology development.

Other multilateral donors include the European Union (energy, legal reform, environment, macroeconomic policy, governance, education, transport, SME development, and information technology), the International Monetary Fund (macroeconomic policy), the United Nations network of agencies, e.g. UNDP (poverty reduction, democracy and governance, post-crisis management, infrastructure, and information technology), UNHCR (refugee support), UNICEF (health, education, and social sector), World Food Program, World Health Organization, and the OSCE (anticorruption and elections).

Most donors participate in formal monthly donor meetings, co-chaired by the WB, UNDP and USAID. Over 20 sector-specific theme groups meet periodically as well, reporting critical technical and policy information to the donor coordination group. There are also several Armenian Diaspora donors, the largest of which is the Lincy Foundation (road network, Yerevan public works restoration and improvements, SME development, tourism and earthquake recovery). The Open Society Institute is also active in Armenia (civil society, education, public health, culture, media, and judicial reform).

USAID/Armenia consulted most of these donors during the development of this strategy.

PART II: DETAILS OF STRATEGIC OBJECTIVES

Strategic Objective 1.3: Increased Employment in a Competitive Private Sector

The Economic Environment

The environment in which USAID/Armenia operates is difficult but promising. Armenia was one of the most industrialized republics of the Soviet Union, exporting industrial, military, and high technology goods, mainly to the 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 a half million workers. A major setback to the industrial sector occurred in 1988, when nearly 40% of production capacity was lost as a result of the earthquake.[11] The subsequent break-up of the Soviet Union combined with the collapse of its trade, payments, and financial system dealt a crippling blow to Armenia's industries, many of which were essentially non-viable in the absence of the Soviet command economy. Armenia's real GDP is estimated to have decreased by approximately 60 percent between 1991 and 1993, with inflation hitting 11,000% and the budget deficit ballooning to 48% of GDP in that year. 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, although the Nagorno-Karabakh conflict and the attendant trade blockade clearly hampered recovery.

More recently, economic performance has been impressive. Growth reached double-digit levels in 2001 and 2002; real GDP growth for 2002 was 12.9%, and reached 14.8% in the first half of 2003. Successive governments have largely followed the World Bank/IMF's prescriptions for fiscal and monetary policies and large-scale privatization of state assets. At three percent and below (for 2002, below 2%), inflation is modest. A sound, convertible national currency is bolstered by remittances; private transfers (primarily from the Diaspora) came to 4.6% of GDP in 2002. Armenia's reforms have earned the country the reputation in the West as one of the best macroeconomic performers among the non-Baltic former Soviet states. Indeed, Armenia's banking legislation is among the most liberal in the former Soviet Union; it places no restrictions on foreign banks. WTO accession underscores Armenia's achievements.

Notwithstanding recent gains, poverty remains widespread throughout the country. Armenia's ten-year transition to a free market was characterized by a dramatic plunge in living standards with growth benefiting few and income disparities widening; half of Armenians live in poverty and more than one in six in extreme poverty. Even after several years of strong growth, output in 2001 was 25 percent below the level in 1991, providing for a per capita GDP of $700 for the

[11] Industrial production includes energy output that was reduced because of the closure of the Metzamor Nuclear Power Plant for safety reasons in the aftermath of the earthquake.

country's estimated 3.2 million residents. Much of the growth that has occurred has been narrowly based and has not had significant employment effects.

Strategic Objective

The strategic objective of increased employment in a competitive private sector will be measured by the number of full-time jobs created, which can be responsibly associated with USAID interventions. USAID/Armenia's decision to focus its economic growth resources on creating employment opportunities in Armenia is based on the Mission's view that sufficient systemic and institutional reforms are now in place to support increased numbers of sustainable, productive jobs. The role of micro, small, and medium-sized enterprises (MSMEs) is and will be central in decreasing unemployment and enhancing the competitiveness of industries. Consequently, USAID/Armenia intends to focus much of its strategy on the development of sustainable MSMEs.

Development of the private financial sector is an important component of this strategy. The financial sector has not been afforded its own SO, however, as permitted within the E&E Bureau's Strategic Framework, since Armenian financial markets are seen in a supporting role to enterprise and employment growth. The assessment process leading up to articulation of SO 1.3 considered the full range of gaps and constraints in the economic enabling environment and one – development of better functioning labor markets – will receive coordinated attention in SO 1.3 and in SO 3.4 because of its special role in creating sustainable employment opportunities.

Development Hypothesis

Job creation in a competitive private sector lies in both an improved business environment and stimulation of MSMEs. Improving the operational characteristics of the Armenian business environment will clear the way for MSMEs to capture market-based growth opportunities.

First, there must be dedicated follow-though to implement the body of laws, regulations and policies already largely in place, many of which were the product of earlier USAID assistance to the GOAM. Organization weaknesses, bureaucratic intransigence, and outright rent-seeking behavior remain a major obstacle to achieve these goals. The transparency, consistency, and capacity of existing regulatory bodies (e.g., the State Committee for the Promotion of Economic Competition and the Natural Monopolies Regulatory Commission) must be strengthened. In parallel, the voice of professional and business associations must be stronger and more coherent so that these associations are capable of participating in the on-going policy dialogue with the government and parliament as further "rules of the game" are developed. Capable association management, growing membership, and a determination to advocate for continued reform are mutually reinforcing. A new culture of small businesses, banding together to lobby for change in government procedures and – too often – corrupt practices, will complement parallel efforts under SO 2.1 to create a corresponding culture of openness, and acceptance of continual civic participation, in Armenia's legislative and executive branches. More traditional banking institutions continue to need attention, especially in consolidating the industry into stronger and more progressive banks with improved corporate governance practices that expand their business models beyond purchasing government T-bills.

Smaller, more entrepreneurial businesses are likely to remain in the outer periphery of commercial banks' focus. Non-banking financial institutions (NBFIs), through debt instruments and equity investments, can fill much of this financing gap. The Mission's capital markets program will emphasize this segment.

One of the keys to strengthening the role of MSMEs is a more dynamic and responsive microeconomic environment, wherein Armenian firms are able to create and sustain jobs. In support of this goal, the linkages necessary for fully functioning productive sectors must be strengthened; the microeconomic structure must be reshaped, principally through a focus on competitiveness, to give MSMEs the opportunity to capture economic opportunities. Business "clustering," which captures the backward and forward linkages of enterprises to associated industries and service sectors, government, financial markets, world markets, and even academia, will be an important analytical and operational tool to ensure that the gaps are covered, the constraints are addressed, and competitive alternatives are better understood. Woven throughout this strategy will be the paramount questions of whether good jobs are being created, businesses are making money, and poverty and unemployment is being whittled away.

Critical Assumptions

The development hypothesis holds true under the following critical assumptions:

- General macroeconomic conditions (low inflation, favorable exchange rates, GDP growth) will remain favorable;
- Armenia will maintain cease-fire conditions with Azerbaijan and will continue negotiations on reaching a peace agreement;
- Armenia will continue to pursue regional cooperation with neighboring countries; and
- The government of Armenia will formulate and carry out private sector reforms, rule of law and anti-corruption initiatives.

Illustrative Activities

<u>IR 1: Improved Business Environment</u>

Key "first generation" financial and capital market reform objectives of earlier USAID strategies have largely been achieved, although, as always, deepening and consolidation of those reforms is an ongoing process. These reforms mainly focused on freeing interest rates, eliminating subsidized or directed credit, strengthening regulation and supervision, ensuring the independence of the supervisor, and privatizing banks. Assistance to the Central Bank of Armenia (CBA) will continue at least for an interim period to work through the banking system's undercapitalization and dubious asset structures, unravel corporate governance problems, and clarify the banks' liquidity and foreign exchange vulnerabilities. The program's main focus will be to avoid future financial shocks that would undermine MSME and job growth, and should wind down midway in the strategic period.

"Second generation" reforms will include (1) encouraging the entry of new actors, such as credit unions, leasing companies and other NBFIs especially attuned to the needs of MSMEs too small or too invisible to attract commercial bank interest; (2) further strengthening the legal and regulatory infrastructure; and (3) creating credit bureaus, rating services, and internationally-accepted accounting and auditing standards that bring more transparency to the investment and lending process and build mutual trust between businesses and financial institutions. Creating legal and administrative structures for the enforcement of repossession of assets (collateral) are of particular concern to USAID. These innovations should collectively help raise the level of and access to credit by businesses and consumers, which has been declining relative to GDP. USAID will assist the CBA in implementing the NBFI regulatory framework pursuant to 2002 enabling legislation. Thus far, the NBFI segment of the financial market has been largely composed of micro-finance institutions (MFIs). Done in a balanced manner, NBFI development

can enhance domestic savings mobilization while weeding out weak or corrupt performers that may have shaken out of the bank reform and consolidation process of recent years.

Beyond the financial sector, USAID/Armenia will support efforts to create a more favorable legal and regulatory environment for the growth of private enterprise. Projects aimed at reducing regulatory barriers, improving protection of economic rights, and developing more efficient mechanisms for resolving disputes fall into this category. Tax policies that enhance growth in the small business sector will also be supported. Finally, USAID/Armenia will help build the capacity of businesses and professional associations to advocate for public policies that encourage enterprise development.

IR 2: Growth of Micro, Small, and Medium Sized Enterprises (MSMEs)

Creating the conditions whereby micro, small, and medium sized enterprises are able to flourish is a critical component of creating employment opportunities for Armenians. In other CIS countries, upwards of 90% of economic growth and new employment is attributed to MSME development; in Armenia, that figure is closer to one-third. While IR 1 attempts to lay the foundations for economic growth through reforms to the environment for enterprise growth, IR 2 focuses on creating the conditions whereby firms will have the tools at their disposal to take advantage of growth opportunities. From a supply perspective, industry structuring must be more efficient so as to enable firms to take advantage of the efficiencies and resources that will support enterprise growth opportunities. On the demand side, markets and linkages must exist so that Armenian goods and services can find buyers.

For private enterprises to survive and grow, they must be able to compete in both domestic and international markets. There is a group of factors that collectively contribute to increased competitiveness. These include the ability and readiness of companies to innovate and upgrade, the degree of sophistication of related and supporting industries, the availability of skilled labor, and a more effective flow and interchange of information among the companies, industries, professionals, and markets. Armenia currently faces the situation whereby most of these factors are either partially or completely missing. In order for Armenian companies, and for Armenia in general, to be competitive, all the above mentioned elements need to be improved simultaneously. To address this need, USAID's assistance during the next five-year period will concentrate on the following: (1) expanded focus on industry clusters that have the potential to excel, (2) promotion of a qualified workforce through workforce development programs, and (3) more effective use of entrepreneur and jobseeker networks. The sharing of information through entrepreneur networks creates pressures on companies to innovate and improve. USAID will explore the use of labor market intermediation, though entities such as "temp" hire firms, that make the market between job seeker and would-be employer at lower, more risk-free transaction costs for both sides; SO 3.4 will team with SO 1.3 in this effort.

During the next strategy period, USAID/Armenia will work toward effecting change in the lending environment through bank, firm, and community level interventions to stimulate increased financing for MSMEs. The proposed activities will seek to strengthen core competencies of finance institutions lending to MSMEs and expand the network of these institutions, as well as help them introduce new MSME financing instruments (leasing, fund-type instruments, guarantees, etc.). Institutional strengthening of financial institutions in this manner will provide new opportunities for lenders and MSMEs alike. USAID/Armenia will also support efforts to achieve ISO standards, improve MSME business development services (BDS) to facilitate financing, and to develop information systems that promote a transparent information

clearinghouse for finance institutions and MSMEs. BDSs also need to respond to market forces rather than inadequately attempt to offer a broad range of services in all economic sectors. USAID will work to wean the BDS segment from dependence on donor capital and raise service quality to international standards.

Expected Results

By the end of the strategy period, the Mission expects the following results:

- The legal, regulatory and policy framework is more conducive to the fostering of labor-intensive MSME growth;
- The capacity of businesses and professional associations to advocate for sound public policies is enhanced;
- Commercial banks have greater competence and interest in serving MSME customers;
- New financing instruments (leasing, fund-type instruments, guarantees, financial cooperatives, etc.) are available;
- The competitiveness of businesses, as well as of supporting and related industries and environments, i.e. business clusters, is increased;
- MSME business development services are more widely available and quality is improved;
- The ability of the Armenian MSMEs to access financial markets, attract investments, produce efficiently, and identify and explore new markets for their products is enhanced;
- The utilization of innovative technologies is greatly increased among micro, small and medium enterprises;
- More effective entrepreneur and jobseeker networks to foster improved competitiveness are created, which will result in growth of the private sector and increased employment; and
- The mechanisms/organizations to assist the existing and newly emerging workforce to acquire commercially viable skills and/or to upgrade its knowledge base are in place.

Linkages

This SO supports the U.S. Embassy to Armenia's (MPP) Strategic Goal of *Economic Prosperity and Security.* It is linked to USAID's Economic Growth Agriculture and Trade Pillar Goal 1 *Economic growth/agricultural development encouraged* and objectives 1.1 *Critical, private markets expanded and strengthened*, as well as Goal 2 *Human capacity built*. Efforts to promote reform, transparency, accountability, ethics and public advocacy are crosscutting and will all contribute to Mission objectives in SO 2.1, *Improved Democratic Governance*. This SO also contributes directly to the GOAM goal of *Provision of Pro-Poor Economic Growth* as outlined in Armenia's approved Poverty Reduction Strategy Paper (PRSP) of August 2003.

Strategic Objective 1.5: Secure and Sustained Access to Energy and Water Resources

The Energy and Water Environment

Despite continuing problems, Armenia (with USAID assistance) has achieved measurable progress in the energy and water sectors. The Soviet era power grid remains essentially intact. Physical infrastructure upgrades have been accompanied by regulatory reform and

institutionalization, especially in energy, that have increased transparency, accountability, and self-reliance. Power cuts have abated, raising business confidence.

Even with the progress achieved, the energy sector remains weak and vulnerable. Armenia has virtually no fossil fuel resources of its own and remains dependent on imported natural gas and nuclear fuel for between 70% and 80% of its total energy needs. It has a significant problem with the safety of its nuclear generation facility and nearly a quarter of the country's supply of electricity has been unaccounted for or stolen, although this has improved markedly in the past year. Armenia's access to Caucasus and Iranian/Central Asian supplies is hampered by continuing political disputes. Links to Russian resources are problematic due to the instability of the Georgian energy sector; however, Russian interests are now a major owner of power facilities in Armenia and Georgia, which may change the dynamic for broader regional proposals for power cooperation that extend into Western Europe. The existing dilapidated heating systems place unsustainable demands on electric power supply; the cost of heating is a burden for up to 80% of Armenia's households, with the greatest burden of non-affordability and lack of heat falling on the poor.

Of special interest and concern to the United States is Armenia's nuclear power plant, Metzamor. The primary supplier of electricity, with an operable capacity of approximately 400MW, Metzamor does not meet western safety requirements, as it lacks a containment facility. It also suffers chronic cash shortages, resulting in basic maintenance and operational difficulties. The USG and EU have been pressing the GOAM to retire the plant. A generally accepted condition for the closure of the nuclear facility is some combination of replacement capacity, load shedding, and greater overall system efficiency.

The hydroelectric capacity already in place requires rehabilitation. Small-scale hydro facilities hold additional promise. In addition, impediments to development of other renewable energy sources need to be overcome, and a market for their application must be developed. These types of sustainable energy demonstration projects contribute to achieving global climate change objectives. Ultimately, the best least-cost supply solution for Armenia is the development of a regional energy market in the Caucasus (including Azerbaijan, Armenia, and Georgia); clearly, prospects are uncertain at this time.

Two long-term demand side solutions can be exploited as well to bring Metzamor closure closer to political and economic reality. One is conversion of electric heating to other sources, especially natural gas. The second is greater overall system efficiency, specifically through limiting technical (line) losses, anti-theft initiatives, and financial transparency and accountability to counter misallocation, misappropriation and chronic non-payment by the well-connected.

Environmental pressures are evident in all sectors. Existing institutions are inadequately equipped to effectively manage the wide range of existing environmental problems. This inadequacy extends to capacity, skills, and capital resources. Water from Lake Sevan has been withdrawn for irrigation and hydroelectric generation at unsustainable rates, critically lowering

the level of the lake and causing deteriorated water quality. Physical water allocation among the various regions of the country is uneven. Further, its provision is characterized by inadequate infrastructure, theft, nonpayment of services, and misallocation of potable water. Land and forest degradation has increased sharply as a result of weaknesses in land management, poor agricultural practices, increased fuel wood use, over-grazing, and uncontrolled collection of wild edible and medicinal plants and mushrooms.

Nevertheless, in recent years the government has begun to refocus attention on environmental issues. The 1998 National Environment Action Program (NEAP) provides a strategic framework for policy and investment. The Ministry of Nature Protection (MNP) produced a 1999 Biodiversity Country Study as Armenia's first national report to the Convention on Biodiversity (CBD). This was the basis for further development of a national Biodiversity Strategy and Action Plan.

Strategic Objective

The strategic objective of secure and sustained access to energy and water resources will be measured by the percentage of the Armenian population with affordable heat and 24 hour access to potable water. SO 1.5 combines classic energy sector development and water supply/quality objectives that serve three overall, interrelated goals of U.S. assistance in Armenia: (a) achieving energy security not based on unsafe nuclear power; (b) providing critical economic infrastructure for growth and jobs; and (c) ensuring reliable and affordable access to essential utilities for all Armenians. The strategy addresses institutional development of the governing bodies of the water and energy utilities and the delivery of safe, reliable, affordable and accessible public utilities. The problems relating to water and energy, including heat, must be solved to facilitate economic growth, raise Armenians' living standards, and – not least important – build mutual trust and common purpose among government, the private sector, and the general citizenry. This SO further supports President Bush's sustainable development initiatives for clean energy, water for the poor and global climate change.

Development Hypothesis

To secure Armenia's electric power resources over the medium to long term, Metzamor's 400 megawatts has to be replaced. Barring unexpected breakthroughs in the Nagorno-Karabakh dispute or access to nearby Iranian supplies, the solution to Armenia's power balance almost certainly must be found internally. If widely implemented, heating-related fuel switching to direct gas heat (replacing peak electricity heating that uses gas-fired generation) could save 400 megawatts alone, and could reduce Armenia's gas imports by 33-50% from resulting efficiencies. A small hydro program could produce 200 megawatts – half of Metzamor's production. Similarly, industrial and residential efficiency programs – in various technical, regulatory, and anti-theft/anti-corruption dimensions – could save at least 200 megawatts. Armenia's wind energy potential equals Metzamor's capacity, although per kilowatt hour costs still have to drop and on-line availability increased for this to be a serious contender. In reality, neither heating conversion, efficiency improvements or renewables alone are likely to make up for the loss of Metzamor. Consequently, the Mission believes prudence dictates a three prong approach in the 2004-2008 strategic period to press forward in all three areas simultaneously.

Technical assistance, and even major complementary investments from the World Bank and the EU, cannot accomplish advances in these areas without deep GOAM commitment. USAID's success so far with the power sector metering activity is instructive in two ways. First, the GOAM will move on key reforms given the right blend of financial incentives, and expressions of donor concern and resolve. Second, the public will accept higher effective energy costs – undermining politicians' claims that subsidies are sacrosanct – if it deems the required sacrifices to be equitable. USG agencies will impress upon the GOAM the urgent need to take whatever legal, regulatory, and policy initiatives are necessary to further restrain consumption and increase supply, without throttling growth potential or putting the cost of energy supply out of reach of the poor majority. Clear performance benchmarks and timelines – inside or outside an MCA context – together with the offer of expert U.S. assistance to break key technical bottlenecks under an MOU or similar instrument, in close alliance with other major energy sector donors, will be an important tool in our ongoing dialogue. USAID will also support forward-thinking energy users to organize and lobby for wise energy policies. Absent meaningful government and public action on energy reform, USAID is prepared to scale back its commitment.

If and when regional energy sources were to become available again, Armenia would be in a strong bargaining position if it were to achieve both Metzamor closure and a stable, cost-effective and pro-growth energy model. While utility tariffs may have to rise even for the most cost-effective energy investments to compensate for the loss of cheap Metzamor nuclear power, USAID will seek GOAM commitment to compensatory means-testing tools such as metering (already successfully proven) and differential "safety net" pricing to ensure that benefits of safe, reliable power are affordable by the broad spectrum of Armenian citizens.

Restoring reliable potable water supply, a top priority for both the public and the GOAM, will require reorganization and restructuring of the water sector similar to that already achieved in the electricity sector. This would break the vicious cycle of non-payment leading to and reinforcing low quality of service. Successfully restoring 24-hour safe drinking water supply will especially benefit the poor, who cannot afford the water storage tanks of the middle class and rich. Restructuring has already begun. Its successful conclusion will not only improve the environmental sustainability of water resources management in Armenia and the quality of life of all Armenians, but it will also ensure the transparent commercial operation of water companies that is required to attract the substantial investments needed for system rehabilitation. This rehabilitation, in its turn, is crucial to support continued economic growth and reduce opportunities for corruption. To provide the foundation for improved water systems it is essential that water management and protection institutions be further strengthened. As with the energy sector, USAID will employ a combination of technical assistance, training, donor coordination, and clear performance benchmarks to increase both public and private sector capacity – and commitment – to implement potable water supply reforms.

Critical Assumptions

The development hypothesis holds true under the following critical assumptions:

- The GOAM will maintain commitments to rehabilitate the energy and water sectors;
- Other donors – bilaterals, World Bank, IMF, and UNDP – will continue their efforts to improve the energy and water sectors;

- Exogenous factors do not discourage the private sector from investing in the energy and water sectors;
- Relations with Russia remain on good terms, and relations with other countries in the region will not deteriorate further; and
- The public will accept the tradeoff between increases in utility tariffs, and the eventual closure of Metzamor Nuclear Power Plant and its replacement with cleaner, sustainable energy sources.

Illustrative Activities

IR 1: Improved Performance of Institutions for Sustainable Energy and Water Management

National legislation for GOAM and National Assembly action will be drafted and promoted as needed to counter binding constraints in any or all of the three operational prongs of this SO. Implementation of the mechanisms of effective and balanced water management, including the basin planning and management approach, are required to further develop water management and regulatory institutions, including the WMPA and BMO. NMRC – the energy and water regulator – will be further strengthened to deal with nuclear safety investments or decommissioning, as well as public access to information and participation in regulatory proceedings. A civil society "watchdog" of GOAM regulatory and management bodies will be encouraged through technical assistance. Transmission, dispatch, and settlements operations will establish independent governance structures that constrain inappropriate political interference. Condominium associations and other private heating consumers will be encouraged to increase their cooperation with local and national governments to develop heating systems policies. The impact of expected staffing cuts in energy utilities will be assessed to minimize adverse effects on employment and labor markets.

IR 2: Improved Delivery of Heat and Water Supply

Various heat supply alternatives such as central heating rehabilitation and modernization, co-generation, small heat-only boilers for apartment blocks, and conversion to direct natural gas will be developed to determine the cost, management, and environmental benefits in different residential and commercial scenarios. This work will be closely collaborated with major donors (such as the World Bank, Germany, and Japan) planning substantial capital investments down line. Customer information, billing, collection, and service capabilities of municipal organizations, condos, and similar private entities will be supported. Armenian entities responsible for promulgating health, safety and environmental standards in heat/energy supply will be assisted to assess which technologies best meet these objectives. In addition, private management for water supply companies can be used to attract private sector investment, and a significant part of the heat supply rehabilitation will be led by energy service companies in developing a competitive market for heat and other forms of energy efficiency. In combination with strengthened commercial operations for heat and water supply companies, active engagement will also increase public awareness of the benefits from energy efficiency and of the need to pay for enhanced quality of service in water and heat supply through realistic tariffs.

IR 3: Increased Energy Security

Settlement of Armenia's political disputes with its neighbors and the ending of sanctions against Iran would, separately or collectively, have positive energy supply and broader economic impact on Armenia. Along with the governments of countries in the EU and other donors like the World Bank, the Embassy will continue to encourage the GOAM to seek regional integration with its

neighbors from energy, economic, and political standpoints. USAID will work with the GOAM to vigorously undertake internal reforms in the energy and potable water sectors. USAID will assist in developing the Least Cost Generation Plan, which evaluates renewable energy sources, alternative sources of natural gas, and means of financing and expanding the natural gas distribution system. USAID will work with the GOAM, World Bank, and IMF to ensure that poor-household energy cost mitigation mechanisms are operationally built into the implementation of the GOAM's Poverty Reduction Strategy Paper (PRSP). Public entities involved in energy and water sector policy and management will be assisted in public outreach to advocacy groups, NGOs, business associations and other institutions of civil society. This will be done so that they are better informed about both individual and group benefits from energy efficiency and how these contribute to increased Armenian energy security. Local think tanks will be engaged and the media trained to bring fresh perspectives to the debate on public policy choices. USAID will work with the GOAM and donors to ensure private sector approaches are given first consideration, and that commercialization and privatization processes are fair and transparent.

Expected Results

By the end of the 2004-2008 strategy period, the Mission expects the following results:

- The percentage of the population with access to affordable heat and 24-hour potable water will increase, benefiting all economic classes, but especially the poor;
- At least 200 megawatts of electric power will either be produced or otherwise freed up – or implementation firmly underway – by a combination of heating-fuel switching, renewables development, and system efficiencies;
- Key energy and water resources management institutions (e.g. Regulatory Commission, Water Resources Management and Protection Agency, State Committee on Water Management, river basin management organizations, energy service companies, and condominium associations) will function openly and effectively;
- Armenian energy sector markets will operate on a sound commercial basis, meeting the interests and needs of consumers, producers, and intermediaries (utilities);
- Legislation, regulations and standards will support the improved performance of key water management institutions;
- More efficient energy use will be demonstrated through successful pilot projects, which will be replicated in broader donor and GOAM programs;
- Successful commercialization of renewable energy projects will contribute to reducing global climate change;
- Corruption at all stages of production and distribution of essential utilities will be significantly reduced; and
- Armenia's energy security will be significantly strengthened, and the country will be better insulated from energy shocks through greater internal, and as possible, external, source diversity, transparent energy planning and management, and fiscal and financial solvency.

Linkages

SO 1.5 supports the U.S. Embassy's overarching Mission Performance Plan objective of *Assisting Armenia in the acceleration of economic growth through the promotion of private sector activities, regulatory reform, improved government services, sustainable development and poverty reduction* by promoting the rational management and use of its energy and water resources. This SO supports the Presidential signature sustainable development initiatives for

clean energy, water for the poor, and global climate change and the USAID EGAT Pillar Goal 3, *The world's environment protected* and Objective 3.1, *Improving energy efficiency and protecting the environment*. It is also related to EGAT Goal 1, *Economic growth/agricultural development encouraged* and Objective 1.1, *Critical private markets expanded and strengthened*. SO 1.5 also supports democracy programs having a direct impact on combating corruption, linked with the Democracy, Conflict and Humanitarian Assistance Pillar Goal 5, *Democracy Strengthened* and Objective 5.4 *Encourage more transparent and accountable government institutions*. It contributes to the Mission's strategic objectives in SO 1.3, *Increased Employment in a Competitive Private Sector*, and SO 2.1, *Improved Democratic Governance*. Finally, this SO contributes to the GOAM goal of *Provision of Pro-Poor Economic Growth* as outlined in its PRSP.

STRATEGIC OBJECTIVE 2.1: IMPROVED DEMOCRATIC GOVERNANCE

The Democracy Environment

Armenia inherited tremendous challenges upon regaining its independence in 1991. In a little more than a decade of transition, the country has had mixed progress in transforming the Soviet system into a democratic system of government. Much still remains to be done to help Armenians create a truly democratic Armenia. Citizens are still learning their roles and responsibilities in a democratic system, and democratic institutions remain in their infancy.

The Soviet legacy and the troubled path of democracy since independence present both obstacles and opportunities for the further development of democracy in Armenia. Constraints to Armenia's democratic development can be categorized into three inter-linked and mutually reinforcing problem areas: dominance of the executive branch, a lack of democratic political culture, and corruption. All democracy and governance problems fall into one or more of these three categories. Significant progress in one area cannot be made without also addressing obstacles in the others. Similarly, progress made in one contributes toward progress in the others.

Police stop another opposition protest in Yerevan after second round of voting in 2003 Presidential Election. (Photolur photo 3/18/03)

A major legacy of the Soviet system is a politically passive population coupled with institutions that do not enable civic participation. The notion that citizens might organize without the state was limited to a few dissidents. The initial democratic fervor prompted by the political opening of the Gorbachev period produced massive civic activism in the country around independence. But the extremely difficult socio-economic situation following independence and discouragement over the many problems with the development of the democratic system since then have led to cynicism among many citizens. While they are not apathetic, they are discouraged by the events over the past decade that suggest citizens' voices find few sympathetic ears in state institutions and politics, and have withdrawn from participation in public life into private concerns. According to a recent USAID-funded survey, 74% (down from 88% in 2001)

of the respondents strongly or somewhat agreed that people like them have little or no influence on the way things are run in Armenia. Forty-six percent indicated that they did not contact an elected official because it would do no good.[12]

Recent demonstrations to protest the flawed 2003 presidential elections are reminiscent of the mass rallies just prior to the demise of the Soviet Union. It remains to be seen, however, whether the public will channel this energy into greater political involvement or whether the government's refusal to recognize citizen demands will create a populace that is dejected by the futility of its efforts and becomes even more politically reclusive than before.

Without significant checks from civil society and without the political will to allow a sharing of power, an equal separation of powers will not come to fruition. As noted by the USAID/Armenia-commissioned Democracy and Governance Assessment, "Executive dominance within the Armenian political system poses the greatest threat to D/G consolidation in the country. Executive leaders have reduced competition sharply in the political and economic spheres, and created a *political machine* through which they control the country. This enables them to limit or eliminate citizen recourse, reducing Armenians' capacity to challenge officials' use of their powers to enrich themselves. Lack of recourse discourages political involvement by citizens…"[13]

The extent of executive dominance was demonstrated during the recent presidential elections. Government officials at all levels, both elected and appointed, not only campaigned for the incumbent and utilized state resources to support the president's candidacy but also used their position to intimidate voters and members of the opposition. The judiciary, in disregard of Council of Europe recommendations and international standards of human rights, allowed the detention of supporters of the opposition candidate during the campaign period prior to the second round based on questionable administrative violations. Defendants were not allowed access to their attorneys. Election officials themselves contributed to or allowed serious irregularities to take place. Threats of job dismissal or arrest quieted some of the most active and vocal candidate proxies and supporters of the opposition.

The lack of transparency and accountability, along with the weak economy, has created an environment that allows corruption to flourish. Corruption is an enormous problem that affects all sectors of the Armenian political, social, and economic landscape and permeates all levels of government. According to a Transparency International/Armenia survey, 84% of public officials, 80.4% of businesses and 80% of the public considered corruption as problematic, very problematic, or extremely problematic. The entrenched state and business interests have little will or incentive to disrupt the status quo. Despite pronouncements by the Government against corruption, the GOAM has yet to demonstrate a genuine commitment to combating corruption. Moreover, coupled with the public's acceptance of corruption as a fact of life, weak challenges from civil society have not been able to significantly impact the problem.

Nonetheless, there has been some progress and a number of isolated successes, both within civil society and the government, that signal opportunities for change. Activities under the previous strategic objective, "More Transparent, Accountable and Democratic Governance," focused on enhancing citizen participation, supporting the development of civil society and non-

[12] International Foundation for Election Systems (IFES), "Citizen's Awareness and Participation in Armenia, Survey 2002." Hereafter, unless otherwise noted, survey results referenced in this section are taken from this IFES survey.
[13] ARD, Inc., "Democracy and Governance Assessment of Armenia," (hereafter DG Assessment), June 2002, p. 2.

governmental organizations, and developing non-state print and broadcast media. In addition, democracy activities strengthened the capacity of local governments, parliament, and, to a limited extent, the justice system.

Strategic Objective

This strategic objective consolidates the achievements of past democracy objectives in a single integrated strategic objective to improve democratic governance by both expanding civic participation and strengthening governance institutions in Armenia. The measure of success at the SO level will be an improved Freedom House composite democratization score.

Development Hypothesis

To improve democratic governance, citizens of Armenia need both expanded opportunities to participate in civic life and more open governance institutions to channel participation into a stronger, more democratic system of governing. Democratic governance is required to reform the economic and social system to better meet the aspirations and needs of Armenian citizens. Improving democratic governance requires greater citizen participation, which will come from increased advocacy of non-governmental organizations, more information provided to citizens by media outlets, increased activism by young men and women, and greater community involvement in resolving local issues. These components will stimulate the demand side for improved democratic governance as well as hold government institutions accountable through the democratic process. The supply side for improved democratic governance is achieved by strengthening governance institutions, which in turn encourage civic participation.

On the demand side, NGOs, media, community activists and increasingly aware youth all play an integral and essential role in ensuring that calls for reform come to fruition. On the supply side, to effectively serve as a counterbalance to the executive branch, other branches of government need to be strengthened. More opportunities for citizen participation are needed to address the growing demand for participation. There are many possible avenues for citizen participation, whether through local governments, the National Assembly, or the legal system; yet, when taken alone, none can have much of an impact on the strengthening of democratic governance. Therefore, it is critical to view governance and civic participation as two sides of the same coin. As pressure for reform through citizen participation increases, governance institutions must be strengthened in order not only to have the capacity to accept greater citizen input, but also to be able to demonstrate to the public that their participation is not futile, and that these institutions can act independently. Vibrant civic participation and robust democratic institutions – together checking the power of the executive branch – need to work together to meet citizen aspirations in a democratic fashion while simultaneously holding the institutions of governance accountable to the citizenry.

USAID will attempt to increase competition within elite circles and de-concentrate power in Armenia through a number of programs, including legislative strengthening, rule-of-law programming, limited political party building (particularly to encourage women's participation in politics), local government capacity building, and civil society strengthening. Key to addressing this issue is the reinforcement of separation of powers and the promotion of alternative voices and centers of power.

By supporting NGO advocacy efforts and non-state media, USAID is working to ensure that alternative points of view are raised and introduced into the decision-making process. In the

classical sense, civil society challenges the state to bring about change. Recently, civil society in Armenia has begun to assume that role. Over the past several years, USAID successfully has supported the formation of a civil society. Under the new strategy, USAID will support NGOs as effective, knowledgeable advocates for policy and legislative change.

Corruption is an enormous problem that crosses all sectors of the Armenian political, social, and economic landscape. While no one, either in the government or private sector, denies that corruption exists in Armenia, there has been little evidence of political will to address this problem. Attempts by the international community to engage the GOAM in developing a viable anti-corruption strategy have thus far failed. Lack of political will notwithstanding, there are members of civil society who are ready and willing to take on this challenge. Given the cross-sectoral nature of corruption, USAID intends to support activities that directly combat corruption and to continue to integrate anti-corruption elements throughout the Mission's portfolio. Accepting recommendations in the Rule of Law/Anti-Corruption Assessment, USAID efforts will continue to strengthen the National Assembly, the Chamber of Control (Armenia's supreme audit institution) and, possibly, the judiciary; to promote the implementation and enforcement of codes of ethics for judges and lawyers; and to increase transparency and accountability in all sectors in which USAID operates. USAID will support NGO, media, and private sector efforts both to mobilize popular will against corruption, and to implement activities that combat corruption.

Critical Assumptions

The development hypothesis holds true under the following critical assumptions:

- NGOs, media outlets, and political activists will be allowed to operate without a significant crackdown;
- The economy will not deteriorate to the point where citizens become either completely disengaged or revolt;
- Armenia will remain politically stable, without widespread internal conflict; and
- Hostilities with neighboring countries will not be re-ignited.

Illustrative Activities

IR 1: Civic Participation Expanded

A significant thrust of USAID's new strategy will be encouraging civic participation at all levels, in an effort to engage citizens in the decision-making process. As noted in the DG Assessment, USAID has found that citizens will become engaged when they can see the direct impact of their participation. Moreover, it has become evident that many community issues are either national issues as well, or are affected by decision making at the national level. USAID plans to build on this by broadening efforts to foster citizen participation at the grassroots level and by drawing the linkages and facilitating advocacy efforts at the national level. The Mission will strengthen advocacy NGOs, by providing core-funding and advocacy grants as well as tailored technical assistance. It will also strengthen non-state media, particularly by supporting assistance that will heighten its business acumen, consolidate the over-saturated market, and improve objective reporting. The Mission will also

work to encourage civic activism among youth and increase community involvement in local concerns.

Although society as a whole bears the costs of corruption, it is also society's tolerance or indifference that allows corruption to flourish. Accountability for corruption also ultimately rests with the population at large. USAID will support public awareness campaigns, involving NGOs, media, and the private sector, that cover both the costs of corruption and the shared responsibility in combating it.

IR 2: Targeted Governance Institutions Strengthened

USAID will assist targeted government institutions to improve their internal management systems and their ability to implement transition reforms, to strengthen their oversight and fiscal responsibilities (the latter especially relevant to local governments), and to help them increase their public accessibility and accountability. To that effect, USAID will provide assistance to the national legislature, local governments, and the legal sector.

An increased focus on youth – Armenia's future leaders – is particularly important in rule-of-law (ROL) programming; therefore, an integral part of the ROL assistance will be legal education. Given the lack of progress toward judicial independence and the lack of political will on the part of the judiciary to even push for its own independence, USAID has decided to shift assistance from the judiciary, in general, to legal education until judges begin to promote their independence and to act as independent arbiters, and not as agents of the executive. In the meantime, work with the judiciary will be limited to maintaining contact for the purposes of monitoring the sector and encouraging reform. If the GOAM and judges clearly indicate that they are genuinely committed to establishing the judiciary as an independent branch of government, the Mission will selectively restart programs with the judiciary.[14]

Although USAID has provided support for political party strengthening over the past five years, the very nature of the system has hindered party development. There are roughly 130 political parties registered with the Ministry of Justice, of which only 25 to 30 could be said to be truly active, though only a handful has broad popular support or distinct ideologies or platforms. Given the lack of progress to date and the current environment, USAID will limit political party development efforts to encouraging women's participation in politics and developing women political leaders. Currently only four of the 131 parliamentarians, none of the forty-seven mayors of cities, and only thirteen of the 930 heads of communities are women, yet more than three-quarters of Armenians say that they are more likely to vote for a female rather than a male candidate if she is equally qualified.

Expected Results

By the end of the 2004-2008 strategy period, the Mission expects the following results:

- Citizens will be more engaged in local community issues;
- Young men and women will be more involved in political and civic activities;
- NGOs will successfully advocate for their constituents' interests at the local and national levels;
- Civil society will be mobilized and take specific actions to combat corruption;

[14] USAID assistance for the establishment of "Economic Courts", an important element in building investor and general business confidence in the rule of law, will be administered under SO 1.3

- A more competitive media sector will provide objective and balanced information on public issues;
- Targeted local governments will have improved technical and managerial capacity;
- Citizen input will be incorporated and institutionalized into national and local decision-making processes;
- The National Assembly will increasingly and more effectively counterbalance the executive branch; and
- Lawyers will enter the legal sector better trained and more knowledgeable about substantive issues.

Linkages

SO 2.1, Improved Democratic Governance, supports the E&E Bureau objective of *better-informed citizens participation in political and economic decision-making*, and through that objective, is linked to the DCHA pillar and the Agency objective of the *development of a politically active civil society* and the USAID-State performance goal of *measures adopted to develop transparent and accountable democratic institutions, laws, and economic and political processes and practices*. This objective also supports the Agency's other democracy objectives regarding political processes and more transparent and accountable government institutions and the E&E Bureau's rule of law and local government objectives. In Armenia, this objective supports one of the MPP's three overarching goals, *advancing the process of democratization to provide an efficient government that respects the rule of law and is responsible to its citizenry*. This SO also contributes directly to the GOAM goal of *Improvement of Human Development and Protection of Human Rights* as outlined in its PRSP.

Strategic Objective 3.2: Increased Access to Sustainable, High-Quality Primary Healthcare Services

The Health Sector Environment

During the Soviet era, Armenians had the longest life expectancy, and one of the best developed healthcare systems, of all the Soviet republics. The system was known for impressive health outcomes, which were attributed to factors such as the population's wide access to education, water and sanitation, and a comprehensive range of state-subsidized medical services. Post-independence economic conditions, however, placed new demands on, and revealed inefficiencies in, the Soviet-style health system.

In the early 1990s, the capacity of the Armenian government to maintain the country's health system was limited due to a severe reduction in revenues. Currently, Armenia spends too little on healthcare (about 6.4% of the total annual national budget, or about 2% of GDP, in 2001). A large portion (53%) of the budget is devoted to curative, hospital care, at the expense of primary, outpatient care. Currently, it is estimated that private financing, much of it through informal payments, represents about two-thirds of national health expenditures.

The major causes of death in adults are similar to those in developed countries: cardiovascular disease, cancer, and accidents.[15] Acute respiratory infections and diarrheal diseases account for nearly half of all infant deaths. Armenia's infant mortality rate (36 per 1,000 live births) is nearly double that of Russia. The 2000 Armenia Demographic and Health Survey (ADHS) data suggest that anemia rates among children (24%) may have doubled over the last several years. Armenia's maternal mortality ratio[16] is seven times greater than the average for Western Europe.[17] Total contraceptive prevalence is 61%, but only 22% for modern methods. The total fertility rate is 1.7; the total abortion rate is 2.6.

Although Armenia is considered a low HIV prevalence country (<0.1%), data indicate a concentrated epidemic among drug users (15%) and prisoners (5.5%).[18] Prevalence is low in commercial sex workers (<3%), pregnant women (<0.5%), and men who have sex with men (4.5%). Knowledge of HIV transmission is high, yet not reflected by healthy sexual behavior such as regular condom use. Armenia has the lowest incidence of tuberculosis (42.5 cases per 100,000) in WHO's Eastern European region, but underreporting is strongly suspected.[19] All TB rates in the region, including Armenia's, have been on the rise for several years.

Throughout the country, utilization of healthcare services is low. Outpatient visits declined by 42% between 1991 and 2000. The ADHS found that lack of money was the most frequent reason given by respondents for not seeking healthcare. In rural areas, access to services is further inhibited by geographic barriers, as illustrated by disparities in the use of antenatal (ANC) services. The median number of ANC visits among rural women is three, compared to six by urban women. Between 1996 and 2000, 16% of rural women gave birth at home, compared to 1% of urban women. Among children with acute respiratory infections, only 29% of urban and 19% of rural children were taken to a health professional for care. The national average for stunting in children (low height for age) is 13%, and is three to four times more prevalent in rural areas than in Yerevan.

Without adequate financing over the past decade, health facilities have fallen into disrepair, workers' wages have gone unpaid for up to 18 months, information systems and providers' skills have not been updated, and community outreach services have not been maintained. The scarcity of resources has also constrained the government's ability to implement reforms. Moreover, the historical legacy of an authoritarian, top-down approach to healthcare administration has discouraged individual initiative and stifled management and institutional development at the regional and local levels.

Ministry of Health (MOH) responsibilities have changed significantly since the health system was decentralized in the mid-1990s. Ownership authority for all but a few tertiary facilities was transferred from the MOH to regional authorities and/or local governments. Health facilities became semi-autonomous and more responsible for their own financing. However, there is no mechanism in place that requires facilities to be accountable to regional and local authorities.

[15] Statistics in this section are from the 2000 Armenia Demographic and Health Survey (ADHS) unless otherwise noted.
[16] 48 deaths per 100,000 live births.
[17] Data for Western Europe, UNICEF 2002.
[18] USAID/Armenia HIV/AIDS/STI Strategy FY2003-2008, and the National HIV/AIDS Center.
[19] WHO EuroTB statistics for 1999. Armenia's rate is half the average for the region.

Today, the central MOH's roles include health policy and regulations, strategic planning, development of national programs, drug policy, and licensing of medical personnel and facilities. It also retains decision-making authority for the health sector budget, resources allocation, and pricing of services. Regional and local health officials are responsible for operationalizing national programs and enforcing MOH policies and regulations, yet have no budget support from the national level or a voice in resource allocation.

The State Health Agency (SHA), created in 1998 to serve as the principal public buyer of health services, is the conduit for 80% of state funds for healthcare. State funds to cover services authorized under the Basic Benefits Package (BBP) are transferred from the SHA, now located within the MOH, directly to health facilities. Facilities generate additional revenues by providing other services (outside the BBP) and private care. However, the inefficient management practices that prevailed under the old system continue under the new. Locally elected governments have limited capacity to advocate or fund better services. Health reformers recognize that the current attributes, roles and responsibilities of the different stakeholders must be modified if privatization[20] of health services is to effectively evolve.

Rural health posts[21], located in small villages, are run by nurses, midwives, and/or *feldshers* and are supervised by staff from nearby polyclinics and ambulatories. Officially, the role of the FAP staff has been limited. For example, patients seeking routine maternal and child health (MCH) services are supposed to be referred to physicians. However, FAP staff is often forced by circumstances to deliver services for which it is not properly trained. The FAPs have also deteriorated since independence, but with a minimum of improvements, they remain a very viable option for delivering quality primary healthcare (PHC) to rural populations.

USAID support to Armenia's health sector began in the 1990s with a focus on improving the quality of overall care and women's health services through a program that linked premier U.S. healthcare institutions with select hospitals and polyclinics in Yerevan and four of Armenia's 11 regions. U.S. partners leveraged considerable matching funds, instilled new health provider values, and improved the quality and administration of services. In later years, USAID financed efforts to improve primary care at community centers that served the elderly and the handicapped, and mobile medical teams that provided health services to hard-to-reach populations. Without this assistance, the beneficiaries would not have accessed any healthcare.

In August 2000, USAID began its flagship five-year Armenia Social Transition Program (ASTP) to support MOH reforms. Activities include: design and implementation of the organizational and regulatory framework for family medicine as the predominant specialty for PHC; open enrollment for the population to receive state-funded PHC services; MOH/SHA and health facilities' information systems; better targeting of vulnerable populations; reducing corruption through transparent contracting, cost accounting and financial management practices; and laying the groundwork for sustainable, national PHC coverage. ATSP's successes include: ASTP pilot sites formally recognized as national health system pilots; a new, unified curriculum for family

[20] The "privatization" of health facilities is more of an "autonomization" at this point in time.
[21] Rural health posts are called f*eldsher acousher posts* (FAPs). *Feldshers* are a small and dying cadre of mid-level provider.

medicine training developed and adopted; family medicine departments established; and population enrollment and quality improvement programs introduced in pilot sites. Moreover, the MOH's Primary Healthcare Strategy (for 2003 –2008) and the recent National Health Policy draft document (for 2004-2015) notably incorporate many of the strategies being promoted and piloted under ASTP.

To complement ASTP efforts and reinforce MCH programs at the primary care level, USAID/Armenia has supported efforts to improve providers' performance in reproductive health (RH), MCH, and sexually transmitted infections (STIs) including HIV/AIDS prevention. A pioneering initiative to prepare primary care providers to respond appropriately to gender-based violence cases was also undertaken, and may serve as a model for government and NGOs to focus more intensively on this neglected area. Since 2001, USAID partners have worked with policy makers at the national level on RH policy and norms, and with local health authorities and primary providers in Lori and Shirak regions on RH service quality and organizational issues. Enhanced RH health services should contribute not only to the increased use of modern contraceptive methods, but also to a reduction in the number of abortions.

While health reform efforts have evolved considerably since the 1990s, it is premature to predict the final outcome. Current health services are still characterized by antiquated and costly facilities, and a vertical, highly specialized, non-integrated approach to care. The unpopular optimization of healthcare staff and facilities, part of the MOH reform agenda, has only been partially realized. There are still too many providers, underutilized facilities, and an inappropriate skill mix. Some highly trained specialists oppose attempts to promote family medicine practice. The Basic Benefits Package – designed by reformers to meet the basic health needs of the country's most vulnerable people – has been less effective than envisioned at the time of its introduction in 1998. Its implementation remains problematic despite four revisions. Finally, a number of other health financing and equity issues have yet to be satisfactorily resolved.

Strategic Objective

USAID's support to the GOAM is designed to increase access to sustainable, high-quality PHC in program areas. Achievement of the SO will be measured by increased utilization of family medicine services, improved clinical skills of providers, and increased client satisfaction. During the first few years of the strategy period, activities will continue to be largely concentrated in Lori, with targeted assistance to vulnerable populations in other regions. Based on results with policy development and adoption at the national level and implementation of reforms at pilot PHC sites, assistance may be extended to other regions in the latter years of the strategy.

The objective has a twofold approach: it will address MOH capacity and institutional needs on the one hand, and reinvigorate PHC services at the health facility level on the other. USAID partners will work closely with the MOH, the SHA, regional and local government authorities, healthcare professionals and managers, consumers and communities, and other donors to firmly establish the framework and expand support for family medicine and other reforms. A concerted effort will be made to incorporate client perceptions of quality care into PHC programs to address low service utilization rates.

In recognition of the continuing economic hardships endured by over half the population, USAID will continue to provide assistance to meet the immediate needs of Armenia's most vulnerable populations, targeting especially the elderly and the rural poor. Mobile medical teams will be used to serve these neglected groups. In the interests of sustainability, the teams will develop referral systems to fixed site facilities and may charge nominal fees. Family medicine norms and standards will be applied.

Development Hypothesis

Within an environment of limited resources, the efficiency of a national health system can be improved by shifting services away from specialized and hospital services to primary care and family medicine practice. Primary care has the capacity to increase its scope of services through staff training, provision of up-to-date diagnostic services, evidence-based treatment protocols and access to drugs and supplies. The additional cost of providing a wider scope of services at the primary care level is minimal since the personnel and infrastructure are already in place. Family medicine physicians are generalists who are competent to treat approximately 85% of health problems, which reduces the need for a large number of specialists and translates into cost savings for both patients (consumers) and the health system as a whole.

Strengthening PHC will ensure that the entire population will have access to the most cost-effective, essential services that have the greatest impact on the health status of the Armenian people. Consumer-oriented services will enable innovative enrollment-based health schemes to become a reality. The availability of quality PHC services in polyclinics, ambulatories, and FAPs will free up hospitals and other tertiary institutions to focus more exclusively on curative care. Well-designed community education programs that promote healthy life styles and preventive care, as well as raise awareness about communicable diseases (such as TB and HIV/AIDS), will spark public interest in, and demand for, family medicine and quality PHC services.

Targeted approaches, such as a continually refined BBP and transparent financing practices that take into account the needs of the poor and vulnerable are necessary to ensure equity during difficult economic times. A commitment of additional financial resources for health is necessary but not sufficient for scaling up interventions. Building effective and efficient systems that are responsive to client needs is of utmost importance for increasing access. Worldwide studies suggest that significant increases in use of services can occur when providers and services are customer-focused and where provider-community dialogue is an integral component of health system design and implementation.

Critical Assumptions

The development hypothesis holds true under the following critical assumptions:

- The MOH will continue to prioritize and pursue sector reform, to expand PHC and family medicine, and address regulatory and health financing challenges;
- The overall state budget for the health sector will gradually increase over time;

- MOH resources for PHC will gradually increase, with a concomitant decrease in the percentage of total MOH budget allocations for tertiary care;
- The World Bank and other donors will continue to support improvements of the healthcare infrastructure and systems reform;
- The Armenian economy will remain stable or improve slightly, with only a marginal increase in the number of individuals employed in the formal sector; and
- Infectious diseases such as tuberculosis and HIV/AIDS will continue to be addressed by other donor programs and/or sources of financing (GTZ for TB, and The Global Fund for HIV).

Illustrative Activities

IR 1: Strengthened institutional capacity to implement the GOAM/MOH primary healthcare reform agenda

USAID will strengthen the capacity of institutions – schools of medicine, the National Institute of Health, regional health departments, health provider organizations – to improve the enabling environment for PHC and to prepare family medicine providers for service at the primary care level. To build a sustainable foundation for PHC, USAID will work with the MOH to identify, test and implement improved healthcare financing mechanisms and promote practices, such as cost accounting and financial management, to achieve greater transparency and accountability. Moving client payments for services from the informal to the formal system will counter the mindset of enabling corruption and show healthcare managers and providers that the cost of services can be recovered in a professional, ethical manner. Other regulatory reforms will be prioritized and addressed, such as the reduction of state guarantees and revision of the BBP for vulnerable peoples, the introduction of new provider payment systems, expanded financing options, more transparent contracting practices and provider licensing, and increased competition for provision of services. USAID will also pursue the continued optimization of sector resources, the revision of roles and responsibilities of various cadres of providers, and enforcement of performance standards for PHC professionals.

IR 2: Improved service delivery in priority PHC disciplines

USAID's health sector assistance also focuses on clients directly benefiting from improved PHC services, through the discipline of family medicine. This will be done by incorporating clients' perspectives on quality care into services and strengthening the in-service technical and administrative capacity of the MOH, SHA, regional healthcare authorities, primary care facilities, service providers, and professional associations. USAID will also support strategies, such as the use of mobile medical teams, to provide PHC services – including supplemental feeding for children under three and pregnant and lactating women – in poor, remote communities that have no easy access to health services. Assistance for services will concentrate on provider professionalism, system efficiency, sustainability and customer orientation. Lessons learned and results in the field will be fed back into the system and used to inform and/or modify policy, norms and standards that are promulgated by the central and regional health authorities. Special emphases will be placed on strengthening MCH services, especially in the FAPs and rural ambulatories, and on STI control and prevention activities. These will complement HIV/AIDS interventions financed from other sources, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria, which is one of 17 USG development-related Presidential initiatives.

USAID will continue to monitor the TB situation and may collaborate during the strategy period with MOH and other donors currently active in TB work (e.g., GTZ), if the need arises.

Expected Results

By the end of the 2004-2008 strategy period, the Mission expects the following results:

- The regulatory environment at the national level will facilitate the improvement and expansion of PHC services;
- The MOH and regional governments will have a greater capacity to plan, implement, monitor and regulate health service delivery, including health cost financing;
- New healthcare financing mechanisms will be in place;
- Cost accounting systems will be functioning in targeted facilities;
- PHC services will be accessible to a greater proportion of the population;
- The quality of PHC services will be significantly improved;
- Client satisfaction with PHC services will be increased; and
- Management, supervision, and technical skills of PHC providers will be strengthened.

Linkages

This SO 3.2 supports the MPP's Goal Paper 3 Performance Goal 2 of *Economic institutions, laws and policies foster private-sector economic growth, sustainable development, and poverty reduction* by contributing to its Strategy 3, *Strengthen social safety-net and help individuals adjust to market systems*. This SO is linked to USAID Agency Goal: *World Population Stabilized and Human Health Protected*, and to Global Health Pillar Support Objectives SSO 2, *Increased use of key maternal health and nutrition interventions* and SSO 3, *Increased use of key child health and nutrition interventions*. Efforts under this SO, through its IR1 *Strengthened institutional capacity to implement the GOAM MOH PHC reform agenda* will have a cross-cutting effect, contributing the Mission objective of *Increased Democratic Governance*. This SO also contributes directly to the GOAM goal of *Provision of Minimal Welfare for the Population* as outlined in its PSRP.

Strategic Objective 3.4: Improved Social Protection

The Social Safety Net Environment

Basic social protection programs ceased to exist with the collapse of the Soviet Union, followed by an almost complete collapse in the Armenian economy. Assistance for the country's vulnerable population was either eliminated or severely reduced, as a new Armenia struggled to sustain itself and rebuild both its economy and its infrastructure. This was true also of pensions for the elderly, welfare assistance for the most needy, assistance for the mentally and physically challenged, subsidized housing, and unemployment benefits for those in career transition.

Chronically inadequate GOAM budgets mean that essential social benefits provided to the most vulnerable populations remain woefully substandard. This situation is all the more alarming since the private sector has not developed enough to provide productive work, and the demands on the state for assistance are still substantial. More than one in six Armenians (17%) still lives in extreme poverty. Providing for the very young, the disabled and the elderly are fundamental social obligations that are embraced by Armenia's Ministry of Social Security (MOSS). A large fiscal deficit, though, prevents it from providing adequate core benefits. Pensions currently average $13.50 per month, Poverty Family Benefits are $13 per month, and unemployment

assistance is $5 per month. These benefits are well below the minimum living standard of $34 per person per month.

The Ministry is eager to create programs that encourage people to cross-train and/or retrain in order to break their dependency on assistance. The Ministry is also committed to employing the systems necessary to track "safety net" benefits and ensure that payments are timely, fair and adequate. USAID's interest is in ensuring that state benefits are truly targeted on the most needy and vulnerable, and in assisting the unemployed to obtain the right skills for the marketplace.

Over the last five years, Armenia, with USAID support, made great strides in social insurance systems management. The Nork Center for Information and Analysis was established, and its staff developed the system for administering and tracking the poverty family benefit and social security cards, similar to those in the United State. Social security cards will be used to administer and monitor citizens' benefits. The center also hosts a computer repair facility that maintains all computers for the MOSS and its local social service offices.

To further develop synergies in the social protection environment, USAID assisted MOSS in creating a pilot Integrated Social Service Center (ISSC) in Vanadzor (in Lori marz). This center introduced data sharing IT systems and integrated family assistance benefit administration, pensions, disability determination, unemployment compensation, employment programs and other social services. An Actuarial Sciences faculty and program were established at Yerevan State University, and the program has matriculated its first class of actuaries. These actuary skills will assist the Ministries of Social Security and Health in forecasting and administering future benefits needs. Complementing these skills, the National Statistics Service continues to provide computer training and population data to GOAM staff.

USAID's efforts in Social Assistance Reform resulted in improved legislation and more purposeful targeting of benefits. The number of families receiving social assistance decreased from 210,000 to 145,000, and assistance was refocused towards families with children. To complement these efforts, the GOAM strengthened the audit systems and reformed the appeals system. Yerevan State University established a Social Work program and continues to train social workers in both outreach services and benefits administration. Additionally, a curriculum for counseling and benefit administration was created.

Finally, the immediate needs of vulnerable populations were addressed through programs such as soup kitchens for the elderly, mobile medical teams that deliver basic health care services to remote areas, and public works programs that offer temporary employment while improving community-identified public facilities.

Strategic Objective

Over the course of the Strategic Plan, this SO will improve social protection by strengthening assistance systems for the vulnerable, offering vocational training and direct work experience, and ensuring that essential insurance programs are operationally sound and responsive. Success in obtaining this goal will be measured by real increases in GOAM benefits payments, fewer Armenians below the food poverty line, effective use of social security cards in tracking benefits for the most needy and all insurance recipients, and reduced levels of unemployment. USAID's program will complete current projects in benefit administration and data gathering/tracking. It will complement these programs with intensive, short-term vocational training, skills-based labor

development programs, improved social services created through better targeting, and social partnering with qualified NGOs to improve service delivery.

Social Protection is defined here as an overall benefits system that addresses both the long-term universal coverage needs that will be provided by the state to individuals (such as pensions for the elderly) and the short-term protection needs (such as Family Poverty Benefits and social housing). This strategic objective is closely linked with SO 3.2 (health) in ensuring the basic framework for Armenian's social needs. Through its support of employment assistance systems (especially re-training), and helping labor markets to generate jobs for the unemployed, SO 3.4 is also linked to the employment objectives of SO 1.3.

Development Hypothesis

To truly improve social protection programs, the Mission will focus on three core areas: improving social assistance services to the most vulnerable, including assistance with housing when necessary; re-training labor in order to reduce the need for government subsidies; and establishing operationally viable social insurance systems. Effectively re-training the jobless and the underemployed will have dual fiscal effects: increasing the gainfully employed workforce, which will result in a healthy tax base, and reducing the unemployment benefits burden on the GOAM budget. Similarly, building social insurance systems, such as pension reforms that build financial security for the future elderly, are needed if the structural integrity of public finances is to be established and preserved. The launch of the social security card system, which will be used to track and administer benefits, will be completed within two years.

Absent attention to these structural problems, the Armenian public sector, the donor community, and NGOs will be mired in acute humanitarian crises. The Mission will work closely with other donors and the GOAM, and expects to exit most of the social insurance systems work before or at the end of the strategic planning period. Also, the Mission's vocational training and labor development program will be part of a major multidonor effort that includes World Bank and EU programs. These training and labor development programs will be designed so that women are adequately prepared to enter new professions and are equally regarded as qualified candidates for all employment, even in traditionally male-dominated work sectors. NGOs will continue their impressive work in direct assistance and advocacy. Additionally, USAID will help promote improved partnerships between the GOAM and NGOs to create better targeting of the vulnerable populations and their needs. These changes will ensure that resources are used efficiently and effectively.

Critical Assumptions

The development hypothesis holds true under the following critical assumptions:

- The MOSS will remain committed to strengthening and targeting its social protection services and programs;
- Unemployment levels will not rise. (NOTE: Future efforts in optimizing government work forces in the civil, educational and medical sectors could result in a short-term rise in unemployment, which is expected to be offset by an improved economy and more private sector job opportunities);

- Remittance levels will remain stable. Any dramatic reduction in remittance levels will result in an increase in demand for government assistance and subsidies, thus diminishing the type and level of assistance that can be offered; and
- Population levels will remain stable.

Illustrative Activities

IR 1: Improved Social Assistance Programs for Targeted Populations

USAID, together with the government, donors, and NGOs, will work to better target meaningful assistance to the unemployed and vulnerable groups, and to build a broad social consensus and social conscience for such targeting. Building mutual trust and credibility through effective service delivery will be a key component of this strategy. National implementation of the social security card system will ensure benefits flow to the unemployed and the needy, while saving scarce budgetary resources by providing clear targeting of recipients. USAID will also help MOSS to expand its organizational capacity, including assistance in clarity of scopes of work, structural improvements, and long term program planning and implementation, as is noted in the GOAM's PRSP.

USAID will actively promote NGO/GOAM collaboration in social partnerships and help cultivate improved communications, to combat the fear, mistrust, and misinformation that currently exists between government and NGOs. USAID will also help NGOs and MOSS to increase public awareness of services offered, laws, individual rights and responsibilities, eligibility requirements and service restrictions. Programs such as mobile social workers and printed and audio materials will help disseminate information about the social assistance program to populations often overlooked by the system due to geographical, geopolitical and economic realities.

IR 2: Reduced Need for Government Subsidies

In order to improve Social Protection in Armenia, not only must there be better social assistance and insurance services, but there also must be a reduction in the number of people requesting these services. Thus, USAID and MOSS, along with other donors, will enhance skills training and labor development programs. These programs, coupled with vigorous private sector job creation, are critical for bringing unemployment and poverty levels down. A reformed education system – largely the province of other donors – will be the principal means of creating skilled entrants into the labor force. However, another substantial cohort – the presently un- and under-employed, especially older school drop-outs – needs its own skills training programs. The central and regional governments, and the NGO community, must be involved in the process from the start so that they are able to continue the programs independent of intensive outside support, and so that they are confident in their abilities to identify employment needs, address employer concerns, provide appropriate training and market their services and customers.

Short-term vocational training will help prepare adults whose skills have been displaced and/or outdated by the recent, drastic changes in Armenia's economic situation. Since employment centers (Republican Employment and Labor Agencies) already exist, USAID will partner with the GOAM, donors, implementing partners, and – most critically – private businesses to develop demand-driven, comprehensive training programs that develop the skills needed to secure jobs in the areas where the unemployed live. This will help prevent urban migration levels that cannot be sustained by government resources. The first task will be to identify potentially dynamic industries and determine which absent skill sets are inhibiting growth. Training programs will differentiate the supply and demand for labor within specific economic sectors and geographic areas, and promote equal access, regardless of sex or age. The latter will be particularly important for reducing the number of female-led households dependent on government subsidies, and to mitigate the existing gender-based pay inequities. The vocational training programs will complement the World Bank commitment to improving secondary education through skills training programs. USAID will also assist in restructuring Employment and Labor Agencies to improve benefits distribution and access to information about job vacancies and employer expectations. These services will satisfy many of the training and employment readiness concerns identified by both the GOAM (PRSP) and in USAID's Human Capacity Development report.

Labor development programs, including specific public infrastructure projects, will be targeted to capitalize on the skills being taught in employment centers, serving not only as short-term options for family income, but also to provide the necessary work experience to help participants begin career transitions. Labor development programs will benefit social service programs by combining the opportunity to train workers and provide short-term work contracts with the structural and operational needs of social service programs such as homes for the elderly, orphanages, or centers for the disabled.

IR 3: Operationally Viable Social Insurance Programs Established.

The Armenian working public that expects, justifiably, that social insurance programs such as pensions will be there for them when the time comes must have confidence that GOAM administration is up to the task over the long haul. Otherwise, the delicate social balance between those who need access to the social insurance systems now, and those investing in the country's social insurance schemes for the future, will collapse. With this in mind, USAID will work with the GOAM over the next five years to maintain and solidify its existing social insurance systems and embrace new support areas for the vulnerable, such as disability benefits. The Mission expects to complete most of the components of its social insurance program at the end of this SO, but in order for that to occur, legal, institutional and IT areas to prepare for the sustainability of social insurance programs must be improved. Collection systems must be strengthened and closely monitored, particularly in the Social Insurance Fund (SIF.)[22] To combat corruption and ensure timely payments in the benefits system, USAID will support accounting and budgeting reforms. USAID is committed to ensuring that the tools are in place for MOSS to continue to enhance and implement the social insurance programs when USAID leaves.

[22] The SO 3.4 team will work closely with the SO 1.3 team and the GOAM to ensure that the administration of insurance systems does not unintentionally burden SME formation or, especially, job creation with a non-competitive total wage bill. Other anti-employment aspects of the labor code will be analyzed as well.

For social insurance programs to be sustainable, there must be a willingness among the general public to trust the system to protect them and provide justly for them. This trust will not come easily, as most Armenians are well aware of the system of graft that deters legitimate claims. Educating the public about policies and regulations will encourage citizens to demand just treatment from the system and to seek counsel when it fails them. Also, USAID will support systems that track benefit contributions and employment activity, log inquiries and complaints, and address personnel issues such as job responsibilities, all of which will guide the efforts for greater transparency.

Expected Results

By the end of the 2004-2008 strategy period, the Mission expects the following results:

- Existing Integrated Social Service Centers (ISSCs) will be fully functional and provide appropriate services;
- More frequent social partnerships between GOAM and NGOs will occur;
- Accounting reform will be implemented and greater transparency will be achieved in budgeting for SIF;
- Local government fiscal and administrative capacity to provide social services will be strengthened;
- Living conditions for the elderly, orphans, the disabled and the very poor will be improved in general;
- Financing of labor development programs will be less centralized; and
- Republican Employment and Labor Agencies will be restructured to improve their capacity.

Linkages

SO 3.4, *Improved Social Protection,* supports the Embassy MPP Goal of *Economic Prosperity and Security* as outlined in Performance Goal Paper 2, by contributing to its Performance Goal 2 of *Economic institutions, laws and policies foster private-sector economic growth, sustainable development, and poverty reduction* through its Strategy 3, to *Strengthen social safety-net and help individuals adjust to a market system.*

This SO supports the USAID Agency goal, *Broad-based economic growth and agricultural development encouraged*, by contributing to EGAT/PR's objective of *adequately addressing the needs, capabilities, and vulnerabilities of the poor and contributing to the achievement of the Millennium Development Goal of reducing poverty by half by 2015*. It also contributes to EGAT/PR/PASS' objective of *reducing the risks and vulnerabilities of poor populations and other disadvantaged groups to income shortfalls, short-term food deficits, and/or the loss of personal or collective assets.*

Within this strategy, SO 3.4 supports SO 1.3's efforts to achieve *Increased employment in a competitive private sector* by contributing to its IR 2.1.2, *Increased opportunities for workforce development.* It supports SO 2.1's efforts of *Improved Democratic Governance* by contributing to its IR 1.4 *Increased community involvement in addressing public issues* and IR 2.2 *More responsive and effective local government.* This SO also contributes directly to the GOAM goal of *Provision of Minimal Welfare for the Population* as outlined in its PRSP.

Program Support Objective 4.2: Cross-Cutting Initiatives

A number of important programs and initiatives have impact across the Mission's Strategic Objectives. Since these initiatives support achievement of the overall program vision, the Mission has judged that it is inappropriate to formulate complete results frameworks for them. Program Support Objective (PSO) 4.2 will fund activities that are broad in nature, which contribute to the achievement of all of the Mission's Strategic Objectives.

Gender Differentiation

In some program areas, such as maternal and child health activities within SO 3.2 or labor market development and employment creation programming under SO 3.4, gender considerations may affect the approach taken within a given activity. In others, such as enhancing the role of women in political party building in SO 2.1, and widening the pool of potential women borrowers as well as providing non-financial business development skills programs to increase the productivity of women-owned small enterprises in SO 1.3, specific activities are designed to directly address gender issues. To ensure that gender is addressed, all activities designed, implemented and assessed under this strategy will take into account differences and inequalities between men and women. All results framework indicators will be disaggregated by gender to the greatest extent feasible.

Trafficking in Persons

The Bureau of International Narcotics and Law Enforcement Affairs within the Embassy is vigorously addressing trafficking in persons. USAID stands ready to address additional Armenian needs as they emerge, such as providing economic opportunity to those deemed especially at risk of being trafficked, raising public awareness, and warning or assisting actual or potential victims. This is an area where potential exists for a GDA with interested Diasporan parties.

Human and Institutional Capacity Building

This strategy emphasizes performance improvement of individuals and institutions critical to the achievement of the Mission's strategic objectives. Without major improvements in individual and institutional performance, there is little likelihood of successful implementation of government reforms. Heretofore, the Mission's participant training program has had more general skills-building objectives. To improve performance, enhancements in knowledge, skills, and attitudes (KSAs) through training interventions are necessary, but not sufficient. The Mission will therefore use performance and institutional needs analyses and will stress coordination of KSA enhancements through training with other technical assistance interventions designed to ameliorate non-KSA performance barriers.

Eurasia Foundation

The Mission will continue to fund Eurasia Foundation activities in Armenia, in line with its core grant.

Education

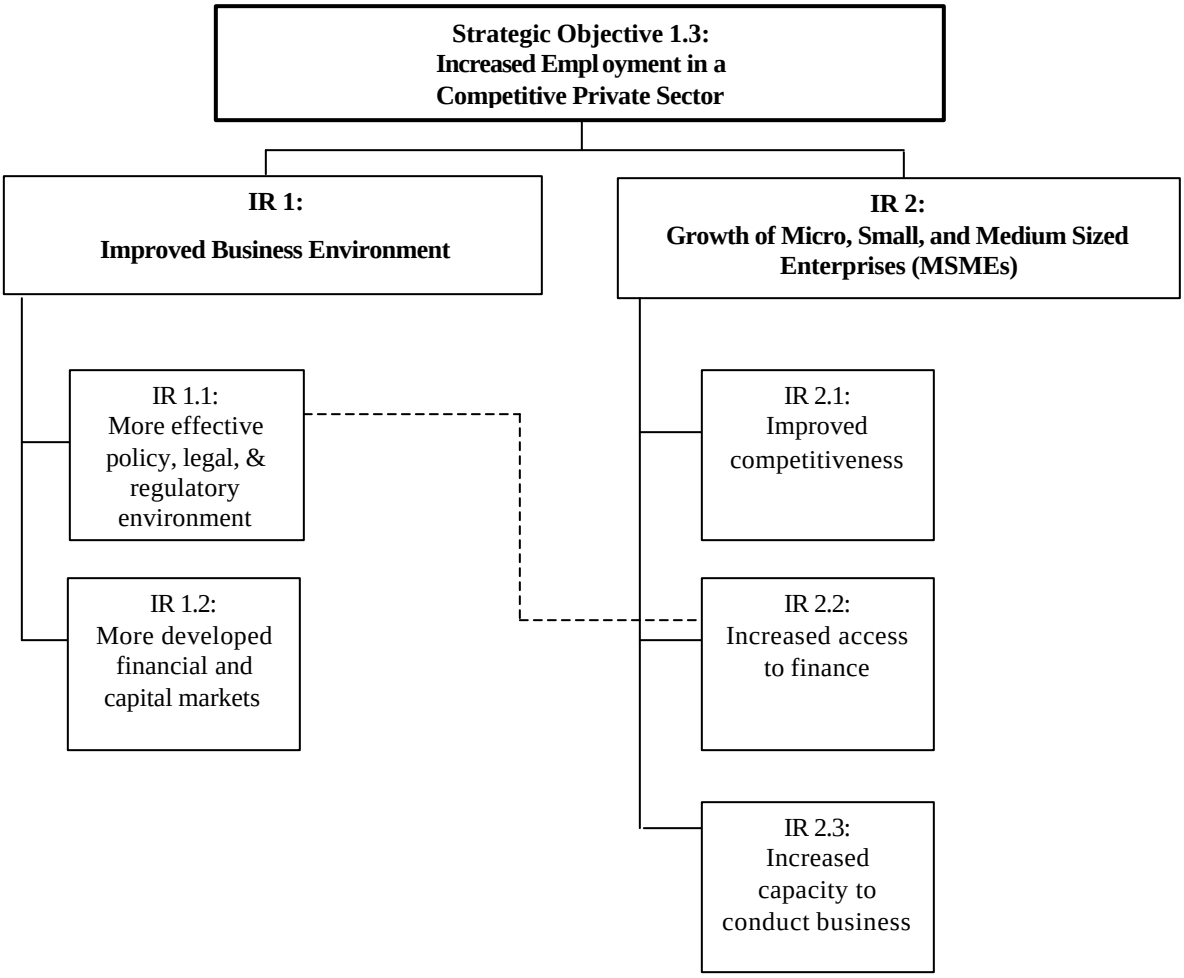
Washington guidance for preparation of the FY 2004-2008 strategy, especially the "parameters message," asked the Mission to review the coherence, structure, and priorities of its ongoing and planned education sector-related activities. This guidance – and the Mission's parallel concerns – reflects the emergence of more sharply-etched issues in educational quality, relevance to the demands of the new economy, and equitable access for the poor and very poor at the primary, secondary, and higher education levels. Approximately a decade after independence, reforming formal education in Armenia is increasingly critical to sustainable job creation, a democratic civil society, and long-term poverty reduction.

Under this Program Support Objective, the Mission has created a new FSN position to, in part, continue analysis of the problems and opportunities in the sector, and to facilitate the dialogue with major sector donors (World Bank, EU/TACIS, and GTZ) and the GOAM. This new coordination function also will build on ongoing education aspects within other SOs across the Mission's portfolio to ensure that critical programmatic gaps in formal education, where USAID has a comparative advantage and where budget resource limitations permit, are being systematically addressed. The following are examples of Mission educational interventions, most of which are part of other SOs, that will start or continue in the new strategy period include: the American University of Armenia endowment; civic and economics education in secondary schools; a law faculty development program at Yerevan State University (YSU); development of accounting and audit curricula at YSU; development of a unified family medicine curriculum at the State Medical University (SMU); development of a business curriculum at the State Engineering University of Armenia (SEUA); and assistance for curriculum reform, adult education, and outreach programs of computer science departments at three universities – YSU, SEUA, and the State Institute of Economy (SIE). These USAID-managed activities complement current FSA-funded public diplomacy (Embassy) activities in Armenia, notably the Project Harmony (PH) School Connectivity Project, the Educational Partnership Program (EPP), the Junior Faculty Development Program (JFDP), the Middle School Level Teacher Training Program (MLT), Curriculum Development for Pre-Service Education, and Curriculum Development for School Administration Leadership Training.

A summary of recent assessments and analyses in education commissioned by or otherwise made available to the Mission can be found at Appendix VII. The Mission will continue consultations with its stakeholders on its coordinated work in the education sector.

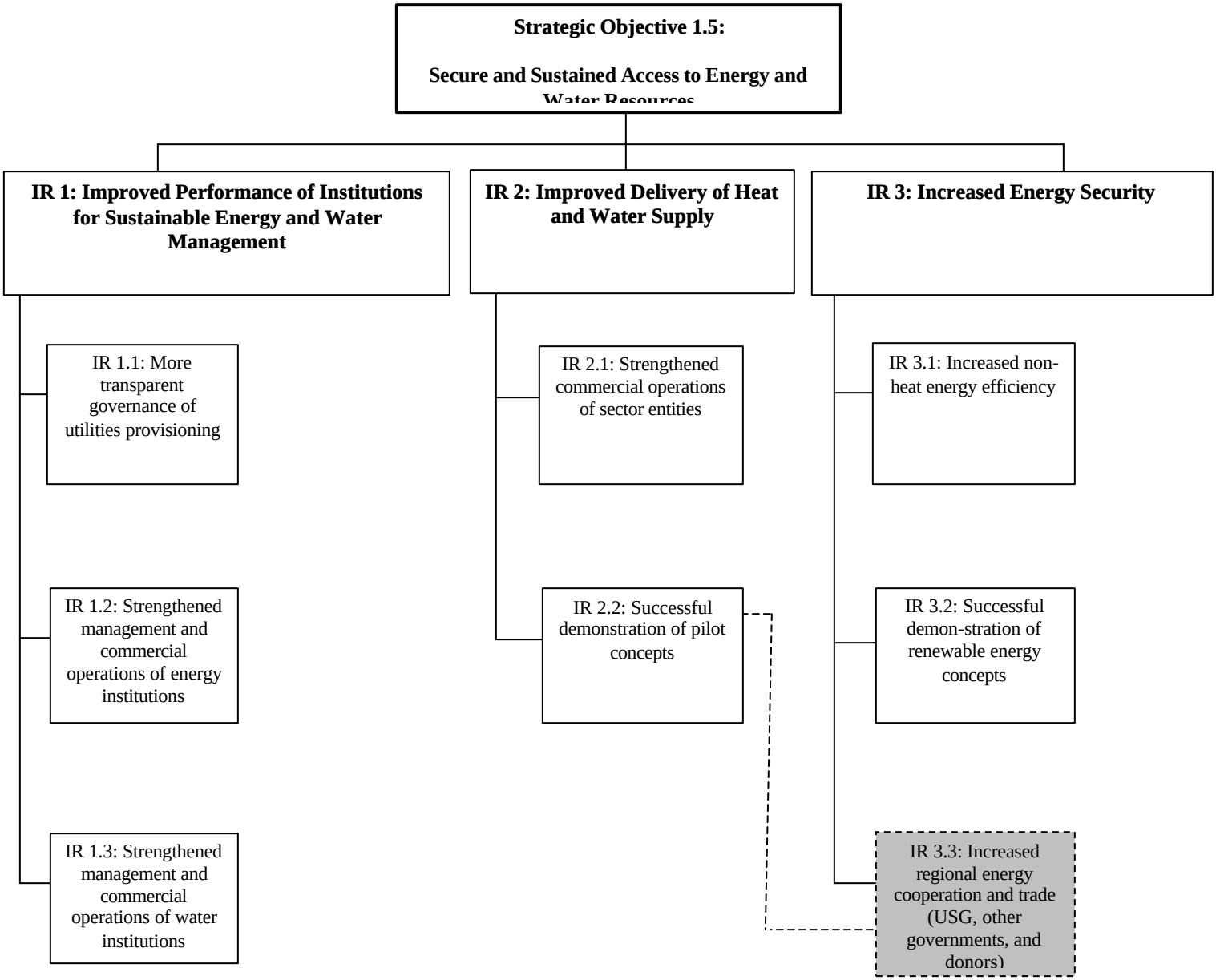
Appendices
Appendix I: Results Frameworks

Results Framework
USAID/Armenia has identified the intermediate results that will be used to achieve increased employment in a competitive private sector. They are illustrated in the following chart:



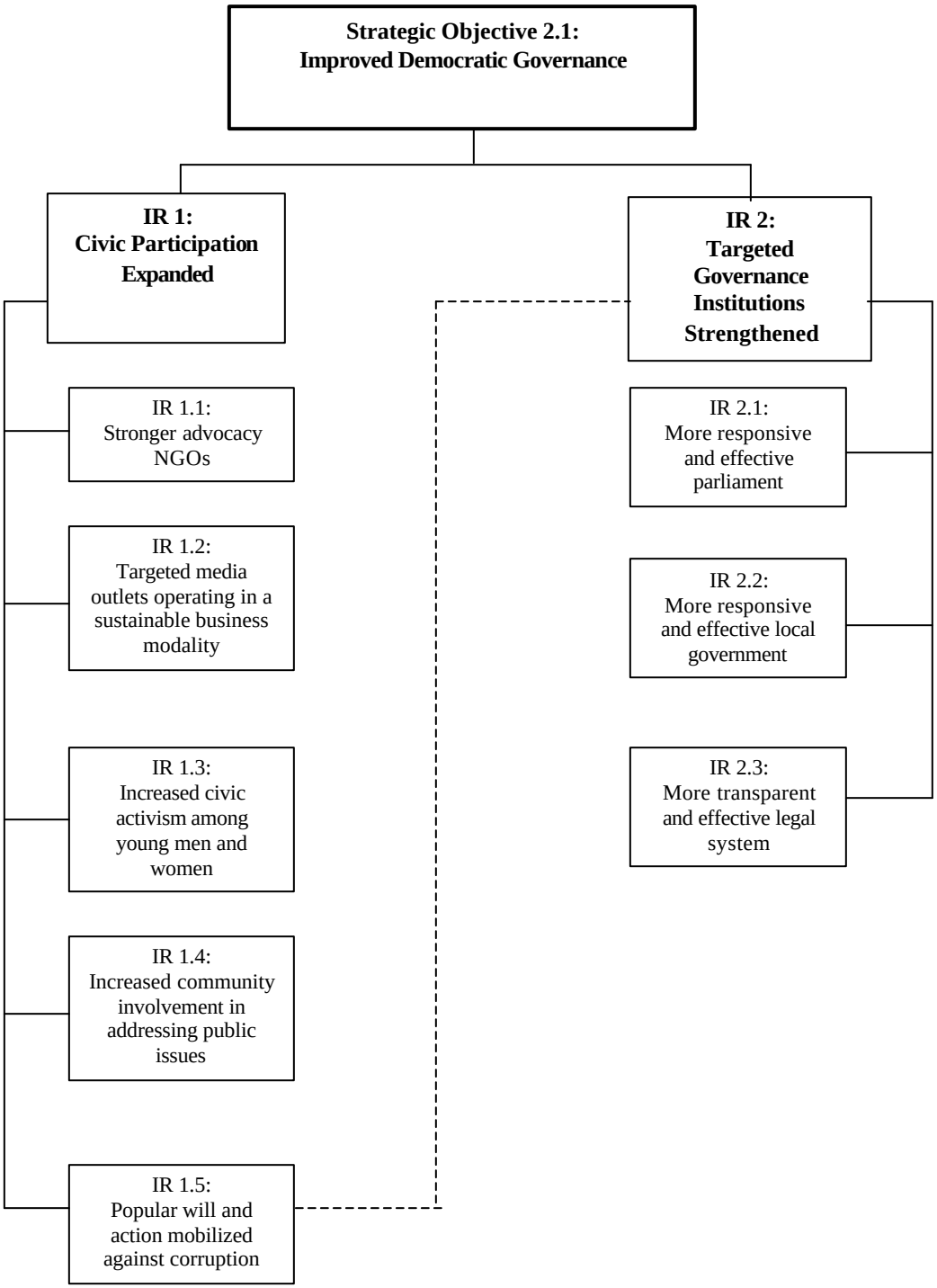
Results Framework

USAID/Armenia has identified the intermediate results that will be used to achieve secure and sustained access to energy and water resources. They are illustrated in the following chart:



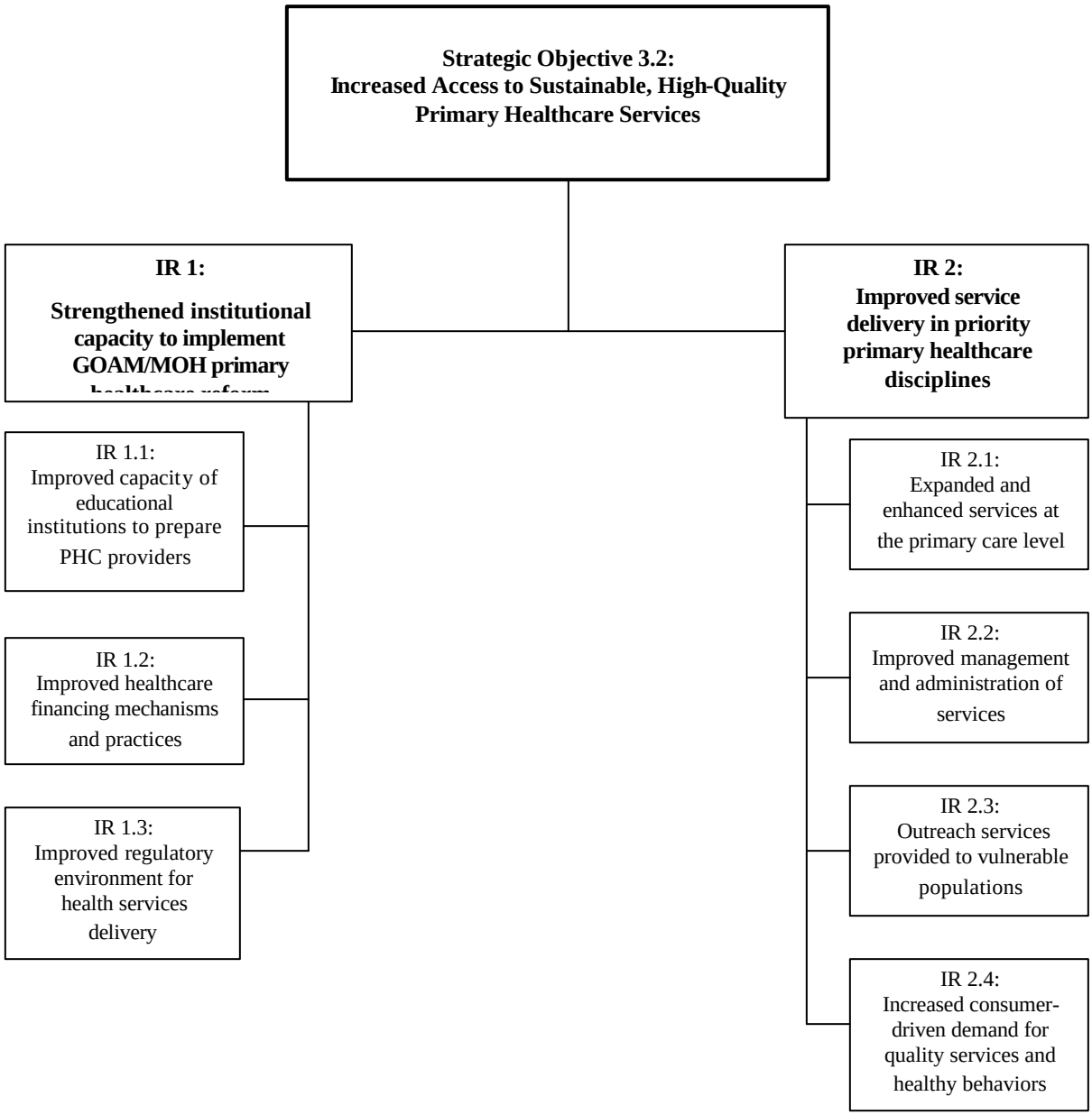
Results Framework

USAID/Armenia has identified intermediate results that will be used to improve democratic governance. They are illustrated in the following chart:



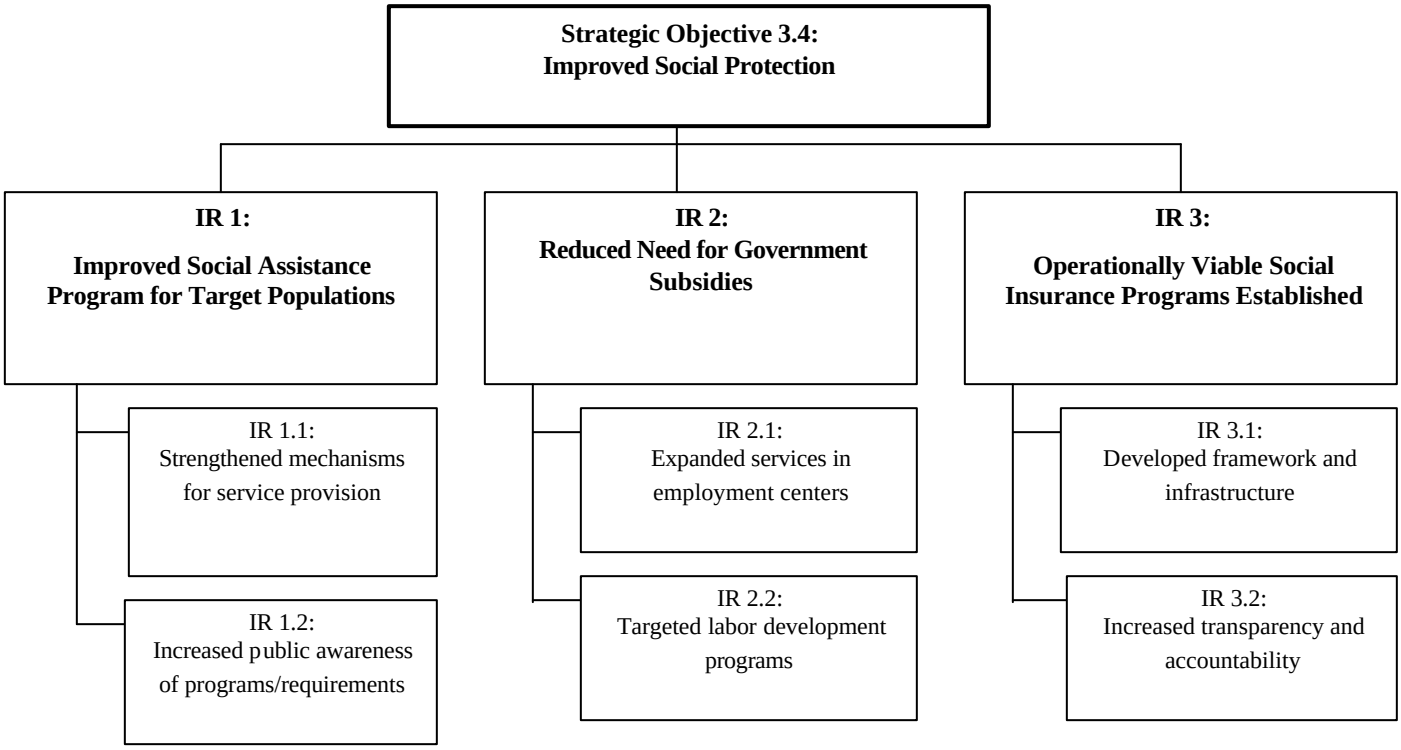
Results Framework

USAID/Armenia has identified the intermediate results that will be used to achieve increased access to sustainable, high-quality primary healthcare services. They are illustrated in the following chart:



Results Framework

USAID/Armenia has identified intermediate results that will be used to improve social protection. They are illustrated in the following chart:



Appendix II: Preliminary Performance Management Plan (PMP)

Strategic Objective 1.3: ***Increased Employment in a Competitive Private Sector***

RESULT STATEMENTS		PERFORMANCE INDICATORS	INDICATOR DEFINITIONS AND UNITS OF MEASUREMENT	BASELINE DATA		2004		2005		2006		2007		2008	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
SO 1.3	Increased Employment in a Competitive Private Sector	Number of FTE* jobs created, disaggregated by gender	Increased number of full time equivalent MSME employees resulting from USAID-supported interventions	2003	M1,600 F 400 T 2,000	M1,800 F 700 T 2,500		M2,500 F 1,000 T 3,500		M3,100 F 1,400 T 4,500		M3,800 F 1,700 T 5,500		M4,600 F 1,900 T 6,500	
IR 1	Improved Business Environment	Number of new businesses established in assisted areas disaggregated by owner gender													
IR 2	Growth of Micro, Small, and Medium Sized Enterprises (MSMEs)	Total value of sales, disaggregated by domestic sales and export													

NOTES: *FTE = Full Time Equivalent; A full PMP will be completed in collaboration with GOAM and implementing partners in FY 04.

Strategic Objective 1.5: ***Secure and Sustained Access to Energy and Water Resources***

RESULT STATEMENT		PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		2004		2005		2006		2007		2008	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
SO 1.5	Secure and Sustained Access to Energy and Water Resources	% of population with access to heat supply and potable water	Percent of population with access to: - 24 hr potable water; - affordable heat. Unit of Measurement- % of population.	2003	10% 10%	20% 15%		30% 20%		40% 30%		50% 45%		65% 60%	
IR 1	Improved Performance of Institutions for Sustainable Energy and Water Management	Selected Armenian Institutions/Agencies/Associations/NGOs functioning effectively	Key energy and water-resource management institutions (e.g., Regulatory Commission, WMPA, SCWM, BMOs, ESCOs and Condo Assocs.) functioning effectively. UNIT OF MEASUREMENT- Index of effectiveness: 1= established; 2=performed some functions; 3=performing most functions; 4=performing effectively all functions												
IR 2	Improved Delivery of Heat and Water Supply	Number of customers connected to sustainable heat distribution centers; number of customers receiving improved quality of water services	Number of customers – a. Connected to sustainable heat distribution centers – b. Receiving improved quality of water services Unit of Measurement – a. Number of customers; – b. Index of improved quality of services: 1=number of customers with access to 6h potable water; 2=12h; 3=18h; 4=24h												
IR 3	Increased Energy Security	Generation needs replaced by energy efficiency and renewable energy pilots	MW of renewable generating capacity (including hydroelectric) facilitated through USAID assistance and reduced consumption from energy efficiency pilots.												

NOTES: A full PMP will be completed in collaboration with GOAM and implementing partners in of FY 04.

Strategic Objective 2.1: ***Improved Democratic Governance***

RESULT STATEMENTS		PERFORMANCE INDICATORS	INDICATOR DEFINITIONS AND UNITS OF MEASUREMENT	BASELINE DATA		2004		2005		2006		2007		2008	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
SO 2.1	Improved Democratic Governance	Democra-tization Assessment	***Freedom House*** assessment of democratization. A general score for democratization addresses political process, civil society, independent media, and governance and public administration	2003 *	TBD *	TBD*		TBD *		TBD *		TBD*		TBD*	
IR 1	Civic Participatio n Expanded	Percentage of targeted population exhibiting civic consciousnes s and activism.	Definition: A list of basic information questions will be included in a survey to determine what percentage of targeted population exhibits increased civic consciousness and activism (as defined by % of citizens with civic knowledge and skills, exhibiting democratic values, and participating in political activities). This indicator is based on illustrative indicators included in the USAID/G/DG Indicators Handbook. Unit of measure: Percent												
IR2	Targeted Governance Institutions Strengthene d	Scorecard of citizen access to the governance process at all levels	Definition: A scorecard will be calculated, based on various criteria dealing with different aspects of citizen access to decision-making processes at the national and local levels. This indicator is based on illustrative indicators included in the USAID/G/DG Indicators Handbook. Unit: Index Score												

NOTES: *Freedom House baseline data for 2003 will be available in 2nd quarter of FY 04 when out-year targets will be set. A full PMP will be completed in collaboration with GOAM and implementing partners in of FY 04.

Strategic Objective 3.2: ***Increased Access to Sustainable, High-Quality Primary Healthcare Services***

RESULT STATEMENT		PERFORMANCE INDICATOR	INDICATOR DEFINITION AND UNIT OF MEASUREMENT	BASELINE DATA		2004		2005		2006		2007		2008	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
SO 3.2	Increased Access to Sustainable, High-Quality Primary Healthcare Services	Utilization rates for Family Group Practices (FGPs), FAPs, and other health facilities in program areas.	Number of clients by facility (FGPs, FAPs, etc) per year in program areas	2003	*	numeric baseline + 15% increase		numeric baseline + 20% increase		numeric baseline + 25% increase		numeric baseline + 30% increase		numeric baseline + 35% increase	
		Improved clinical skills among family medicine providers in FGPS and staff of FAPs	% of change in clinical skills of family medicine providers measured by direct observation, periodic review of clinical protocols' adherence, etc.	2003	*	baseline +10%		baseline + 15%		baseline + 20%		baseline + 25%		baseline + 30%	
		Increased client satisfaction reported by facilities in program areas	% of change in client satisfaction (measured by survey) in program areas compared with baseline	2003	*	baseline + 20%		baseline + 25%		baseline + 30%		baseline + 35%		baseline + 40%	
IR 1	Strengthened institutional capacity to implement primary healthcare reform														
IR 2	Improved service delivery in priority primary healthcare disciplines														

NOTES: *baselines to be established within 1st quarter of FY 04; A full PMP will be completed in collaboration with GOAM and implementing partners in FY 04.

Strategic Objective 3.4: ***Improved Social Protection***

RESULT STATEMENTS		PERFORMANCE INDICATORS	INDICATOR DEFINITION SAND UNITS OF MEASUREMENT	BASELINE DATA		2004		2005		2006		2007		2008	
				Year	Value	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
	Improved Social Protection	Reduction in percent of population below food line.	Percent of people living in extreme poverty. Monetary determination of extreme poverty is adjusted for annual rates of inflation. *Note: Target figures are estimates based on available information from annual household surveys.*	2002	18%	16%		19%		18%		16%		15%	
IR 1	Improved Social Assistance Program for Targeted Populations														
IR 2	Reduced Need for Government Subsidies														
IR 3	Operationally Viable Social Insurance System Established														
NOTES: A full PMP will be completed in collaboration with GOAM and implementing partners in FY 04.															

Appendix V: Biodiversity Analysis

The USAID strategic program in Armenia for 2004-2008 does not include a specific environmental SO, nor does it have a direct focus on environment issues through any particular Strategic Objective. Environmental issues that affect biodiversity are indirectly addressed, however, through a number of proposed activities, in particular those to:

- Promote more efficient and environmentally sound management of energy and water resources under Strategic Objective 1.5 (Secure and Sustained Access to Energy and Water Resources);
- Potentially develop ecotourism under SO 1.3 (Growth of Micro, Small, and Medium Sized Enterprises), in the event that tourism is identified as a suitable cluster;
- Encourage civic participation at the grassroots level by strengthening advocacy NGOs, working to encourage civic activism among youth, and increasing community involvement in local concerns, to develop the linkages and facilitate advocacy efforts at the national level under SO 2.1 (Improved Democratic Governance); and
- Address such crosscutting issues as anti-corruption, human and institutional capacity development and a strengthened participatory relationship with the GOAM under PSO 4.2 (Cross-Cutting Initiatives).

The program to promote more efficient and environmentally sound management of energy and water resources can be expected to have a positive impact on ecosystems and biodiversity, even if it does not explicitly incorporate such concerns. In particular, the focus on support for developing more effective delivery of heat and other non-heat energy efficiency and renewable energy resource pilot projects will strongly and directly reduce the pressure for deforestation. This, in turn, will create opportunities for enhanced conservation of forest ecosystems and related biodiversity resources.

The new strategy's water sector activities focus primarily on enhancing the efficiency of potable water supply companies. As a practical matter, however, they necessarily involve also providing support to the nascent institutions for integrated basin water management that have been created pursuant to the Water Code of 2002. These organizations include both national and local river basin management organizations, which offer a clear opportunity to enhance local capacity for more effective water management. A key principle of the integrated basin approach to water resources management is to incorporate an explicit accounting for the natural resource uses of water, including ecosystem uses. This can be expected to contribute to improved management of aquatic ecosystems and bio-resources.

Activities under the Strategic Objective to improve democratic governance will encourage civic participation at the grassroots level in variety of areas to be defined by local stakeholder interests. Although it is not possible *ex ante* to declare that these activities will include ones that explicitly improve the environment, local ecosystems, and biodiversity, it is possible and even likely in the specific locations where these are priority local concerns. Past efforts to strengthen advocacy NGOs and to increase community involvement in local concerns have involved environmental activities. Further, civic activism among youth often involves a concern for the environment.

The forces leading to environmental degradation, over-exploitation of natural resources and the accompanying decline in ecosystem and species biodiversity are often linked to the corruption associated with the illegal capture of rents through non-transparent resource extraction and use. Thus, Mission crosscutting activities directed at anti-corruption, as well as those targeting human and institutional capacity development and strengthening the participatory relationship with the GOAM in developing programs should contribute directly to reducing threats to biodiversity.

The following recommendations are based on the full review and analysis presented in the updated **Biodiversity Assessment Report** of key biodiversity issues and problems in Armenia and of the options available for enhancing Mission contributions to biodiversity needs under the proposed USAID/Armenia Strategic Plan for 2004-2008. Given that the Mission's new strategy, as noted above, does not have a specific environmental strategic objective, nor does it have a direct focus on environment issues, it is proposed that activities with an environmental impact be integrated into the SOs, as appropriate. The discussion above indicates clearly that there are a number of specific areas in which this approach can be expected to have a substantial, positive effect on the environment and contribute to key biodiversity conservation needs.

1. Support community-based initiatives that build local participation for natural resource management and biodiversity conservation through grants to NGOs and other organizations. This support can be provided through the planned energy and water sector programs, with regard to their components related to expanding and deepening public participation in key management decisions for these resources. As noted above, the focus on developing more effective heat supplies and enhanced energy efficiency will directly reduce the pressure for deforestation. This fact can be used to leverage opportunities for enhanced community participation in conservation of forest ecosystems and related biodiversity resources. Activities to strengthen the institutions of integrated basin water management also offer a clear opportunity to enhance local capacity for more effective water management. Focusing even limited resources on efforts to incorporate explicit accounting for the natural resource uses of water, including ecosystems, would contribute to improved management of aquatic ecosystems and bio-resources. The Mission, in implementing its energy and water programs, can also pro-actively seek opportunities to establish and expand partnerships (e.g., between international and Armenian environmental NGOs) to support these activities.

2. Support environmental NGOs to build capacity and develop local natural resource management and biodiversity initiatives, in the context of strengthening civil society. Water and energy activities that affect natural resources management and conservation of biodiversity (as described in point (1) above) can be coordinated as appropriate with activities to improve democratic governance that seek to encourage civic participation at the grassroots level in variety of areas, as defined by local stakeholder interests. In cases where these locally-defined interests lead to activities that explicitly improve the environment, local ecosystems, and biodiversity, efforts can be focused to strengthen advocacy NGOs and to increase community involvement in local concerns, as well as to improve the environment. Such assistance could range from small grants programs to larger grants that would give selected NGOs the opportunity to develop more detailed technical focus, including technical training and support, in ways that combine civil society strengthening and technical expertise.

3. Review and analyze options to support information gathering, dissemination, and monitoring systems that benefit all stakeholder groups. The GOAM and MONP have taken initial steps to implement their obligations under the Aarhus Convention to increase public access to information and participation in environmental decision-making. Many of the forces currently operating that contribute to environmental degradation, over-exploitation of natural resources and the accompanying decline in ecosystem and species biodiversity are linked to the corruption associated with illegal capture of rents, which can thrive only in an atmosphere of non-transparency and suppressed public participation. Mission crosscutting activities directed at anti-corruption, as well as those targeting human and institutional capacity development and strengthening the participatory relationship with the GOAM in developing programs should be used in program development to contribute directly to reduce the threats to biodiversity.

4. Continue to provide active support in information sharing and coordination among donors and other organizations supporting environment in Armenia. USAID has been a leader in organizing and participating in regular donor meetings on the full range of development issues. In conjunction with other key donors in the environment sector – UNDP, the World Bank, the German and other bi-lateral assistance programs, USAID will continue to ensure that donors meet regularly with each other and with the GOAM and the MONP to discuss and harmonize existing and planned environmental activities. This continued commitment to coordination and information exchange will ensure that any proposed USAID interventions complement and leverage other donor programs and avoid duplication.

5. Promote regional cooperation as possible through information sharing, exchange visits, conferences, joint studies, and partnerships, focusing on potential trans-boundary projects in water, energy or biodiversity conservation. Environment remains an area that presents significant opportunities for confidence-building measures at the technical level aimed at enhancing communication and laying the foundation for future cooperation between Armenia and her neighbors, in particular Georgia, Azerbaijan, and Turkey. Armenia and Azerbaijan have already engaged in very effective and enhanced technical level dialogue on trans-boundary water issues in the context of USAID-funded and other donor activities in the past three years. Watershed protection, which can be extended to include sustainable forest management, wetland protection, and biodiversity conservation, is an important element of improved water supply and quality and can be supported in the context of any broader, multi-donor initiative. In addition, information sharing and environmental education cooperation offers a low-cost option for increasing awareness and promoting environmental initiatives, both nationally and regionally, based on the experiences of the different countries. The potential roles of the Regional Environment Center for the Caucasus in Tbilisi should be constantly reviewed in this context.

Appendix VI: Bibliography and Brief Summaries of Studies Used to Formulate the Strategic Plan

Armenia Labor Market Evaluation and Strategy Assessment
Education Development Center, Washington, DC, April 2003

Methodology and analysis:
A three-person assessment team used the analytical framework called SWOT (Strengths, Weaknesses, Opportunities, and Threats) to organize and evaluate the importance of the wide variety and types of information gathered for the labor market assessment. The team visited Armenia and conducted interviews with government officials, USAID staff, implementing partners, and civil society groups. Before the team traveled to Armenia, they read extensively and drew upon their respective experiences to develop a list of potential target industry clusters and a menu of potential interventions to strengthen the labor market.

Throughout, the assessment considers the labor market from three perspectives:

- The demand side of the labor market, which provides the jobs, is the employer's need for workers with certain capacities;
- The labor marketplace itself, the connection between firms seeking employees and people seeking jobs, and the regulatory, tax, and policy environment in which this occurs; and
- The supply side of the market, which comprises workers, job seekers and potential job seekers. It also includes the education and training institutions that help people gain the skills and knowledge needed for employment.

Conclusions:
Indicators of labor market dysfunction abound in Armenia. The assessment team gave high priority to options for crosscutting USAID technical assistance, to create a more efficient and transparent labor market in Armenia and thereby promote employment growth and poverty reduction.

- Enhance the Capacity of Territorial Employment Centers;
- Build Up the NGO Role in the Labor Market as a Complement to the Public Sector;
- Enhance the Capacity of Business and Professional Associations to Provide Leadership in Adoption of Best Practices in Workforce Development and Productivity Improvement;
- Encourage Development of Industry Clusters to Enhance Competitiveness;
- Use Public Service Employment More Strategically - as a Tool for Developing Marketable Skills, Developing Infrastructure for Economic Growth and Enhancing Local Government Capacity; and
- USAID should convene a series of conversations with groups of key Armenian partners and other donors to get their feedback on this assessment and to help USAID further refine and prioritize the options proposed.

Human Capacity Development Assessment
USAID, March 2003

Methodology and analysis:
The assessment was prepared by a three-member team that:

- Reviewed the Mission results framework, including strategic objectives, intermediate results and performance indicators;
- Reviewed key Mission strategic documentation, as well as recently completed technical sector assessments and historical/operational training documentation;
- Conducted interviews with relevant Mission personnel, training implementation contractor and other implementing partners. The team also interviewed representatives of organizations and GOAM counterparts to which USAID has provided assistance; and
- Applied the performance improvement framework, focusing on its major implementation stages.

Conclusions:

- Increased HCD will increase Armenia's absorptive capacity for more development and investment resources;
- Efforts to further strengthen institutional capacity can have a positive effect on reform efforts;
- An HCD approach grounded in Performance Improvement will maximize the impact of capacity building activities on both Armenian partner institutions and sectoral results;
- Implementation of an HCD strategy will require changing USAID/Armenia's focus from training to human capacity development, by:
  - Changing the mindset of USAID, the HCD contractor and TA contractors
  - Changing the roles of the HCD contractor and the TA contractors (including utilizing new programming options under PTP)
  - Changing procedures
- The management implications of adopting an HCD approach include:
  - Changes in processes and the way in which projects are implemented
  - Monitoring and measuring changes in institutional capacity
  - Increased workload level for USAID activity managers and TA contractors

A Quick Education Sector Assessment
Aguirre International, March 2003

Methodology and analysis:
Work was carried out in Washington and Armenia between January 30 and February 26, 2003. More than 50 meetings were held with: the Ministry of Education and Science (MOES) and other Armenian education authorities, leaders, and experts; USAID, the World Bank (WB), the European Union (EU), and other key donors; Armenian Diaspora organizations; public diplomacy staff in the U.S. Embassy; representatives of international and local NGOs; a local, private consulting firm developing a higher education reform policy paper; and USAID contractors.

In addition, the assessor reviewed documents, reports, and other relevant material prior to and during the assignment, including recent assessments of the education sector in Armenia from pre-school through tertiary levels.

Conclusions:

The USAID-supported education initiatives were well designed and generally achieved their objectives. However, as a group, they could have accomplished more if they had been designed and conducted within a broader educational development strategy.

The main needs of the education sector are to:
- Improve the quality, relevance and efficiency of education services;
- Provide more equitable educational opportunities for Armenian children and youth;
- Improve employment opportunities for graduates; and
- Increase the engagement of parents, communities, the private sector and the society at large in assuring the educational goals are met in a fair, equitable and effective way.

USAID involvement in education (even if limited) would help sustain Armenian commitment to educational reform, help leverage other donor funds and provide opportunities for reform efforts to draw on U.S. expertise in the sector.

USAID should focus its attention on general education and/or higher education, rather than on pre-school and vocational-technical education. Technical assistance and training should be the principal components of any activity.

Options for assisting with general education (grades 1-10) include:
- Policy and strategic planning
- Standards and curriculum
- Assessment
- Teacher training
- Information technology
- School decentralization and governance
- Education programs for out-of-school youth

Options for higher education include:
- Policy and strategic planning
- Targeted activities in support of USAID objectives
- Student loan and scholarship programs
- Renovation of academic staff
- Relevant curricula and programs
- Graduate education and research

Gender Assessment Report & Action Plan
Susan D. Somach, March 2003

Methodology and analysis:
An independent gender specialist visited Armenia and conducted interviews with government officials, USAID staff, implementing partners, and civil society groups. The specialist read extensively and drew upon experiences to develop a framework for the assessment.

The Gender Assessment was developed within the framework of the following documents:

- USAID Automated Directive System (ADS), last modified 1/31/03;
- Mainstreaming Gender: More Effective and Better-Targeted Development; and
- USAID/Bureau for Europe and Eurasia's Strategic Framework.

Conclusions:

- The result of gender disparities is not only a human rights issue, but also an under-utilization of human capacity critical to successful development;
- Lack of time, due to the double burden of both family and economic responsibilities, is one of the biggest barriers to women's interest and/or ability to pursue top positions in business or any type of elected position;
- In addition to culture and tradition, lack of interest or political will constrains the promotion of gender considerations; and
- Opportunities for promoting gender considerations are facilitated by:
  - Armenia signing and ratifying the Convention on Elimination of all forms of Discrimination Against Women (CEDAW)
  - The development of a Gender Plan of Action, which has been presented to the GOAM
  - The establishment of a Commission on Women and Children by the Ministry of Social Security
  - The reestablishment of a gender working groups and other gender initiatives by the local UNDP office
  - The Council of Europe and European Union standards on gender equality
  - Foreign donor involvement in institutional, legal and regulatory reform
  - USAID's domestic violence programs
  - USAID's local governance activities

Assessment of USAID/Armenia's Direct Assistance Programs
USAID, February 2003

Methodology and analysis:
The assessment team was composed of a resident USAID staff member and a consultant with extensive USAID experience. The assessment included meetings with USAID staff, national government officials, implementers, and program beneficiaries, both in Yerevan and the regions. Poor weather and presidential elections that took place during the assessment reduced the number of site visits and meetings with government officials from the initial plan. However, the team was able to draw on previous site visits and meetings to contribute to the findings and recommendations.

Conclusions:
Overall, the direct assistance programs have supported the delivery of social services and primary health care to the most vulnerable, and provided short-term income to the unemployed through public works activities. Although there are many lessons learned, the GOAM has been slow to adopt some of these models in their development plans.

However, through the implementation of these programs, there are some critical lessons learned which USAID can apply to future direct assistance activities:

- Targeting to the person level is possible at a relatively low cost;
- Implementers must establish relationships with counterparts at the national and local levels to support the sustainability of activities;
- Community involvement in the design and implementation of all programs is critical for overall success;

- Although programs may not be financially sustainable in the near term, involving operating partners in the design and implementation of all aspects of the programs will help to transfer skills to those who remain after USAID funding ends;
- In order to gain the maximum benefits for NGOs participating in the program, NGOs should implement significant components of programs and not small, stand alone activities; and
- USAID's breadth of programming and flexibility allows USAID to link direct assistance activities with development activities.

USAID/Armenia Energy Program Assessment
USAID, February 2003

Methodology and analysis:
USAID/W EE & EGAT provided a team to perform an Energy Program Assessment on past and to recommend future energy program activities. This Assessment included two visits to Armenia, including interviews with World Bank Country Representative; Washington Energy Program Staff; Department of Energy & Nuclear Regulatory Commission Country Coordinators; Department of State (EUR/ACE); GOAM Minister & Deputy Minister of Energy; GOAM Deputy Minister of Urban Development; Chairman of the Armenian Energy Regulatory Commission; the General Directors of ArmRusGasprom, Armelnet, Armenergo National Dispatch Center and Settlement Center; and USAID Contractors AEAI and PA Consulting.

Conclusions:
- It appears that the GOAM is committed to pursuing further reforms in the energy sector and has the vision and political will to continue to support privatization and energy/water sector reform in spite of anticipated politically unpopular tariff increases and service terminations (for nonpayment);
- The role of the energy regulator will become more important in the future as it will need to deal with the new "private" entrants to the electricity system and other changes related to commercialization, expansion and regulatory changes;
- Non-transparency in the financial settlements and revenue allocation system remains a problem;
- The overall efficiency of the energy system could be improved by substituting natural gas or localized hot water, heat-only boiler heating for electric space heating and hot water supply;
- The rehabilitation and expansion of the gas distribution system and the revision of tariffs and regulatory guidelines are a critical priority for the GOA and donors; and
- Affordability of energy by the poor and elderly is a fundamental problem. More attention needs to be given to social safety net implications of energy system development, particularly for heating.

Assessment of Opportunities for USAID Assistance to Armenia in the Environment
USAID, January 2003

Methodology and analysis:
USAID/Armenia's Senior Energy Policy Advisor reviewed reports of work and analysis related to the environment in Armenia. The review included assessments prepared for USAID/Armenia's 1999-2003 Strategy, efforts under that strategy, work supported by other

donors, policy and legal developments in Armenia, and independent analyses of environmental issues in Armenia.

In preparing the assessment, the author reviewed relevant background documents and information on biodiversity, forestry, solid waste management, water supply and sanitation, and industrial pollution and waste management. Due to time constraints, he did not specifically addressed watershed management, land management, toxic chemicals, energy, and radioactive wastes. The major background documents referenced included:

- USAID Biodiversity Assessment for Armenia (1999);
- Republic of Armenia National Environmental Action Plan (November 1998);
- Republic of Armenia Rio+10 National Assessment Report (2002);
- Republic of Armenia Lake Sevan Environmental Action Plan (April 1998);
- Republic of Armenia First National Report to the Convention of Biological Diversity (April 1998); and
- Republic of Armenia Interim Poverty Reduction Strategy Paper (March 2001).

Discussions were also held with appropriate USAID staff members and stakeholders. The individuals consulted included USAID/Armenia energy and water program staff, USAID/Washington environmental program staff, Government of Armenia representatives, implementing partners, and other donors.

Conclusions:

- The water program has realized substantial positive results and created the strong desire on the part of key Armenian counterparts for further support;
- Enhancing energy security remains crucial for Armenia's development and increased energy efficiency and development of renewable energy resources are elements to realize this goal;
- While there remains a well-defined agenda for energy sector privatization and related restructuring reforms, it is clear that this set of energy sector activities will decline in importance over the next several years and end before the end of the 2004-08 strategy period;
- Environment sector issues in Armenia are set to increase in importance over the strategy period 2003-08, as the significance of effective environmental protection and sustainable natural resource management as cross-cutting elements of national policy grows;
- Armenia has developed clearly articulated priority issues and proposed actions in all areas of environmental policy, including the development of the National Environmental Action Plan (NEAP) and the Lake Sevan Action Plan (LSAP); and
- Four potential environmental sector intervention areas are identified for consideration as part of the mission's new strategy: Sustainable resource-use management; Environmental management; Industrial pollution management; and Environmental health.

Conflict Vulnerability Assessment
USAID, January 2003

Methodology and analysis:
A two-member team from Washington, DC conducted interviews during two weeks in October 2002 in Yerevan; the team also held a brief conflict workshop with USAID/Yerevan staff and selected partners, and traveled to Bagratashen and Noyanberyan in Tavush Marz to assess cross-border trade and a town adjacent to Azerbaijan damaged in the Karabakh conflict.

The team employed the conflict assessment framework developed by DCHA/CMM to help organize and analyze the risks of civil conflict. The assessment evaluates the type of risks of conflict that Armenia faces, and evaluates them relative to past years and compared to other countries. The Agency conflict assessment framework presents a synthetic view of the conclusions of social scientific research on conflict to date and the implications of this analysis for USAID programming.

The framework breaks down the most important categories of causes of conflict analytically to facilitate the analysis of conflict risks. Four broad categories are the essential building blocks of conflict and might precipitate violent conflict on a significant scale. Each forms a critical step in a causal chain that may ultimately lead to widespread violence. Without factors in any one category, conflict is far less likely. When numerous factors in all four categories are place in a region, country, or sub-region, and the risk of widespread violence increases dramatically. The incidence of conflict remains contingent, and might be sparked by a wide variety of triggers.

Conclusions:
An analysis of potential for violence related to each of the four causes of conflict reveals:

Motives for conflict:	It is unlikely that these will attribute to conflict in the short- or medium-term;
Organizations:	Self-imposed limits on party and elite competition limit the incentives to use violence. Popular attitudes of disgust towards politics and particular leaders encourage non-participation in politics rather than violence;
Institutions:	Opportunities for violence are constrained by the relatively robust forces of the state and other mechanisms within society; and
Regional factors:	It seems unlikely in the short-term that either Armenia or Azerbaijan would restart the conflict over NK. Should instability in Georgia develop, Armenia would most likely try in the short term to minimize the risk of conflict, rather than intervene.

Therefore, although there are factors that suggest high risks of conflict, Armenia appears to be a relatively stable country. However, if Armenia's democracy does not become more representative and if the economy does not better provide for the population, grievances will grow and the risk of internal conflict over the longer-term will become significant. Changing geopolitical circumstances could either exacerbate or reduce pressures for conflict.

Implications for USAID: Given the relative stability in Armenia, USAID and the USG can push hard for fundamental reforms to produce competition in the political and economic system with little fear that destabilization might lead to violence in the short term.

Armenia Rule of Law/Anti-Corruption Assessment
ARD, Inc., December 2002

Methodology and analysis:
An assessment team of four individuals conducted field assessment in Armenia from September 9 to September 27, 2002. In Yerevan the team met with GOAM officials, civil society organizations, business associations, USAID/Armenia and the Embassy team, USAID implementers and other international donors. In Vanadzor the team met with government officials, NGOs and media. All members of the team attended interviews judged as most

important. On other occasions at least two team members attended interviews, with rare exceptions. Interviewing team members regularly briefed other members on interviews not attended by the other team members.

Interviewees were asked to provide information available from their perspective that relates to rule of law and/or anti-corruption issues. Interviewers also asked respondents to give their opinions on the effectiveness of work and the amount of corruption in their area of focus and their basis for those opinions. Interviewees were asked to identify major problems and suggest solutions. They were also asked to identify possible friends and opponents of reforms and the possible factors that might motivate these players. They were asked to identify major constraints as well as factors that might facilitate needed reforms.

Conclusions:
The primary constraints to reform in the rule of law include:

- Lack of financial resources;
- The absence of transparency;
- Executive branch interference with judicial independence;
- Systemic corruption is one of the most serious development challenges facing Armenia;
- The GOAM has yet to demonstrate the sustained political will necessary to give corruption the attention and resources it deserves;
- The fusion of political and economic power and the lack of separation between the public and private sectors are among the main causes of corruption in Armenia;
- Major constraints to implementing public-private anti-corruption activities include the current low level of development of civil society organizations, the political passivity of the Armenian public and the virtual absence of any mutual trust between civil society actors and public officials;
- Effectively fighting corruption will require a much higher level of commitment, leadership and intervention than is currently demonstrated by the Armenian state, civil society entities and donors, including the U.S. government;
- Many of those who are in the strongest position to combat corruption are the very ones who are its chief beneficiaries; and
- The most significant drivers of corruption in Armenia are:
  - Public and private sector institutions operate in an environment of low transparency and accountability
  - Perverse public-private relationships plague the public sector and public sector reforms are incomplete

An Assessment of USAID's Health Strategy in Armenia
Robert J. Taylor, Capri-Mara Fillmore, Tatyana N. Makarova, November 2002

Methodology and analysis:
A three-person team visited Armenia for three weeks in late April and early May, 2002. The team was lead by a health management and reform specialist, and included a family physician/epidemiologist, and a specialist in health organization and finance, with extensive experience in the former Soviet Union. Prior to the visit, the team reviewed relevant literature. During their time in Armenia they conducted site visits and interviewed a broad range of policy officials and healthcare providers, in Yerevan and outlying regions. The team also interviewed

USAID officials in Washington and Yerevan, staff of implementing organizations in Armenia and the U.S., and other donors.

Conclusions:

- USAID's health program activities are on track and do not need major redirection. In fact, maintaining the continuity and momentum of current activities is vital. Any dramatic shift in course or emphasis could weaken the gains that have been made and restrain further progress;
- The GOAM's health reform agenda has three major thrusts: Improving access to primary health care services; Improving health financing; and Optimizing health care facilities and personnel;
- USAID should continue to support and complete the reform process that has started, while also supporting activities that address the immediate health needs of the most vulnerable; and
- To help build understanding and advocacy for family medicine, USAID should continue the current practice of sponsoring study tours and hands-on training to expose GOAM leadership to family medicine training programs and practices sites.

USAID/Armenia HIV/AIDS/STI Strategy
The Synergy Project, November 2002

Methodology and analysis:
A team of three specialists reviewed literature, and conducted site visits and interviews in Armenia. Interview subjects included representatives from several national ministries and agencies (Health, Detcnse, National Statistical Service), regional bodies, and direct care providers. The team also interviewed international donors, international NGOs and contractors, and local NGOs.

Conclusions:

- Even though Armenia has been considered a low HIV prevalence setting, and is classified as a Basic Country, the results of a recent HIV seroprevalence survey show Armenia to be more likely in the early stage of a concentrated epidemic;
- This is a critical time to intervene to prevent further spread of HIV from subpopulations at higher risk to the general population; and
- The GOAM has taken decisive steps in the past year to adopt a sound national strategy for HIV prevention in line with UNAIDS/WHO recommendations.

Evaluation of USAID/Armenia's Social Transition Program (STP)
MSI, October 2002

Methodology and analysis:
The assessment team began its work in Washington, D.C., meeting with USAID officers familiar with the STP program. The team also met with several of the STP contractors and World Bank experts, and reviewed STP documents provided by USAID. In Armenia, the team conducted more than 150 interviews, with USAID/Armenia staff, implementing partner staff, counterpart GOAM agency officials, Armenian practitioners and clients of project sites, and community volunteers. The team also conducted site visits and organized a workshop with invited

counterpart and implementing partner participants. The team also reviewed dozens of additional documents acquired in the course of meetings.

Conclusions:

Social Sector

- The pace of development of non-governmental institutions, including financial markets, insurance markets and corporate governance, could constrain increased individual and employer provision of social insurance and benefits;
- Assuring implementation of the personal code and social insurance accounts is critical to continuing the reform process; and
- Gaps in the current STP social sector reform program include:
  - Employment, unemployment and the labor market (viewed as a serious gap)
  - Coordination and involvement of the Ministry of Finance and Economy
  - Training for social policy implementation/management of government leaders at the marz and local government levels
  - Contracting with NGOs, including for-profit firms, for the design and delivery of social services and benefits

Health Sector

- In spite of successes, progress toward establishing the basis for an effective and efficient health care system has been modest;
- Until GOAM officials and health care professionals have a greater understanding of STP objectives and approaches and their roles under the reformed system, the sustainability of the health care reform process will be uncertain; and
- Primary constraints to health sector reform include:
  - Inflated workforce with limited understanding of the reform process
  - The limited institutional and financial capacity of the Ministry of Health to implement reforms

NGO Service Delivery

- Although most of the NGO programs are social or humanitarian relief programs, they do have the potential of generating long-term positive economic impact;
- The impact of USAID programs could be increased through increased reliance on Armenia NGOs, however these first require strengthening; and
- NGOs have the best chance of developing productive relationships with government at the local level, where they are most likely to interact on issues of common interest.

Armenia Pension Reform Assessment
Denise Lamaute, USAID/E&E Bureau, September 2002

Methodology and analysis:
The author reviewed literature and conducted site visits and interviews in Armenia, during July 2002.

Conclusions:

- If Armenia is to have a fiscally sound and sustainable pension system that provides an adequate income for retirees for several generations, then some very basic changes should be made to the Armenian pension system;
- The pension system in Armenia is administratively and operationally inefficient;
- More effective compliance and enforcement measures should be instituted in conjunction with an integrated governmental approach to tax collection and compliance; and
- A stable and growing economy with a shrinking shadow economy is needed for successful pension reform in Armenia.

Democracy and Governance Assessment of Armenia
ARD, Inc., June 2002

Methodology and analysis:
A three-person Armenia D/G assessment team visited Yerevan and completed field investigations in 19 days. Team members interviewed a broad range of informants in four groups knowledgeable about governance in Armenia. The team interviewed roughly 100 individuals. The team asked respondents to list the two or three most serious D/G problems currently confronting Armenia. Next, the team asked why respondents thought the actors involved in creating these problems behaved as they did. Finally, informants were asked to suggest changes in institutional arrangements that would lead key actors to modify their strategies over time to consolidate democracy and good governance. Assessment conclusions and recommendations reflect team analysis of these interviews and documents addressing D/G issues in Armenia.

Conclusions:

- The primary obstacle to consolidating democracy in Armenia is the dominant executive. With no effective system of checks and balances to restrain the executive's decision making and behavior, it is possible that Armenia could become increasingly authoritarian;
- Consolidating democracy in Armenia requires progressive empowerment of citizens; and
- DG activities will be more likely to succeed if they address problems of immediate interest to citizens, where positive payoffs are likely.

Armenia Financial Sector Strategy Review
USAID, May 2002

Methodology and analysis:
A USAID Banking and Financial Markets Specialist (with support from USAID/Armenia staff) reviewed the supervisory structure and options for the future for the Armenian financial sector. The review was coordinated with World Bank and International Monetary Fund, which are active in Armenia. Analysis was based on review of the legal infrastructure and discussions with key staff of the:

- Central Bank of Armenia (CBA)
- Ministry of Finance and Economy
- Securities Commission

- Insurance Inspectorate
- Banking Association
- Local representatives of EBRD, USAID, World Bank, and the IMF
- Leading locally active banks
- Audit companies
- KPMG/Barents advisors to the CBA's Bank Supervision Department.

Conclusions:

- The current focus of banking sector activities on on-site supervision is too narrow, leading to missed opportunities in other areas. Advisors must be pro-active and have the flexibility to become involved in any issue affecting the safety and soundness of the banking system;
- Efforts in the area of capital markets have prepared the way for capital market activity. However, there are currently few eligible investment grade companies to take advantage of this infrastructure in Armenia. Banks operating as intermediaries between the few existing buyers and sellers could be a more cost-effective approach to capital markets for Armenia; and
- Development of a three-pillar pension system is premature until an adequate financial sector foundation is in place.

Situation Analysis on HIV/AIDS in the Republic of Armenia and Strategy Proposal for USAID/Armenia
Christian Fung, USAID, April 2002

Methodology and analysis:
In addition to reviewing secondary information sources in English, the author also interviewed over 20 individuals over three weeks in February and March 2002, including members of the Government of Armenia (GOAM), United Nations (UN) agencies, international private voluntary organizations (PVO), and indigenous non-governmental organizations (NGOs). All stakeholders were invited to a discussion with partners on March 15, 2002. The author presented a draft strategy, followed by an exchange among participants.

Conclusions:

- Although HIV prevalence is currently low, experience in Eastern Europe in the late 1990s, where HIV rates increased dramatically, indicates that there is reason to be concerned and to take preventive actions;
- The GOAM and local NGOs have the capacity to carry out HIV/AIDS programs;
- Available data raise more questions than provide answers. Data quality is questionable; and
- There are several unknowns related to HIV/AIDS in Armenia, including the implication of proposed health reforms (i.e. optimization) for prevention and care of HIV/STIs, gender differences associated with HIV/AIDS prevention, and characteristics of high-risk groups and how to reach them.

Armenia Agriculture Assessment Team Report
USAID, March 2002

Methodology and analysis:
A team of 3 USAID/Washington representatives, an USDA agriculture expert consultant, and an agro-forestry expert assessed the state of Armenian agriculture and reviewed USAID and USDA programs that address the challenges facing Armenian agriculture. The assessment included meetings and a review of other donor programs in the area, as well as visits to a broad sector of Armenian agribusinesses.

Conclusions:
- While the agricultural sector will continue to be important, it will not be the engine of growth for the long-term; production capacity is limited;
- In the short to medium-term, agriculture will continue to be the primary sector for employment and the major contributor to Armenia's GDP;
- Import substitution and the development of exports (especially to other CIS nations) are essential for continued agricultural growth;
- For the export market, value added products (cheeses, processed fruits & vegetables, wine and brandy) offer the greatest potential;
- Limited availability causes processors to compete for a consistent source of quality raw products;
- Training in food safety, certification, quality requirements, packaging and basic management skills are needed to develop export markets;
- Land consolidation is needed to increase the quantities of raw materials available for processing;
- There is a need for trade associations (for both producers and processors) to influence needed legislation and government policy;
- The USAID and USDA programs generally do not overlap, but may compete for some of the best projects; and
- The USDA MAP credit programs (Strategic Loans, Producer Credit Clubs, AgroLeasing) should be subjected to an in depth assessment by a third party.

Market Assessment for Microenterprise Services in the Republic of Armenia
Chemonics International, February 2002

Methodology and analysis:
The assessment team conducted a review of policies, laws, regulations and supervision practices as well as socioeconomic trends within Armenia that can influence the size, nature, quality and development of MF products and services. The team held consultations through individual meetings with microfinance stakeholders, including domestic and international non-government organizations (NGOs), government funded development agencies, project implementing agencies, donors, commercial banks, foundations, limited liability companies, consultants, and microentrepreneurs. The Assessment Team developed two questionnaires for the study, used to collect comparable information and to quantify the responses.

Using the “Financial Systems” paradigm, the team analyzed the policy environment from both the macro and sectoral points of view, including a discussion of fiscal and monetary policies and policies affecting the agricultural and financial sectors, along with issues in the legal environment and in current or draft banking regulation and supervision.

Conclusions:

- Some of the activities that donors can support to create an improved enabling environment in Armenia are:
  - Policy awareness seminars and workshops for government officials
  - Encouraging new legislation to enable savings mobilization by appropriately regulated MFIs, accompanied by a medium-term component to develop regulation and supervision to implement the new legislation
  - Direct work with the CBA to improve understanding of microfinance issues, and further strengthening of the CBA in its capacity to supervise commercial banks activities in microfinance
  - Support proposed legislation on leasing and pledges of movable property, along with development of regulations and supervision procedures to implement the laws
  - Investigate design of an electronic payment or cash transfer system within Armenia.
  - Support development a private credit bureau
  - Consider support business development services (BDS) in the package
- USDA's credit activities in Armenia distort the market for loans to agriculture-related producers in Armenia and are not sustainable.

Commercial Legal and Institutional Reform Assessments for Europe and Eurasia: Diagnostic Assessment Report for the Republic of Armenia
Booz Allen & Hamilton, December 2001

Methodology and analysis:
The assessment was conducted by a team of six expatriate lawyers with assistance from USAID/Yerevan and local private-sector counterparts. The team reviewed laws, regulations, and related literature, relying heavily on prior work, with assistance in updating from local assistants and various legal professionals. In Armenia, the team interviewed numerous government officials, NGOs, multilateral and bilateral donor agencies, judges, lawyers, investors, businesspeople and investors to assess the commercial legal environment of Armenia.

Conclusions:
- Armenia's legal environment does not provide the stability needed to attract investment;
- The highest priority for long term commercial law development in Armenia is not in the laws themselves (except secured lending), but rather in institutionalizing systems of making and enforcing those laws already on the books;
- The new commercial court system offers an excellent opportunity to start changing the legal and judicial culture for enforcement of contracts;
- Armenian commercial legislation does not provide adequately for economic growth through the expansion of credit;
- Any efforts to improve the legal environment would have important spin-offs for other areas of USAID interest, including anti-corruption, the court system, the legislative process, civic education; and
- Even with good commercial laws and an improved institutional environment, small market size will continue to constrain trade and investment unless Armenia becomes involved in regional trading groups and develops strong trade links with neighboring countries.

USAID-Armenia SME Sector Assessment
PricewaterhouseCoopers, July 2000

Methodology and analysis:
The team undertook a review of current USAID Armenia economic reform activities relating to SME development. They then assembled and reviewed over one hundred documents (including assessments, studies, strategies, reports, sector and sub-sector surveys) provided by a range of Armenian national organizations, international donors and fund providers.

Using the collected data, the levels of stakeholder involvement (in terms of donors, government agencies, and private sector players) were defined; next stakeholder groups were further analyzed and divided into Macro, Intermediate and Sectoral segments (the sectoral level was further divided into industry sectors and sub-sectors).

The team supplemented the document review with meetings with over 150 representatives of the three segments, ranging from an Advisor to the President and various Ministers at the macro level, organizational representatives at the intermediate level, and actual owners and managers of firms at the sectoral level.

At each level, the SME Sector Assessment Team utilized SWOT analysis (one Macro-level SWOT; two Intermediate-level SWOTs, and ten sector and sub-sector level SWOTs) to focus on issues within each sector and sub-sector. The process also allowed a broader review and evaluation of the SME climate existing within Armenia to facilitate designs for potential resulting projects.

Conclusions:
The major external threats to potential expansion of SMEs generally fall under the responsibility of GOAM. The lack of a Strategic Plan for SME development is a highly significant obstacle, as is the lack of consistency and/or fully transparent laws and regulations regarding taxes and customs. The latter perpetuates bribery and the gray economy. All should contribute to an enabling environment for SME development but fall short. A restrictive policy on 'open sky' increases transport costs on imports and exports (nearly all of which are shipped by air) and severely limits new market development opportunities. The current inter-regional border issues practically stop new market development opportunities both with the lack of reasonably priced ground transportation alternatives. This is particularly evident with the furniture and building materials subsectors because of the weight of required inputs.

The team determined that the following sub-sectors show the most promise in terms of targeted support:

- Textiles and Shoe Manufacturing (sub-sector of Light Industry);
- Jewelry & Gem Processing;
- Tourism; and
- IT & Software Design (sub-sector of Communications Industry).

Appendix VII: Analysis of the Education Sector

I. The Role of the Education Sector in Economic Growth

Two decades ago, the U.S. was reminded that "Learning is the indispensable investment required for success in the "information age" we are entering."[23] There is widespread agreement that education is important in facilitating economic growth, and of the need for educational reform. Indeed, the importance of education and the need for reform are recurrent themes in developed countries almost as much as in transitional and developing economies.

Beyond education's importance in an information-based economy, *A Nation at Risk* quoted Thomas Jefferson on its importance for civil society:
I know no safe depository of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them but to inform their discretion.
The report spurred a discussion that continues.[24] Education is no less important now, and no less important for developing and transitional countries than for the United States.

The recognized importance of education is reflected in the vigor of the discussion, and in assessment of education in development assistance. A USAID overview recognized the methodological difficulties in isolating the contribution of education to economic growth.[25] Sources of analytic difficulty include variable lags between education and resulting economic growth, issues of data comparability among national data sets, variable data quality, lack of a standard measure of educational quality, and the contribution of informal education. The review notes that studies "found that the quality of education was also important, and in some cases, more important than quantity."[26]

Education is obviously a complement to other human and social capital. Significantly, even with effective education, "high levels of entrepreneurship are necessary to absorb [a] rapid expansion in skilled labor."[27] Nelson and Pack, examining countries in SE Asia, also attempted to estimate the significance of work experience. They conclude that an effective formal education sector is necessary, but not sufficient, for economic growth. Education must be accompanied by support for an environment in which entrepreneurs can create opportunities for skilled workers to be productive, and in which all workers have an opportunity to participate.

In its Poverty Reduction Strategy Paper (PRSP), adopted in August 2003, the Government of Armenia embraced education as a tool for economic growth. "Ensuring quality education and enhancing its accessibility in the medium and long run are among the most important factors for

[23] *A Nation at Risk: The Imperative for Educational Reform*, National Commission on Excellence in Education, 1983.
[24] 1998 saw publication of "*A Nation Still at Risk*" by the Center for Education Reform. An example of ongoing discussion is "*Twenty Years after a Nation at Risk*", Christian Science Monitor, April 22, 2003.
[25] *Human Capital and Economic Growth: Theories and Evidence*, USAID/W/EE/DGST, 2003.
[26] Id., p. 3.
[27] Id., p. 4, citing Nelson and Pack, Ec J, July 1999.

economic growth, as well as poverty and inequality alleviation. Further development of the sector is perceived as the utmost priority for economic progress."[28]

II. Analysis of the Education Sector

A. Soviet Legacy and its Aftermath

Armenia's education system has been greatly affected by the economic and social trauma following independence from the Soviet Union in 1991. Armenia was known for a tradition attaching high value to education, for having a literacy rate close to 100 percent, and for a comparative advantage rooted in its well-educated population. A devastating earthquake in 1988 was followed by trade disruption with the collapse of the Soviet Union, an unresolved war over Nagorno Karabagh, and resulting closed borders with Azerbaijan and Turkey.

Armenia faced a drastic deterioration in its education system along with other public services. The dramatic decrease in funding for education has made it nearly impossible for the country to maintain universal general education, or to meet the requirements of an emerging market economy and democratic society. The following problems faced by the education system stand out as particularly troubling:

- severe decline in public funding for education;
- deterioration of physical infrastructure;
- closure of schools and universities in winter due to energy shortages and lack of heat;
- lack of textbooks and teaching materials, and poor quality of those available;
- low teacher salaries resulting in many highly qualified teachers/university professors leaving the system for better paid job opportunities; and
- inadequate teacher training.

Armenia's well-established educational system avoids the task of building a system from scratch, but also includes the burden of reforming an operating institution. The current structure of Armenia's system could be described as a fusion of the former Soviet system and some elements of western practices, both European and American.

- ***Pre-school*** (kindergartens);
- Three tiers of ***general education*** (often times referred to as secondary education)
  - elementary school (grades 1-3)
  - middle school (grades 4-8)
  - high school (grades 9-10);
  - ***Vocational education***
  - preliminary professional beginning both in 8th grade and after completion of high school (craftsmanship)
  - middle professional (after 10th grade in technical schools and colleges);
  - ***Higher education/Universities***

Special education and out of school education are considered to be an integral part of the system.

[28] Poverty Reduction Strategy Paper, Government of Armenia August 2003, p.79.

Pre-school education has suffered most from the blows of the last decade. Most of these institutions (825) were transferred to local governments, which generally lack the resources to maintain them and now charge fees for enrollment. The number of pre-school institutions has declined 34.2 % since 1991, with enrollment down 18%, to 53,000.

General education in Armenia does not distinguish between "primary" and "secondary" education. Schools in Armenia are units inclusive of elementary, middle and high levels; separate schools for each level do not exist. This is an important fact in examining enrollment data, whether primary or secondary. Today Armenia has almost 1,400 secondary schools with 560,000 students attending. The number of institutions has increased 4.7%, in comparison to 1991; enrollment has declined 4.2%. Moreover, Armenia's general education system faces many and diverse problems, including inadequate funding, system inefficiencies, outdated curricula and inadequate assessment methods.

Vocational education has been affected dramatically, with the picture particularly bleak in preliminary vocational education. The 56 institutions now operating in the preliminary vocational system are 40% of the number of 1991. Enrollment has declined 93%, with the number of students attending now at 4,494. Alongside 77 state colleges or professional schools, 63 private vocational institutions were created, most of them in different parts of the country. However, enrollment has declined 13% since 1991.

Accompanying these quantitative indicators are a number of qualitative determinants contributing to the sector's decline. Undoubtedly, there has been a decrease in demand due to economic collapse. This results both from the inability of prospective students to pay, and the irrelevance of the training for likely job opportunities. In addition, there has been an explosion of private universities to attract those young people who formerly might have been enrolled in vocational education.

The developments in **higher/university level** education have fallen into the pattern typical of the overall system, but also have their unique characteristics. The system is comprised of 16 public/state universities with approximately 42,000 students. In addition, more than 70 private universities have opened in the last decade. Enrollment in public institutions has decreased 35% since 1991, primarily because of the introduction of paid tuition in state universities and the expansion of private universities. Even though tuition was necessary for survival of the system, the universities still face an array of problems, including outdated programs, curricula and teaching methods, loss of the best faculty, inadequate equipment, literature, and teaching materials, and limited access to information technologies.

B. The Current Situation

The need for educational reform is obvious, and the GOAM recognizes this need. The executive and legislative branches support education reform. The GOAM explicitly identified education reform in the PRSP. "The main objective for the education sector is to upgrade quality of education and enhance the access to it."[29] Further, the State [National] Program for Educational

[29] PRSP, p. 33.

Development for 2001-2005 (National Program, discussed below) was approved by Parliament and has the status of law.

Even though there is broad agreement on the need for reform, analytical issues (including data quality) are present in Armenia as much as elsewhere. There are a number of anomalies in alternative measures of secondary enrollment rates. The Mission is working with Washington to understand and reconcile these anomalies. The Quick Assessment for Armenia (QA) notes that "Primary school enrollment is said to be in the 80-85% range, which is down significantly from virtually universal enrollment during Soviet times."[30] The PRSP, though, reports virtually universal enrollment in general education.[31] The PRSP reports 2001 enrollment of 98.7% for ages 8-15.[32] Students ordinarily graduate at age 16 or 17, accounting for the enrollment rate dropping to 91.6% at age 16 and 88% at age 17. UNDP's 2003 Human Development Index shows Armenia's literacy rate at 98.5% of those age 15 and above. This data strongly suggests that those educated in post-Soviet years did well, despite the deteriorating system.

A similar data divergence was reported but not discussed in a World Bank paper.[33] For Armenia, the 2001 net enrollment in grades 1-9, reported from household surveys, was approximately 95%, substantially higher than the gross enrollment rates reported from official data.[34] The paper notes the Uzbekistan survey reports lower attendance rates than the official data, and treat this as indication of non-attendance. The Armenia data, on the other hand, report a higher attendance rate from the household survey than from the official data.

The most plausible explanation for this data anomaly in Armenia is that official data include families with children who are "temporarily" absent. That is, families with children are officially counted as resident in an area, even if they are "temporarily" living in Russia or elsewhere (and therefore not attending school). The absence of the children from school is accurately included in official data. The 2001 Armenian Census reports more than 200,000 citizens temporarily outside the country, with approximately 3,000,000 present. Anecdotal evidence suggests that "temporary" emigration may explain some of the "missing" students. The children accompany parents elsewhere for work, but are officially counted as resident. Often, the mothers return with the children when they are school-age. Other anecdotal evidence suggests that the relatively low rate for younger ages is also related to universal male conscription after school completion (which provides an incentive for a delayed start to delay completion). As noted above, the USAID/Armenia is working with Washington to understand and reconcile these anomalies. Both of these scenarios (conscription planning and emigration) are consistent with Armenia's observed enrollment rates by age. Enrollment in pre-school is quite low, at 11.2% for four-year-olds and 17% for five-year-olds.[35] Enrollment rises to 30% at age six, even though primary school enrollment formally begins at age seven (at which age enrollment is 47%).[36] The enrollment rate for eight-year-olds is 93.4%, rising to 98% for nine-year-olds.[37] Persistent

[30] *A Quick Education Sector Assessment*, Richard Dye, USAID, March 2003, p. 3.
[31] PRSP, p. 81.
[32] Id.
[33] *Public Spending on Education in the CIS-7 Countries: The Hidden Crisis*, Burnett and Cnobloch, WB 2003.
[34] Burnett and Cnobloch, pp. 7-8.
[35] PRSP, p. 81.
[36] Id.
[37] Id.

emigration underlines another aspect of Armenia's situation: Many of the most employable citizens emigrate to find work, while there is chronically high unemployment and underemployment among those who remain. The Armenian education system, with its many flaws, is producing more workers than Armenia can absorb, and these workers have exportable job skills.

The PRSP recognizes that the education sector is significantly overstaffed and that teachers are undercompensated. Armenia's schools have an average of 11 students per teacher, compared to 14.3 in OECD countries.[38] Armenia schools also have one non-teaching staff for each 18 students.[39] In 2002, the average teacher salary in Armenia was 41% of per capita GDP, well outside the OECD range of 96-145%.[40]

Even with all the problems, reform is underway in the Armenian education system. Through a World Bank (WB) program (discussed below), measures were undertaken to improve the financial condition of schools, creating incentives and mechanisms to allocate recourses more efficiently. The concept of per-pupil funding (instead of per-class) was introduced first on pilot basis, and was later expanded to cover more than 150 schools. By 2005, most of Armenia's schools are expected to have transitioned to the new funding model. To alleviate the financial burden for students and their families, the National Program envisions other measures related to the system of fees and paid services in pre-school and higher education. The GOAM acknowledges weakness in education management, and included reform in its national plan for education. The WB-financed program supported the establishment of school boards/councils and decentralization of authority. UNICEF also worked with school councils and student councils. There is abundant evidence of progress, as well as of the need for further progress.

C. Critical Issues

The GOAM in its PRSP identifies three primary goals for education reform: A refocus toward market requirements; enhanced quality to reach international standards; and improved accessibility.[41] The GOAM intends to pay "special attention to educational and training programs with the objective to smooth the gap between the job opportunities (supply) and requirements of labor market."[42] This is consistent with National Program priorities. The National Program includes extension of the per-pupil funding model and improved management; local control of schools and measures to increase accessibility; transition to a system with eleven years of general education; focus on market requirements for higher education; and modernized curricula and teacher training programs. These findings are remarkably similar to the "main needs" identified in the QA: "1) improve the quality, relevance, and efficiency of education services; 2) provide more equitable educational opportunities for Armenian children and young people; 3) improve employment opportunities for graduates; and 4) increase the engagement of

[38] Id., p. 79.
[39] Id.
[40] Id.
[41] PRSP, p. 81.
[42] Id.

parents, communities, the private sector, and the society at large in assuring that educational goals are met in a fair, equitable, and effective way."[43]

The capacity to manage reform in general education is closely linked to system inefficiency. This is why the reforms started by the GOAM and later supported by the WB focused (and will continue to focus) on rationalization of staffing patterns, increasing the current pupil-teacher ratio and the workload of teachers, and consolidating underutilized schools. Savings generated by these measures will be directed to increasing teacher salaries, upgrading teaching materials, and maintaining facilities and equipment.

Other goals set out in the National Program are:

- Transition to 11 years of schooling in general education;
- Study of market requirements for those holding bachelor's, certified specialist and master's degrees;
- Update of teaching plans, curricula, teaching materials to adjust the structure and the content of education to the needs of a market economy;
- Development of a unified fee discount system, provision of textbooks, social assistance to vulnerable children, and adequacy of curricula in secondary and special schools to ensure access and inclusiveness in education; and
- Improvement of teacher training methods, modernization of the content and structure of teacher training programs, reorganization of the teacher retraining system, and establishment of social protection mechanisms to provide educational institutions with adequate human resources.

The limitations rooted in current legislation and the existing regulatory framework are clearly understood by the GOAM. Refining the existing legislation, drafting and passing new legislation (particularly regulating private and vocational education), protection of education entities, clarification of roles and responsibilities, establishing standards, and ensuring consistency between education legislation and related legal acts (e.g., the Law on Local Self-government and the Law on Non-Commercial Enterprises) are seen among the priorities for system reform.

To reiterate, the Quick Assessment identifies four "main needs" of the education sector which are generally consistent with the PRSP and the National Program on education. The QA lists: "1) improve the quality, relevance, and efficiency of education services; 2) provide more equitable educational opportunities for Armenian children and young people; 3) improve employment opportunities for graduates; and 4) increase the engagement of parents, communities, the private sector, and the society at large in assuring that educational goals are met in a fair, equitable, and effective way."[44]

Of these four "main needs" two require action outside education. Employment opportunities for graduates cannot be improved significantly within the education sector. The problem is fundamentally an issue of stimulating economic growth to create employment opportunities, not of educating students for unfilled positions. As noted above, there is persistent emigration from Armenia to find work, and chronically high unemployment and underemployment among those

[43] QA, p. 14.
[44] QA, p. 14.

who remain. There is no evidence of skilled positions routinely going unfilled in Armenia. With all its flaws, Armenian education produces more skilled workers than the economy can absorb.

USAID/Armenia, of course, recognizes the importance of education in economic growth (as well as in the development of civil society). In Section I, above, we reviewed this area, and endorsed the GOAM's embrace of education as a tool for stimulating economic growth.

Improving the efficiency of education services involves, among other things, terminating employment for a large number of education sector staff. During the summer of 2003, the GOAM eliminated 4,000 teaching positions, leaving 54,000. The Mission agrees that improved education will require staff reductions as well as improved training for teachers and administrators. Consistent progress in this area, though, would be nearly impossible without improved employment opportunities for displaced teachers and administrators as well as for new graduates. The focus on employment opportunities in the USAID/Armenia Strategy for 2004-08 (the Strategy) directly addresses the need for improved employment opportunities.

The remaining "main needs" identified in the QA are explicitly addressed by the GOAM through a WB-financed project discussed below. Revised curricula, improved teaching methods and better management are an important part of this project. Improved access to education is another element. Decentralized control, with more community involvement, has already begun and will be extended in the continuation project.

To address underfunding of the system, the GOAM is planning to increase public funding of the system both as a percentage of GDP allocated to education and as a share of the state budget.[45] Increased funding for education, though, is necessarily linked to economic growth and enhanced governmental capacity. Effective education reform must be linked to broader strategic goals, to allow management of the process, funding of reforms, and jobs for the graduates and displaced teachers.

The inability of Armenian graduates to find adequate work in Armenia is universally recognized. A Labor Assessment of Armenia recognized that a significant impediment to employment is the dysfunctional labor market, in large part a legacy of the Soviet model rather than a set of market-oriented mechanisms. The "highest priority recommendations focus on improving the capacity of labor market intermediaries, starting with the GOAM Republic Employment Center and territorial employment centers."[46] Improving education is important, of course. The GOAM places a high priority on education, which is "an important and necessary activity that is being pursued as a high priority by both the World Bank and the European Union – in general education and vocational education, respectively."[47] Because of the high level of other donor involvement, in so many areas of education, the Labor Assessment generally recommends strategically selected "niche" roles for USAID, rather than a generic education objective.[48]

[45] PRSP, pp. 79-83.
[46] *Armenia Labor Market Evaluation and Strategy Assessment (Labor Assessment)*, Education Development Center, 2003, p. 4.
[47] *Labor Assessment*, p. 50.
[48] Id., p. 50.

USAID has identified and selected interventions that focus on addressing this need for better employment linkages between the populace and jobs as its best "niche" role.

Overall, the problems in Armenia's labor market have more to do with the weak functioning of that market than with the quality of labor available. A high quality, educated labor force is Armenia's historical strength, fully appreciated by the GOAM. There is a well-documented need for reform in education to improve the competitiveness of the labor force, and to improve the functioning of the labor market. The education sector has problems resulting from Soviet institutions and a decade of hard times after independence. International donors, though, are supporting the GOAM in a broad range of educational reforms. To be most useful, USAID assistance in education should be targeted to situations with promise of impact, such as improving labor market performance or developing skills for an emergent competitive cluster of businesses.

III. GOAM and Other Donor Activity

A. GOAM

The Armenian government has undertaken several measures to address issues in education. Three major documents establishing polices and priorities in Armenia's education sector were passed by the Government of Armenia (GOAM) over the last 5 years.

- The Law on Education was adopted in 1999;
- The State (National) Program for Educational Development for 2001-2005 was approved by Parliament in 2001 and has the status of law; and
- The Poverty Reduction Strategy Paper was approved in August 2003.

The GOAM's reform agenda is well-defined, even if slightly ambitious. The State Program admits the insufficiency of budgetary resources for implementing the reforms and calls for exploration of extra-budgetary resources, without, however, lowering the level of public funding. The implementation of reforms requires extensive donor involvement at all levels, either through carrying on existing programs or designing and implementing new programs. Donor activity in education has addressed all levels. Contrary to a USAID report[49] claiming that "higher education and research received substantially more aid than any other sub-sector" and that "no funds were recorded for secondary education," the World Bank project (later referenced in the report and discussed below) has targeted general education, and extensive further assistance has been approved.

The GOAM recognizes that the "reduction of public spending in the education sector gave rise to deterioration of the quality of education services."[50] It will be undertaking a second phase of education reform, contributing $3-$4 million in addition to a $52 million World Bank loan (discussed below). Armenia's 2002 expenditures on education, though, are only 2.2% of GDP, compared to the OECD average of 4.7%. The PRSP calls for this figure to rise gradually to

[49] Assistance to education in the Transition Countries from non-US Donors, USAID 2003.
[50] *PRSP*, p. 79.

3.8% by 2015.[51] The executive and legislative branches support education reform. Decentralized decision-making is making progress in Armenia.[52]

B. Donor Activity

The World Bank has been and remains the main player in general education in Armenia. The GOAM completed a WB-financed five year program (1998-2002) with three main components. This project, while addressing fiscal and efficiency issues, focused on textbook publication and provision, introduction of new financial mechanisms, decentralization of schools, and rationalization of the school system. The project, however, has had a limited impact on such qualitative aspects of general education as curriculum content, teaching methods or assessment methods.

The WB approved $1.2 million for a Project Preparation Facility in anticipation of a follow-on project that has recently been approved. The follow-on WB project was initially planned for $10-12 million and expected to run through 2007. Recent contacts with Bank management, though, point toward a dramatic increase in this amount. The WB now anticipates $52 million over a period of 10 years, in three stages. Successful completion of each phase will be a condition for funding the next. The rationale behind the Bank's decision is that GOAM has a well-articulated and prioritized reform strategy, and that it intends to build upon the successes of its previous project by focusing more on implementation of reforms.

The new WB project will have four principal components, in addition to assisting the Ministry of Education and Science (MOES) in project management and implementation:

- Development of a national curriculum and an assessment system designed to develop and measure the knowledge and competencies for the new economy;
- Integration of Information and Communications Technologies into the teaching and learning process;
- Modernization of teaching practices; and
- Assistance to the MOES to deepen ongoing reform for decentralizing school finance and management and improving the efficiency of the system.

The EU has made education one of its priority areas, focusing on vocational and technical education, higher education, and information technology (IT). This reflects Armenia's decision, as part of its campaign to join the Council of Europe (CE), to develop its higher education system along European lines.

The EU, through TACIS, has been involved in vocational training and education (VET). "Donor assistance to the VET sector has been limited up to now, with the EU and the German technical aid agency (GTZ) assisting small projects. However, this is due to change dramatically, with the EU's decision to make the sector one of its priorities."[53] Intervention in this sector started with the establishment of the National Observatory of Armenia. The observatory, located in the MOES, supports VET reform by collecting, analyzing and disseminating information, providing

[51] *PRSP*, p. 83.
[52] Burnett and Cnobloch, pp. 5-6.
[53] *QA*, p. 4.

policy makers with recommendations, advice and analysis. The Observatory's reports on the VET system underlie the EU-initiated project in the sector. TACIS saw VET as a sector in severe crisis due to low levels of state financing, lack of popularity of vocational education (closely linked to unemployment and the slow growth of manufacturing), and inadequate enabling legislation. TACIS therefore correctly identified VET as a sector in need of major restructuring.

The TACIS program has been significant scaled down since the QA was conducted. It is currently set at € 3 million over a 30-month period and is scheduled to begin in fall 2003. Program activities will be implemented in three limited areas:

- Policy and structure development: develop a VET strategy, design and implement a new VET law focusing on responsibility of the system, decentralization of VET decision making and financing;
- VET institutions: propose and implement reforms of the most important institutions for improving VET quality, including schools, modern training systems, training and upgrade of trainers; and
- Employment and labor market: develop reform measure for improving employment and labor market perspective of individuals.

The program intends to create/restructure a limited number of regional professional training/retraining centers, and develop and implement curricula for a limited number of subjects/professions. It will work in two regions of Armenia.

Other donors contributing to reforms and improvements in Armenia's education are the Open Society Institute (OSI), UNICEF, bilateral donors including the French, German, Italian, and British governments, as well as private donors. UNICEF is active in pre-school education, implementing a program aimed at the training of pre-school teachers and managers, as well as education of parents. It also has projects to teach life skills in schools, to print textbooks and to work with children in need of special protection.

The Open Society Institute (OSI) has multiple projects in education, including scholarships to study at the Central European University, London School of Economics, and the American University of Bulgaria; establishment of telecommunication centers in schools; and course development in humanities in higher education institutions. OSI's Step by Step project was launched in 1998 and supports improvements in pre-school and early elementary grades. Since 1999 the project has been expanded to cover nine marzes in addition to three cities, Yerevan, Gyumri and Vanadzor. Step by Step has focused on the needs of refugee children and other vulnerable groups.

Despite the absence of a designated UNDP education program, education activities are found within virtually all UNDP sector programs.

DFID does not have an explicit education program, but its work on public administration reform benefits public bodies in the education sector, such as the MOES, marz level education offices, and local governments. The German government, through GTZ, has maintained an interest in vocational education and is likely to be involved in higher education reform, as part of a broader

European effort. The Swedish international Development Agency (SIDA) was involved in development of the Education Management Information System (EMIS) at the MOES and has had a continuing interest in special education. The Dutch have done work in pre-school education.

The U.S. State Department actively implements programs in support of Armenia's education sector. Public Diplomacy (PD) programs in Armenia provide U.S.-based opportunities to conduct research (Regional Scholar Exchange Program, Freedom Support Act (FSA) Fellowships in Contemporary Issues, Fulbright student and scholar programs, among others), to pursue undergraduate or graduate studies, alumni support programs, and programs providing scholarships to high school students.

PD also works with Armenian schools to strengthen their capacity and train their teachers through its Elementary Level and Middle School Level Teacher Training Program. Another important program is the Civic Education for Armenia's Secondary Schools aimed at developing curricula, developing and publishing a Civic Education Teacher's Manual for 7th grade students and publishing quarterly journals. A major PD-sponsored program is the Internet Connectivity/School Linkages Program. Designed to provide secondary school classrooms across Armenia with internet access by donating Internet classrooms to schools, the program meets an important need of the sector by developing IT infrastructure. So far 220 schools out of almost 1,400 Armenian schools have been connected. It is anticipated that 350 schools will be connected by the end of the program in the next 6 months. A two-year extension to the project is currently under consideration.

In higher education, nine University Partnerships were established under a program administrated by the State Department designed to promote curriculum development and administrative reform.

In Armenia, the USAID-supported Eurasia Foundation has been relatively active in education. Included have been such projects as: online civics education; textbook translations; and libraries (with OSI). A $3 million IT project, focused on selected university faculties - journalism, economics, management, and computer sciences – is under development.

The contributions of the Diaspora to general education, while substantial, have focused heavily (90 % by one estimate) on school renovation and construction and provision of furniture, materials, and equipment, including computers.

Donor activity in education has addressed all the levels of education in Armenia. EU/TACIS will focus on vocational and technical education, and higher education. The follow-on World Bank project substantially targets secondary education, and supports continued decentralization. The U.S. Department of State supports a broad range of programs, from school internet connectivity to exchange programs for students and teachers at all levels. USAID/Armenia has supported a portfolio of strategically targeted education interventions integrated into substantive activities.

Armenian education receives extensive donor support at all levels, reflecting its high priority in the GOAM's development plans and broad popular support for education in Armenia. This situation is implicitly recognized in the PRSP's repeated statements of the need to increase the efficiency of the education sector.[54] The WB project includes assistance to MOES in implementing reforms as one of the elements of the program. Even with this heavy donor involvement, there remain opportunities in areas ranging from vocational education (which could complement the competitiveness/cluster analysis discussed below), technical assistance, and assistance in regions not covered by the WB initiative.

B. Remaining Issues

The problems of Armenia's education sector are embedded in, and cannot be isolated from, Armenia's broader need for development. Armenia's strong tradition of support for education informs the GOAM's emphasis on education in the PRSP and is reflected in strong donor support for education reform. The GOAM recognizes that education is inadequately funded and inefficiently delivered.[55] The funding level, though, reflects the dismal state of the economy rather than lack or regard for education. Similarly, the administration of education is not dramatically worse than administration at other government agencies. The presence of Soviet-legacy procedures is not surprising in a country that was part of the Soviet Union until 1991. As noted above, the GOAM recognizes the weakness in education management and the lack of clarity in the governing laws.[56] The WB-funded education program explicitly includes efforts to improve the MOES's administrative capacity and to provide a suitable legislative and regulatory framework.

Two of the principal threats to education in Armenia are the difficulty families have in supporting their children's education and the inability of graduates to find work. Legislative changes to improve access to education are important, but are necessarily restricted where half the population lives in poverty. Even if universal access to high-quality education were assured, though, it would be pointless if the graduates could look forward to no more than assistance while their children are educated. Sustainable education reform must include human and institutional capacity development, to allow entrepreneurs to find qualified workers, and educated workers to find jobs.

With other donor support for education reform, in general education, in higher education, and in vocational and technical education, USAID can make its greatest contribution by helping to remove impediments to effective reform, by identifying potential industry clusters with specialized skill requirements and assisting educational institutions to provide those skills, and to develop human and institutional capacity to support lifelong education.

IV. Strategic justification for anticipated involvement in education

USAID/Armenia includes Education as a cross-cutting theme rather than as a Strategic Objective in its Strategy for 2004-08 (the Strategy). This decision reflects consideration of twenty

[54] PRSP, pp. 79, 81, 85.
[55] PRSP, p. 79.
[56] Id.

assessments conducted by the Mission and recognition of Armenia's high educational potential as a national strength, as well as the deteriorating educational system as a constraint on growth and the GOAM's stated intent to improve its educational system. Other donors have made very substantial commitments to assist in reform, to the extent that there is potential duplication of effort, for example in IT, which is targeted by multiple donors.

Through its cross-cutting Education theme, USAID/Armenia anticipates a significant tactical involvement in education, targeted to its five Strategic Objectives. This Mission anticipates involvement in education beyond the illustrative activities described in the Strategy, although interventions will be selected to advance core objectives rather than purely addressed to educational reform.

The Strategy reflects careful consideration of a broad range of studies of Armenia and the role of education in Armenia's development, and a broad range of strategic options for education. One option, rejected early, would be to generally leave education to other donors. Under this approach, USAID/Armenia would attempt an intervention in education only if it happened to appear within an independently-planned activity. A major, and obvious, shortcoming of this approach is that it eliminates strategic thinking from an area as important as education.

To avoid this abdication of responsibility USAID/Armenia could, instead, more directly partner with the World Bank on filling one of the several gaps that they see in their project. This would necessarily be a small-scale effort within the context of the $52 million anticipated for the WB project over ten years. Whether implemented through loose coordination or through a tightly-integrated program (requiring even greater management effort), a specific focus on education would divert both managerial and financial resources from the Strategic Objectives chosen. As a practical matter, loose coordination may not be possible. The breadth and scale of the WB education program, coupled with the EU focus on vocational and technical education, and higher education, will require that USAID/Armenia design its education interventions to complement the structural reforms under these programs.

A third alternative would be to use education, within a Democracy and Governance Strategic Objective, as a vehicle to focus on corruption. This would not involve USAID in substantive education reform, but would complement broader system wide, curricular and other reforms of the WB project. This approach, while possible, unnecessarily restricts our ability to participate wherever we can be effective. USAID/Armenia is currently supporting teacher's associations and other civil society actors who see corruption as one of the greatest impediments to educational reform. The Strategy includes anti-corruption as a cross-cutting theme in part because anti-corruption cannot be consistently separated from the substance of activities. Just as significant for successful implementation of the Strategy, we think it likely that there will be substantive areas in which education interventions will be necessary to advance activities under a substantive Strategic Objective.

The approach chosen for the Strategy focuses on education as a source of new skills training within a broad competitiveness approach. The market part of the competitiveness/cluster work will be conducted through the Economics Strategic Objective, with most of the skills, education and training components of the competitiveness/cluster work conducted through the Democracy

and Social Transition Strategic Objectives. The competitiveness analysis is an important part of the Strategy and one that the Mission is preparing to move ahead with when the Strategy is approved. The Mission is recognizes that it must rely on assistance from DGST to make this approach work, and also our colleagues in the EG office in the Bureau.

The Strategy embodies nearly all of the recommendations of the Quick Assessment, in a structure that will guide development of specific activities. USAID/Armenia has added an Education specialist to the Mission staff who will continue analysis of the problems and opportunities in the sector, and facilitate dialogue with major sector donors.[57] By integrating targeted education sector interventions into substantive Strategic Objectives, high priority, and selected education activities will be better able to assist the long term sustainability[58] of Armenia's development.

USAID/Armenia has developed working relationships with key educational institutions as well as with other donors active in the education sector. A partial listing of education interventions demonstrates that each of the efforts has been strategically targeted. As part of its democracy and governance portfolio, USAID/Armenia worked with MOES and supported a Civic Education activity that trained teachers in every school in Armenia. To support health reform efforts, the Mission is working with the State Medical University and the National Institute of Health to develop a new, unified family medicine curriculum for Armenia. New programs in social work and actuarial science at Yerevan State University were developed as part of the Mission's social transition work. The USAID/Armenia private sector program supports new curricula in accounting and auditing, as well as a national accreditation system that meets international standards. The Mission provided computer laboratories in three universities to support efforts to develop the IT industry in Armenia. American professors provide training in applied economic research, raising the performance of participating local researchers.

The list of targeted education interventions could be extended; these examples are sufficient to demonstrate that USAID/Armenia has used targeted education interventions extensively, and strategically. There are certainly additional activities, and ways to undertake already planned activities, that address some of the systematic constraints in the education sector, without the massive Mission commitment to coordination with the World Bank or other education donors implied by a separate Strategic Objective for Education. The Mission's competitiveness/cluster work on the workforce skills training could – within the skills areas determined to be most promising – pilot approaches to vocational education that could be scaled up or replicated, in other areas, by other donors or the GOAM. As part of the anti-corruption cross-cutting theme, the Mission could develop approaches to deal with administrative corruption in schools. This would be an extension of current civil society work involving parent groups, local press reporting, and transparent citizen involvement.

Each of these interventions was undertaken through a substantive Strategic Objective, targeted to advance education reform in a high priority area. The interventions can be focused because the problem in education can be demonstrably linked to a problem in the broader society. Education

[57] USAID/Armenia Strategy for FY2004-2008, p. 45.
[58] QA, p. 23.

reforms not only advance the substantive development activity, they also act as demonstrations of broader reform possibilities.

USAID/Armenia proposes that future education interventions be integrated with strategic objectives, rather than undertaken as stand-alone activities. It is not possible, or desirable, for a five-year strategic plan to identify all tasks within the plan. Even so, the Strategy clearly contemplates education and Human and Institutional Capacity Development (HICD) interventions under multiple Strategic Objectives (SOs), designed to advance the development of Armenia. SO 1.3 calls for analysis to identify potential competitive clusters. In turn, targeted education and HICD interventions will allow firms in those clusters to excel. SO 2.1 specifically includes legal education as part of its rule of law and youth focus. SO 3.2 identifies strengthening schools of medicine among its illustrative activities. Through public works programs in SOs 1.5 and 3.4, USAID has consulted with MOES to select schools for upgrading, with renovated heating, indoor plumbing, and electrical systems. Other activities under SO 3.4 will enhance skills training and labor development programs to more closely align labor supply and demand, in an effort closely linked to the Mission's work in SO 1.3; once industries in which Armenia has a comparative advantage are identified, the labor development portion of SO 3.4 will work with employment centers to train people in the skills these industries demand, thereby working to increase employment in the country. The Mission plans its first HICD pilot for these employment centers. SO 4.2 includes Education and HICD among cross-cutting themes. To reduce financial barriers to education, a pilot student loan program recently began at the American University of Armenia, with USAID support provided through the Eurasia Foundation. The Strategy plainly anticipates activity in the education sector, targeted to advance substantive development objectives.

The Mission agrees that among the needs of Armenian higher education is continued access to U.S. models and resources. USAID/Armenia intends to avail itself of the expertise within DGST for assistance in planning activities that fit within its proposed SOs. This will ensure that some of these activities can provide models for the broader systemic reform in education that is essential for Armenia to develop and provide the skills its private sector and its citizens need to succeed. With Armenia's decision to develop its educational system along European lines, and the very substantial assistance from other donors to assist in that development, we believe that Mission education interventions should be carefully tailored to the requirements of specific development activities. The Mission anticipates continued support to make U.S. expertise available where needed. This assistance, like all Mission efforts, will be strategically designed to help create a more secure, democratic and prosperous Armenia, aligning our strategy with the Department of State/USAID Mission: "Create a more secure, democratic and prosperous world for the benefit of the American people and the international community."[59]

[59] Strategic Plan Fiscal Years 2004-2009, U.S. Department of State and USAID, 2003, p. 1.