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**UNITED STATES DEVELOPMENT
STRATEGIC PLAN**

FOR

ARMENIA

FY 1996-2000

April 1996

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USAID/ARMENIA

STRATEGIC PLAN - FY 1996-2000

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ABBREVIATIONS

AIOC - Azerbaijan International Operating Company
CBIHA - Coordination Bureau for Interational Humanitarian Assistance (Georgian Government organization)
CEPAR - Center for Economic Policy Analysis and Reform (Georgia)
CEPRA - Center for Economic Policy Research and Analysis (Armenia)
CIS - Commonwealth of Independent States

CLAU - Caucasus Logistics Advisory Unit
CUG - Citizens' Union of Georgia
DOT - U S Department of Treasury
EBRD - European Bank for Reconstruction and Development
EC/ECHO - European Community Humanitarian Office

ECU - European Currency Unit
EPS - Electronic Payments System
EU - European Union
FMS - Financial Management System
FSU - former Soviet Union

GANSP - Georgia-Armenia Nutritional Supplement Project
GDP - Gross Domestic Product
GIOC - Georgia International Oil Company
GOA - Government of Armenia

GOG - Government of Georgia
GTZ - German aid program
IBRD - International Bank for Reconstruction and Development (World Bank)
ICRC - International Committee of the Red Cross
IDP - Internally Displaced Persons

IFI - International Financial Institution
IFRC - International Federation of the Red Cross
IMF - International Monetary Fund
IOM - International Organization for Migration
IR - Intermediate Results

ITIC -
NBG - National Bank of Georgia
NGO - Nongovernmental Organizations
NET - NIS Exchanges and Training Project
NIS - New Independent States of the former Soviet Union

MW - megawatts

MVD - Georgian State Police

OSCE - Organization for Security and Cooperation in Europe

PAROS - Armenian Government's needs-based voluntary registration program for humanitarian assistance

PVO - Private Voluntary Organization

SCF - Save the Children Federation

SIF - Social Investment Fund

SME - Small and Medium Enterprise

S O - Strategic Objective

STF - Systemic Transformation Facility (IMF)

STI - State Tax Inspectorate (Armenia)

STS - State Tax Service (Georgia)

TACIS - technical assistance program of the European Union for the former Soviet Union

UNDP - United Nations Development Programme

UNHCR - United Nations Human Rights Commission

UNICEF - United Nations International Children's Fund

USDA - U S Department of Agriculture

USGS - U S Geological Survey

VOCA - Volunteers in Overseas Cooperative Assistance

WFP - World Food Program

WTO - World Trade Organization

PART I SUMMARY ANALYSIS OF ASSISTANCE ENVIRONMENT

A U S. FOREIGN POLICY INTERESTS

Armenia is a strategically important republic in the Caucasus which is engaged in a transition to restructure and achieve a market-oriented economy and democracy. Its political stability and economic development is inextricably linked to its success or failure as a market economy. Armenia is important to USG interests because the economic and political transition taking place offers real prospects that it will emerge as a western-oriented participant in world markets -- a model for other NIS states. Armenia could become an island of political-economic independence with an open door to both Europe and Asia. With the settlement of the Nagorno-Karabakh conflict Armenia could also provide the necessary leadership to promote economic integration and political cooperation within the Caucasus.

The country's stony landscape holds few resources except its people -- resourceful, stoic, resilient to hardship, intelligent, homogeneous, proud of their culture, and ready for change. Armenians have seized the opportunity to reform both the economy and their society. Armenia earnestly seeks western advice to formulate its economic, political and social reforms. United States humanitarian and development assistance is important to achieving a strong market economy and a democratic transition.

The potential for economic growth and democratic reform is enhanced because Armenia is small and the population (3.25 million) is over 95 percent Armenian. Before 1991, Armenia's economy was a mixture of agriculture, industry, high-technology and culture. Most of Armenia's markets collapsed when the former Soviet Union disintegrated. Almost all agricultural land has been privatized in contrast to many FSU countries. Urban dwellers, including doctors, engineers and teachers have taken up farming on small plots to feed their families. Armenia's factories operate at 30 percent of capacity. Azerbaijani and Turkish blockades have closed historic trade routes. Manufacturing output is low and unemployment high.

In spite of meager growth since independence, the country has made progress towards a market economy and a democratic society. Since independence inflation has been contained, there is a stable currency, real output is beginning to increase, and Armenians approved a democratic constitution (July 1995). Substantial growth for land-locked Armenia is, however, unlikely to occur until it re-establishes trade ties with Turkey and Azerbaijan.

Like other countries of the Former Soviet Union (FSU), Armenia's economic development has been constrained by the legacy of Soviet central planning and a state planned economy dependent on raw material imports from other parts of the USSR. The privatization drive and economic reforms seek to displace the former trade, payments and financial systems. Remittances from the diaspora in Western Europe and America, humanitarian aid and income from informal economic activity sustain Armenian families.

They have not, however, created a dynamic private sector and increased legitimate business activity in new goods and services

Conflict over the predominantly Armenian populated Nagorno-Karabakh region has led to a trade and transport blockade by Azerbaijan and the closure of the Turkish border since 1991. This blockade exacerbates living and economic conditions and contributes significantly to high energy costs. Electricity is available 8-12 hours per day in Yerevan, but less in other cities, and often nonexistent in rural areas. Some progress has been made in resolving the conflict and a ceasefire has been in place for more than a year, but borders are unlikely to be opened until there is substantial progress toward a permanent peace settlement.

There is a unique opportunity to build a market-based, democratic society grounded in the rule of law if Armenia develops its external markets quickly, and effectively utilizes its highly educated, technical labor force. If it can attract outside investment it should be able to compete effectively in external markets. The Government must seek expertise in economics, law, commerce, finance, government and social welfare to achieve sustainable economic and political growth. It must import and absorb technology at a high rate to become an emerging market, prized for its skilled labor. Armenia's leaders must strive to create an enabling environment for economic and political growth that promotes rather than controls business. If such a strategy is pursued, it is USAID's judgement that Armenia can become an economic leader and model for reform in the Trans-Caucasus. As the reform program begins to stimulate growth there will also be considerable scope for expansion of regional economic cooperation among Georgia, Armenia and Azerbaijan.

B OVERVIEW AND PRIORITIES

Armenia's five development challenges

- replace citizen pessimism with optimism for market-oriented economic, political and social reform,
- replace crisis management with longer-term planning horizons--a behavioral change at the government and household levels,
- generate sufficient exports to finance imports to achieve sustainable economic growth,
- develop a robust investment climate to launch an "emerging market" to sustain economic growth in the 21st century, and
- develop government functions and strengthen institutions which encourage civic responsibility and discourage corruption and malfeasance

As in other post-Soviet republics, Armenia needs to achieve significant progress in economic and democratic reform over the next five years. Armenia's resources are significant: a skilled and educated work force, a homogenous population with strong national identity, and strong support from a large international diaspora and the international community. However, Armenia's highly skilled labor force will not remain fixed. It is important that Armenia move quickly to establish the required enabling environment to mobilize domestic savings and attract large amounts of external investment.

The Armenian economy remains largely based on foreign assistance and remittances from its diaspora. Regrettably, Armenia does not have an obvious present day comparative advantage: it has few exports, it has few industries ripe for foreign investment, and it does not have sufficient natural resources. One-third of its industrial capacity was destroyed by the 1988 earthquake. The country must strive to be an exporting and trading nation. This is difficult given its near total dependence upon external energy sources and only the beginnings of a legal and regulatory framework to facilitate external investment and the development of competitive markets.

Armenia's transition toward a more global political economy has been partially derailed by the conflict with Nagorno-Karabakh and because of stalemated relations with Turkey. The major economic, political and social challenges Armenia faces in its post-Soviet transition have been greatly complicated by its inability to solve these two issues. The trade embargo imposed by Azerbaijan and Turkey has isolated Armenia geographically and economically. Alternative transport routes through Georgia are both high cost and risky.

Despite considerable progress with macroeconomic stabilization, energy shortages have had a devastating impact on industry and left large segments of the population to face

winters with little or no residential heating. Living standards are now beginning to improve. Official unemployment is underestimated at 7 percent, and the social safety net has deteriorated severely. The energy and transportation networks function, but require maintenance and modernization to support domestic output and an export drive.

These problem areas are interrelated. Technical improvements aimed at relieving energy shortages will not remove the oil and gas embargo imposed by Azerbaijan and Turkey. But solving the energy crisis will improve the basic quality of life as well as the investment climate. This in turn should enhance the political will to move forward more rapidly on economic restructuring and with democratic and legal/judicial reforms. Finally, improvements in the political process and in the rule of law, and a greater and more effective voice from pro-reform constituencies, will help keep the transition process moving forward, and more rapidly.

USG assistance to Armenia in 1992-94 focused on humanitarian assistance. The human crisis was so acute that USAID dedicated its resources to work through international organizations, PVOs and NGOs to provide food, fuel and medicine to the population, primarily to relieve suffering from the harsh winters following imposition of the blockade. In the latter part of 1994 the IMF negotiated Armenia's first Structural Transformation Facility (STF) which imposed conditionalities to achieve economic stabilization and some institutional reform. The positive response of the Government to move decisively towards economic reform has given the donor community confidence to begin to shift funds and technical assistance away from humanitarian assistance and increasingly to development assistance and economic reform.

In FY 1995 and 1996, it has been possible to focus additional resources on economic restructuring, energy development and democratic reform while continuing to address immediate humanitarian concerns. Increased resources made available through a relatively large earmark for Armenia in FY 96 permit a larger technical assistance effort and development of a new Caucasus Enterprise Fund to increase access to capital, nevertheless, humanitarian assistance still commands over half the budget. The shift toward greater focus on development and reform will continue during the planning period, and should accelerate as the peace process succeeds and Armenia's economic isolation is broken.

The Strategy presented reflects USAID's resolution to provide new forms of assistance to both government and the private sector. To meet these challenges, USAID is working with the Government, Armenian citizens, and donors to shift the emphasis to support economic restructuring, democratic initiatives and social sector restructuring. USAID is realigning its priorities to address these challenges, limiting itself to those sectors where it can have significant impact within a three to five year timeframe, from FY 1996-2000.

Economic Restructuring

The Government has made impressive strides in paving the way to a market-based economy by bringing inflation under control via tighter monetary policy, stabilizing the currency, liberalizing most prices and trade, and privatizing some state-owned enterprises. However, more needs to be done to ensure that macroeconomic stability is sustained and leads to business growth and development.

Armenia's future lies in external markets. Local markets are too small to achieve sustainable economic growth. The Government has moved to remove trade clearing arrangements with Russia and Central Asian partners. Now, the private sector and Government must work together to replace barter with financial transactions in competitive global markets. Legitimate business activities in the production and export of goods and services must replace short term trade-oriented profit-taking.

What can Armenia sell in global markets? The Armenians believe that they have a comparative advantage in high technology, light manufacturing and high-value horticultural crops. However, they know little about the requirements of the markets they wish to penetrate. Nor does the government have the full trust of those who have to compete for jobs, or of investors who seek returns on their investment. Armenia must enter its markets of choice soon or it will lose opportunity. Privatization of viable industries and their sale to investors who have a track record of corporate profits in external markets is the key to restarting production and to mobilizing domestic savings and attracting foreign investment.

To attract foreign investment Armenia must be prepared to absorb foreign technology in order to put its highly educated labor force to work. It must determine how best to match domestic resources with real opportunities in western markets. Then, it must embark on importing technology to match its priorities. An alternative is for Armenia to try to retrain its labor force and retrofit its industries, but this would not produce significant results, nor is it the appropriate strategy given Armenia's present circumstances.

The Government is in the process of establishing an export-import guarantee agency and providing subsidized insurance to exporters. These efforts should foster external trade. Tax holidays prorated for the amount of foreign direct investment exist, but there is still a bewildering array of special licenses, fees, customs and bureaucratic impediments that turn off foreign investors and drive businesses underground. Petty corruption is a nuisance that outside investors will not tolerate. Armenia's infrastructure is in comparatively good shape--basic utilities and transportation function, but need rehabilitation and are poorly managed. Zvartnots Airport is largely automated but operates like a third-world facility--it is the first and last impression that a potential investor sees on a visit to Armenia.

However, Armenia cannot wait to attract foreign technology because its citizens are voting with their feet. An estimated 400,000 younger persons, many with technical and professional skills, have emigrated since independence.

Like Japan and, now, China, Armenia needs to draw foreign companies into joint ventures, encouraging them to license their technology to Armenian firms. Outside investors will realize quickly that most Armenian factories and labor skills are not immediately appropriate for western markets. Thus, Armenia must be satisfied with less sophisticated manufacturing, for example, assembling componentry or parts manufacturing for the next 2-3 years. Once new technologies are imported and domestic savings increase, domestic markets for cheaper goods will develop. Armenian electronics including televisions may be an example. Ultimately, Armenia can develop its own products and services to compete successfully in the global market. To initiate this growth strategy Armenia should begin by selling its most profitable state-owned enterprises, permitting foreigners to purchase firms outright, or own controlling interests where the potential for profit is high. New investment, technology and management will lead to increases in jobs, output, exports and national income.

Private enterprise constitutes the core of a market economy yet privatization of medium and large state-owned enterprises has lagged, particularly when compared to encouraging progress in privatizing small firms, land and housing stock. While land privatization confers tenure and does allow resale, there are no market structures and legal property rights, and consequently no viable real estate market.

Armenia's economic plight is largely a function of the structural deficiencies of Soviet central planning, the shocks resulting from the breakup of the FSU and the economic blockade. One of the legacies of the Soviet era is a structure of production and trade that was unrelated to the natural resource base. Hence, supply and demand were linked artificially. A principal challenge for the Government and the private sector is to reunite production with markets, thereby establishing clearly Armenia's comparative advantage. Previously, the country's productive capacity was highly dependent on clearing trade with other Soviet Republics in Soviet-style high technology and manufacturing. Now, Armenia must import virtually all of its raw materials and energy. The rupturing of trade links with its former partners together with the huge increase in costs of energy and transport resulting from the blockade contributed substantially to the initial plunge in GDP during the first years after independence. The country inherited a disproportionate share of the Soviet military-industrial complex, including facilities to produce high technology lasers and electronics which now lie idle.

While leaving the Soviet legacy behind, the new democratically elected government has not encouraged the development of internal and external markets. This is due in part, to the focus on meeting IMF and World Bank conditionalities to achieve economic stabilization. However, Government leaders seem less able to stimulate private enterprise. The Government has not privatized industries that could under new ownership and management generate profits and tax revenues, it has not directed national expenditures towards development priorities, it has not curtailed corruption, and, it has been slow to put in place a legal and regulatory framework to promote private investment. The market economy is growing, but it is an "insiders game." Only a small amount of formal business activity is

visible--the rest involves a myriad of contracts in Government and with other businesses, the sum of which creates economic dysfunctions and foreign investor jitters. Soviet business customs prevail because there are few examples of how to do business any other way. Without western oriented laws and regulations governing property rights, contracts, banks and commercial transactions, Armenia is unlikely to allay the doubts of prospective domestic and foreign investors.

The government must begin to evoke more trust from its business community. Armenia must not only enact commercial laws, it must have the capacity to enforce them. Even though key laws have recently been passed no one knows what they mean or how to implement them. A weak judiciary cannot adjudicate contract disputes or enforce even laws and regulations.

With limited resources and time, USAID will focus on the financial and fiscal sectors, development of private enterprises, and the energy sector. While privatization is unquestionably essential as an underpinning of a market-based economy, USAID has not selected transfer of state-owned assets as a strategic objective. EU-TACIS has been and continues to be the primary donor supporting the privatization process, which has seen its greatest success among smaller enterprises, land and housing. Government of Armenia commitment to privatization of medium/large enterprises through transparent and competitive processes is not clear, and assistance in enterprise-by-enterprise preparatory work, as requested by the GOA, is not cost effective.

The financial sector is a USAID focus because it is primary to the development of internal and external markets and is a basic service which business and citizens urgently need. New business development for internal markets is impeded by a lack of western oriented commercial banks, better supervised by a stronger, market-oriented central bank. The population does not trust the banking system, with good reason because half have become insolvent in the last 18 months. Approximately 20 commercial banks have survived and are more or less sound prudentially. However, additional banks will fail as financial markets improve. Bank managers and staff are ignorant of international lending procedures and other banking services like commercial paper and financial markets. Collateralization of assets for loans, cash flow management and marketing are new skills that bank officers must acquire on behalf of their credit hungry customers. Outmoded accounting procedures are commonplace in the banks, industry and government ministries, limiting prudent asset management, loan decisions and the accuracy of financial statements for internal and external financial transactions. Finally, the emergence of an active private sector is impeded by the embryonic state of capital markets to finance new business investment and government spending. There are two private stock markets, but enabling securities laws and procedures to organize investment funds, securities markets and government bond sales are required.

The Government has not taken enough action to improve its own fiscal performance and set its development agenda on a straightforward course. The national budget is filled with pork-barrel projects and fiscal performance is poor. Tax laws need to be modified to

support trade, investment and small business activity. Ineffectual fiscal performance begins with the lack of a national budget law and an effective tax administration. Housing stock and agricultural land, virtually privatized, is not turning over in the formal marketplace, and in turn, is lost as collateral for lending.

The lack of indigenous energy resources and dependence on archaic supply and distribution systems of electricity, gas and oil has plagued the Government since independence. The energy crisis has been further exacerbated by the closing of direct gas and oil pipelines from Azerbaijan. These factors have forced the Government to drastically limit energy supplies to citizens, industries and small business, thus creating enormous hardship and slowing the pace of economic recovery. The Government knows that positive steps must be taken to alleviate this situation. The opening of the Medzamor nuclear power plant in December 1995 while not supported by the US Government has increased the availability of power.

Despite partially solving the supply and generation problems, Armenia is still faced with the need to restructure the energy sector to make utilities commercially viable and to rehabilitate inefficient urban distribution systems. Energy related legal reforms and regulations must be enacted so the sector becomes an asset to the economy rather than a liability.

The impact of USAID's technical assistance efforts in economic restructuring is enhanced by careful coordination with work of other donors, including the IMF and World Bank.

USAID is coordinating with the World Bank the delivery of TA to assist the GOA in drafting a general energy law and establishing a national regulatory commission. Also, USAID/C and TACIS are providing TA to improve metering and collection practices of electrical generation and distribution companies under Armenergo, the National electric utility.

Democracy and Governance

Like other countries emerging from the shadow of communist rule, Armenia is struggling to consolidate nascent democratic governance. Following parliamentary and presidential elections in 1991, the executive and legislature were able to function in a relatively democratic manner. However, beginning in late 1994, there was growing concern that the Armenian Government was taking steps aimed at reducing open criticism of the presidency and to ensure a weak and compliant parliament and judiciary. At least in part, these steps reflected the government's response to increasingly hostile political attacks by a nationalist opposition for refusing to annex Nagorno Karabakh and for seeking to improve relations with and open the border to Turkey.

In the months leading up to parliamentary elections and the constitutional referendum on July 5, 1995, the powerful Armenian Revolutionary Federation (Dashnaksutiun) was banned, the applications of several parties were invalidated by the Central Election Commission, a number of political dissidents were jailed, and several newspapers were closed down. The actual election was found by international and local observers to be relatively "free" in terms of election day processes, but not "fair" in that the outcome favoring the government party appeared largely predetermined. A large percentage of the votes cast (estimated as high as 40%) were determined "invalid." The outcome of the election left the government party with about one half and the government coalition with about three quarters of all seats in the National Assembly.

The constitutional referendum resulted in a newly ratified constitution with provisions establishing a powerful presidency, weak parliament, and weak judiciary. The President is given the power to dissolve the parliament, appoint directly or indirectly all members of the judiciary, appoint all regional governors and, through the Prime Minister, to dismiss popularly elected mayors.

These points call into question the political will of GOA leadership for accelerating the progress in developing effective institutional checks on the executive, at least in the near term. One factor that makes Armenia somewhat unique among former Soviet republics is the greater than usual influence the USG may have in terms of policy dialogue. This influence reflects both the major U.S. role in Armenian assistance and the large Armenian-American diaspora. Ultimately, however, sustainable democratization must be an internally driven process with pro-reform constituencies able to freely organize, express demands, and enter into the governing process.

And in fact, there have been positive signs in the last six months pointing to a modestly growing civil society, and equally modest -- but critical -- signs of independence within the elected National Assembly, and to a lesser extent, the judiciary. The political environment has been relatively stable and open since the July elections, and the GOA has been responsive to recommendations for improving the transparency and fairness of the upcoming presidential and municipal elections. The next five years will prove crucial in determining the direction and depth of democratic reform in Armenia. USAID strategy in democracy and governance will concentrate limited DG resources on citizen participation and legal reform, areas in which we believe important windows of opportunity exist to promote and sustain Armenia's democratic transition.

C CUSTOMER FOCUS

In developing the Strategic Plan for Armenia, USAID/C first identified the array of customers who would ultimately benefit from the results presented in the Strategy. Looking from the grass roots level up, customers include vulnerable groups within the general population, refugees and IDPs and their families, community groups (NGOs, political parties, and various associations), small and medium entrepreneurs, local and municipal government entities, national ministries and the National Assembly. Then based on the Mission's knowledge of Armenia's economic, social and political circumstances and consultation with the key customers, (Ministry of Finance, Ministry of Economics, Ministry of Energy, State Ministry of Agriculture and Food Production, Parliamentary Committees, and various NGOs), results frameworks and timelines were developed.

Though customers were less directly involved in the preparation of the strategy, the Mission has a long standing cooperative relationship with the customers in developing the various program elements which will contribute to the achievement of intermediate results, and ultimately the strategic objectives.

The Mission will prepare a Customer Service plan, as required, in the near term.

D. TRANSITION ISSUES

Most Strategic Objectives in this Strategic Plan will require the full planning period of five years. Whether a point of irreversible progress is achieved will, in most cases, depend on several fundamental factors outside the control of USAID and other donors.

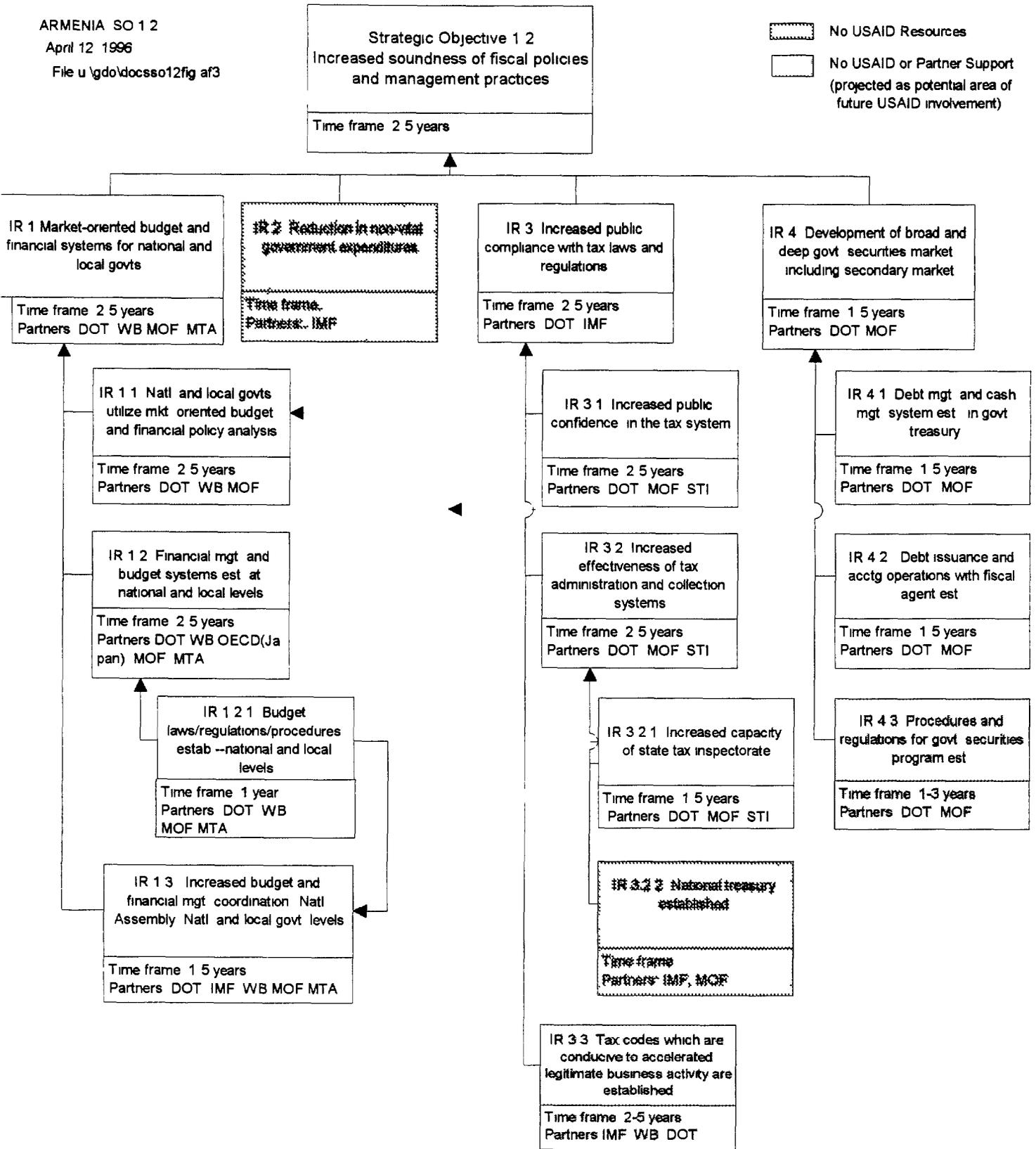
- * Resolution of political conflict and lifting of the blockade, this is critical to achievement of objectives in economic restructuring, the reform of the energy sector, and to alleviation of the continued need for substantial humanitarian assistance. Without such resolution, most SOs will at a minimum require additional time.

- * Political will to undertake the fundamental changes in economic and legal reform required to make Armenia an attractive partner for trade and investment and to encourage Armenians to stay and invest in their country's future, rather than "voting with their feet." Donors can assist in defining the needed commercial/economic legal and regulatory framework, but only Armenians can make these changes happen.

- * A will to balance political power among the executive, legislative and judiciary, to establish the rule of law, and to deal with corruption which undercuts trust and creates systemic disfunctions.

Within this "big picture", this strategic plan has defined specific intermediate results which should be possible to achieve over the time frame toward the transition to a democratic,

market-oriented economy Specific critical assumptions to achievement of the identified intermediate results are discussed in each SO section



Critical Assumptions

- 1) Relationship between USAID and U.S. Treasury remains collaborative and productive
- 2) Servicing of external debt does not constrain sound fiscal management

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PART II STRATEGIC PLAN ELEMENTS

A. Rationale and Plans for Strategic Objectives

ECONOMIC RESTRUCTURING

Strategic Objective 1 2 Increased soundness of fiscal policies and fiscal management practices

Problem Analysis

While macroeconomic stability has, by and large, been achieved, responsible fiscal management is necessary to encourage investment, thereby leading to expansion of the economy, and to improve services to the public. Beginning in late 1994 substantial progress was achieved to improve public expenditures as evidenced by reduced deficit spending and the removal of many cross-subsidies. This effort must be matched with efforts to improve tax codes and administration for functions like collections and the restructuring of the budgetary system with new financial management systems, and elimination of remaining ineffective subsidies. The lack of an internationally-accepted, market-oriented national budget law and treasury functions are a major impediment to fiscal reform. Assistance to the Government is needed to develop new financial functions for accounting, treasury operations and executive budget formulation, execution and control. The next step will be to assist the Government develop a computerized financial management system (FMS) that incorporates the new executive budget and treasury functions. Until market-oriented budget and financial systems are operational at the national and local levels, the GOA will not have adequate guidelines or incentives to make productive and appropriate budget decisions.

The need to increase public compliance with tax laws and regulations, and develop a broad and deep market for government securities both reflect the importance of increased governmental revenues in order to facilitate responsible fiscal management. Without revenue increases, severe pressures will lead to distorted budgeting. U.S. Department of Treasury (DOT) advisers are working to develop a more transparent and fairly administered tax system, which will increase public confidence and compliance, other DOT advisers will help develop the government securities program.

USAID has assisted the State Tax Inspectorate (STI) to develop a system to implement a property tax system which builds on USAID-funded International City/County Management Association's (ICMA) work with property registration. Assessment of property relies on normative methods. For agricultural land these are the values assigned to land categories based on productivity. In urban areas, normative methods approximate market value by adjusting historic "inventory" values for locational and other factors. Property taxes are set extremely low while transfer taxes are 10 percent. The transfer tax dampens investment and encourages evasion of reporting and registration requirements for real estate transactions. Some tax laws are onerous to business and should be abolished or revised. The main problem with the STI, however, is the administration of the tax system. The STI needs considerably more training in audit supervision and processing tax returns. STI

revenue agents are licensed, but since most taxpayers do not file returns, agents succumb to bribery or extortion to collect taxes, with agent and taxpayer never knowing what the actual legal obligation is. A tax payer education service program should be a high priority. However, taxpayers probably would not participate in an improved program unless there were penalties for not honoring tax obligations. At present, penalties will not be effective as there is no tax court or procedures to try tax fraud cases. Assistance is required to develop a cost-effective system of tax enforcement and adjudication.

Results Framework

See Results Review and Resource Request (R4) Part II

Judging Performance

See R4 Part II for performance assessment data

Overall Progress

During 1992-93, Armenia incurred high fiscal deficits and experienced hyperinflation as a member of the disintegrating ruble zone. The Government introduced the *dram* in November 1993, tightened government spending and strengthened the Central Bank's independent control over money supply and prudential norms for commercial banks. The IMF's Structural Transformation Facility (STF), Institutional Rehabilitation Credit from the World Bank in December 1994 and humanitarian assistance from USAID, the European Union and other donors throughout the past two years permitted fiscal policy conditionalities to take hold. The *dram* has emerged as one of the stable currencies among the NIS states, with about 5 percent annual fluctuation against the dollar in the past 12 months--the dram is fully convertible and there has been a small, real appreciation in its value against the dollar. In 1995 and 1996 the Government continued to liberalize prices, charge user-fees, downsize the civil service and push ahead with the privatization of state owned enterprises. Average monthly inflation fell from over 28 percent in 1994 to 1.9 percent for the first 11 months of 1995. The fiscal deficit fell from 56 percent of GDP in 1993 to 16 percent in 1994 and is expected to be under 9 percent in 1995, principally due to sharp cuts in expenditures.

In spite of the dramatic improvements due to tight fiscal and monetary policy, the fiscal situation is weak. There is no market-oriented budget process or understanding of budget planning at the national level, particularly in the National Assembly, the problem is exacerbated at the level of local government where new administrative districts have been formed to assume responsibility for local services and capital development. There is no national treasury function, which impedes government planning and cash management. Although Armenia has a liberal trade regime to support private enterprise, tax codes and regulations are not sufficiently liberal to attract foreign investment. Even if the tax codes were more conducive to private enterprise, the administration of the State Tax Inspectorate is weak. Citizens are not complying with present tax laws to pay personal and business income tax, a value-added tax accounts for most revenue. The State Tax Inspectorate cannot carry out tax collection and audit functions efficiently and revenue agents engage in extortion because they are poorly trained and paid. Until citizens pay taxes, essential investment in

infrastructure and services will go unmet and dependence on external financing will have to continue. The development of a broad and deep government securities market, including secondary markets, is a high priority to restore confidence in the government's ability to finance public investment. Finally, the lack of accurate fiscal data which is available to the public underscores the tentative progress made towards transparent fiscal planning and restoration of public and investor confidence in the Republic's economy.

ENT's Significant Contributions

USAID funds two resident US Treasury Advisors--one for national budget and one for government securities programs.

The Treasury Advisor for Budget is working with the Ministry of Finance to develop a draft national budget law that is modelled after a US state budget system. The draft budget law also meets the international budget standards of the IMF. The Ministry of Finance and the National Assembly plan to enact the national budget law during June 1996. USAID, the World Bank, the new Ministry of Territorial Administration and the National Assembly conducted a National Forum on Local Self-Government that focused on fiscal relations between national and local governments in Armenia. Two major tasks remain: to develop and formalize the fiscal relationships between national and local levels of government within the national budget law, and, to begin the large job of developing competence to carry-out the budget process and abide with the schedule and fiscal limits of the budget law. USAID and the U S Treasury provided U S -based training for key budget personnel from the Ministry of Finance and the National Assembly who must develop the budget system at both the national and local government levels.

The Treasury Advisor for Government Securities assisted the Ministry of Finance and the Central bank to conduct the first public auctions of short term "T-Bills" to finance Government expenditures. The short term interest rates approximate market rates. To date, primary investors are mainly institutional. Secondary markets have not yet been created, although work began to introduce a registry to facilitate secondary marketing of T-Bills. The Treasury Advisor is assisting the Ministry of Finance design and implement a Debt Management Unit that will track all government debt and debt-service obligations. This Unit will work with the Debt Issuance Unit (i.e., government securities) to set quarterly limits for external and domestic public debt and to determine the timing and volume of treasury bill sales.

Commitment and Capacity of Development Partners

USAID's principal partners are the IMF and World Bank, which are responsible for the major fiscal policy reforms that exist as conditionalities in the STF, SAC and the ESAF balance of payments and institutional reform credit agreements with the Government. We work closely with the IFIs and the Government to (1) assess the efficacy of fiscal and monetary policy reforms and laws and regulations which will ensure improvement in fiscal management and provide a supporting environment for economic growth, and, (2) provide technical assistance and training to the Government to carry out fiscal policy analysis and to improve fiscal management. Mainly, our collaboration occurs in two ways: through the US

Treasury Advisors for budget and government securities, and, through policy dialogue between the USAID-funded Center for Economic Policy Research and Analysis (CEPRA) and the IMF with the Ministry of Economy. This has strengthened the Ministry of Economy's use of policy analysis to formulate policy and negotiate with the IMF or the World Bank on program conditionality.

ICMA coordinates its activities in cadastral reform with the IBRD's Institutional Building Loan. USAID (ICMA) and the World Bank will likely collaborate to develop a "demonstration cadastral program" to develop both the public and private sectors' capabilities to survey and map property and Government's capability to legally register property titles in a computerized management information system. USAID will provide the technical assistance, the IBRD will fund the commodities.

Illustrative Approaches

A National Budget and Tax Administration Short and long-term technical assistance by the U.S. Department of Treasury will be provided to the Ministry of Finance (MOF) to improve the methodology for the preparation and administration of the national budget, beginning with the drafting of a new national budget law. Assistance will be given to the State Tax Inspectorate to achieve a cost-effective and fairly administered system of personal, property and commercial tax codes.

B Property Taxes ICMA, through its cadastral reform and real property valuation activities will assist to establish market-valued methods of property assessment. ICMA will also assist in the formulation of policies to establish and administer property taxes which in turn will expand the municipal revenue base to finance legitimate community services and infrastructure projects.

C Government Securities USAID will fund technical assistance from the U.S. Treasury to develop a government securities program to provide a non-inflationary means to finance the national budget. Also, a government securities program will provide the banking system with instruments and markets to effectively implement monetary policy. A resident advisor will work with the Ministry of Finance and the Central Bank to develop a comprehensive legal and policy framework for the issuance of government securities, create a debt management and cash management system for the newly developed "Treasury System" of the Ministry of Finance, create debt issuance and accounting operations for the fiscal agent, develop an active secondary market for government securities, design security structures, and, develop a detailed database for bond sales.

Sustainability

Summary Accomplishments The US Treasury programs in budget and government securities have initiated important fiscal reforms that provide a foundation to sustain fiscal policy.

The Government has made dramatic progress to reduce deficit spending (est. at 9% of GDP for 1996), reduce the civil work force (another 30% in 1996 planned) and continue

its strong control over money supply. However, the Government has also doubled its external debt, albeit largely concessional, and servicing this debt will take a good share of revenue which should be devoted to rebuilding infrastructure needed for economic growth. Presently, there is virtually no compliance with personal income or corporate income tax obligations, so any change will constitute progress. The addition of a U.S. Treasury Tax Advisor beginning in 1996 is important because insufficient technical assistance and training has been provided to the State Tax Inspectorate to enforce or encourage compliance. The IMF will need to accelerate its assistance to the Government to develop a national treasury to separate revenue and expenditure functions. The development of a national budget process after the budget law has been enacted will take at least five years. The marriage of international accounting standards and the development of a coordinated budget process for national and local levels of government will require considerable resources. Here, cooperation between USAID and the IFIs is extremely important--coordination of fiscal policy and use of World Bank funds to provide the equipment and other infrastructure needed to implement an automated budget system throughout the country. Responsibility for training hundreds of elected government officials, members and staff of the National Assembly responsible for the budget system is an issue that must be addressed soon. The development of a government securities market and the debt and cash management system is a high priority of USAID and the IFIs. The development of a public education and information program for taxpayers and government debt instruments is needed but has yet to be addressed.

With successful achievement of the intermediate results by FY 2000 as described in the Results Framework, a sound basis should be laid for achievement of the Strategic Objective of "increased soundness of fiscal policies and management practices". However, several caveats should be noted.

First, two key Intermediate Results are entirely dependent on programs of the IMF that receive no USAID support. One, a principal intermediate result, is the "reduction in non-vital government expenditures", essential to permit the Government to more efficiently target its expenditures. The other, IR 3.2.2, "National Treasury Established", is vital to implementing effective tax processes.

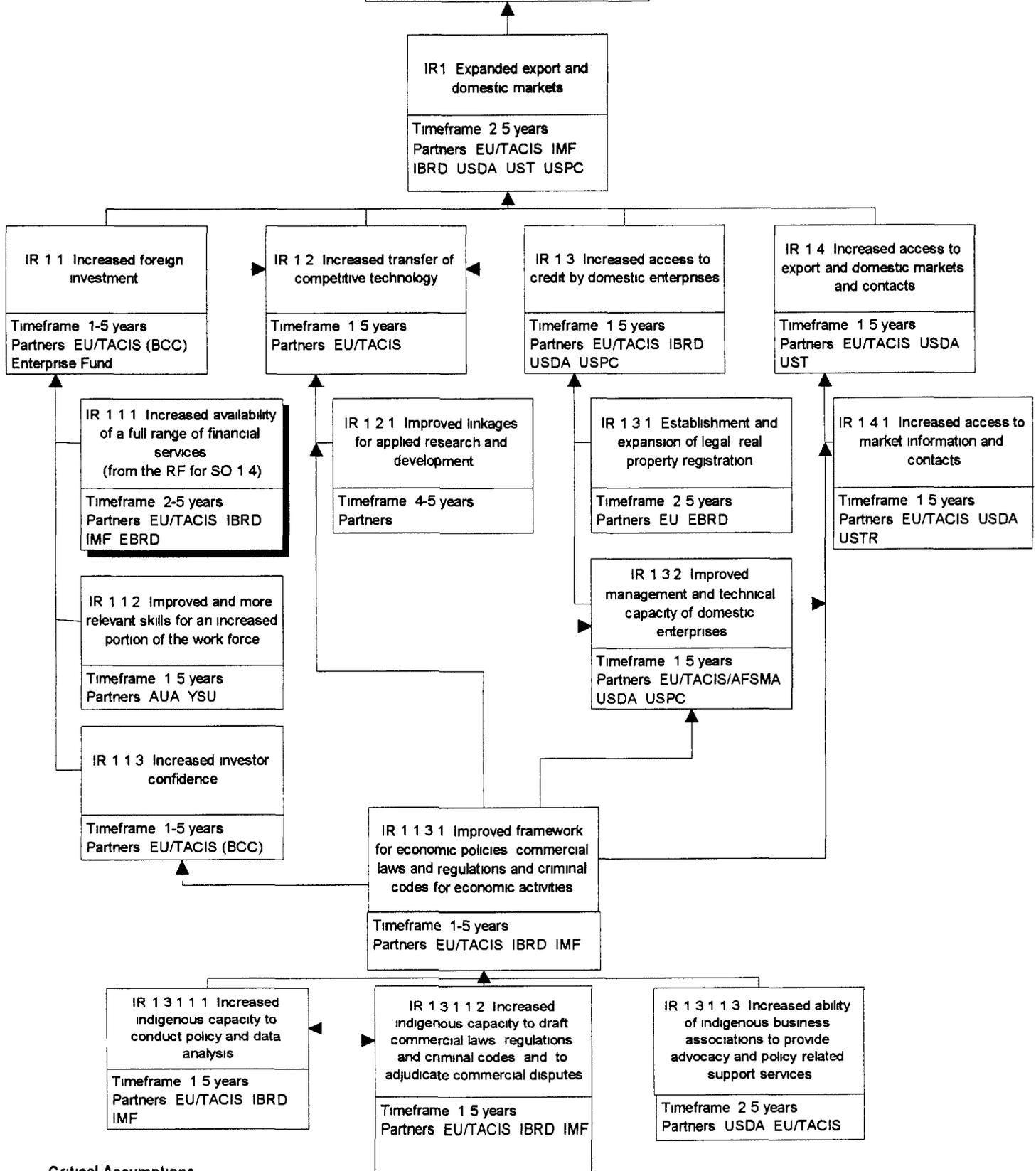
Second, Intermediate Results 3.3 and 4.3 are not currently being addressed by USAID or its partners and have been identified as areas for additional attention if no partner organization moves to address these constraints. IR 3.3, focusing on the need for tax code work to reduce tax rates to nonconfiscatory levels, is important to increased public compliance with tax laws, and IR 4.3, increased public access to government securities information, is necessary for development of a broad market for government securities. If neither USAID nor its partners are able to commit resources to these areas, it may be necessary to modify the SO framework.

The estimated USAID funding level is \$7.3 million between FY 1996 and 2000. Substantial progress toward achievement of the SO should be possible with this level of resources if the above issues are addressed.

Strategic Objective 1.3 Accelerated development and growth of private enterprise

Strategic Objective 13
 Accelerated development and
 growth of private enterprise
 Timeframe 2 5 years

IR from the results framework
 of another strategic objective



Critical Assumptions

- 1) National education system trains a highly productive labor force for markets
- 2) Increased and reliable access to energy (from SO 15) and other productive inputs
- 3) Growth in entrepreneurial spirit and know how

Problem Analysis

Economic transformation and growth in Armenia can only be achieved with a rapid expansion of private enterprise. Armenia's limited resources and market size require it to look to expanded markets, particularly export markets, for long term growth. This in turn requires increased foreign investment, transfer of technology, access to credit, and information about and contacts with foreign markets. An improved enabling environment is needed to increase investor confidence. Foreign investment will drive technology transfer and productivity increases. Armenia must put in place a positive policy, legal and regulatory framework, develop the capacity to implement and enforce it, curtail corruption, expand access to markets and capital, and direct its talented labor pool to take advantage of new, higher productivity technologies, enterprises must improve their management and technical capacities and have access to credit.

Privately owned land and real estate-- the largest, most equitably distributed physical assets in Armenia -- are severely undervalued, due in part to the absence of an effective real estate market. Basic legal mechanisms for owners to sell, trade and mortgage property now exist. However, other than for housing, property rights are not established, i.e., investors cannot buy, sell or trade commercial land and property. Comprehensive property rights need to be defined through a real property code and legal registration system. Public property and land are not managed, planned or allocated in accordance with market principles. A market-oriented system to buy and sell property needs to be developed in order to value property so that collateralized lending and property tax collection can begin. The Government needs to develop zoning guidance or ordinances, procedures for public auctions, and property codes to assign value to land, including land it owns, and from which revenue can be generated.

Results Framework

See R4, Part II

Judging Performance

See R4, Part II for performance assessment data

Overall Progress.

Armenia's economy suffered, as did other FSU countries, after independence in 1991, hyperinflation, loss of markets, enterprise closures, and consequential under-employment of about 80 percent, collapse of government services sectors and no viable financial institutions -- exacerbated by the Nagorno-Karabkh conflict and a trade, transport and energy blockade by Azerbaijan and Turkey. Beginning in January, 1994 macroeconomic stability and institutional reform began with loans for balance of payments support provided by the IMF, the World Bank and humanitarian assistance provided by the major donors, including the United States. One foresighted reform was the equitable distribution of more than 60 percent of Armenia's arable land and most of the farm machinery and livestock to the country's citizens even before independence in 1991. Although agriculture is close to subsistence levels, agriculture accounts for about 56 percent of GDP and employs 80 percent of

Armenia's rural citizens Housing stock was also privatized early on, and this has provided USAID a basis for legal reform of commercial law and the development of viable financial institutions based on collateralized lending

While the macroeconomic situation has improved and the Government has made good progress implementing the fiscal and monetary policy reforms, microeconomic performance is poor There is no doubt that new businesses are being established, and there is an increase in personal wealth--but only for about 10 percent of the citizens who control about 58 percent of the country's wealth Armenia could possess one of the world's most skewed income distribution patterns Trading unused industrial plant facilities for consumer goods has resulted in short-term profit taking About 60-70 percent of that portion of GDP attributable to the private sector comes from the informal sector that is not captured for further investment

The absence of a commercial legal and regulatory framework and a viable commercial financial sector remain as large impediments to accelerated growth and development of private enterprise The discussion of financial markets is covered in SO 1 4 While the framework for commercial legal reform is included in Armenia's draft Civil Code, the basic laws which govern business and commercial transactions will need to be developed quickly to encourage domestic reinvestment in legitimate business activity and corollary foreign investment Commensurate with commercial laws and regulations is the need to adjudicate commercial disputes

The Ministry of Economy recently established a "trade point" which is designed to assist foreign investors and domestic firms with products and services Much more market information and trade promotion is required to put new markets within reach of Armenian entrepreneurs The private enterprises selected by Government as offering comparative advantage include financial services (banking, insurance, trade finance, commodity and currency trading), precision electronic engineering, agriculture and agroindustry (horticultural products, wine, cognac and mineral water), infrastructure and utilities (energy, transport and communication), and textiles and garment manufacturing

USAID's Significant Contributions

The expansion of export markets and the corollary domestic markets in Armenia is the primary focus of all USAID technical assistance under this SO In October 1993, USAID began a business development program that provided business management education and association-building that was dropped from the program in early 1995 It was a wasted effort to try to jump-start a market economy in the absence of markets, especially a viable financial market We began a three-pronged approach in early 1994, about the time that the IMF and World Bank conditionalities began to take hold to stabilize the macroeconomy USAID opened Armenia's first commercial lending facility, loans were disbursed to small and medium businesses at market rates for the first time in recent history This lending program works through sound commercial Armenian banks, which concurrently strengthens development of market-oriented lending institutions To develop the basis for collateralized lending, USAID assisted new apartment owners to organize associations and pay for housing maintenance and repairs through member fees The registration of new associations has

proceeded rapidly. The enactment of Armenia's first market-oriented real property law in January 1995 provides the basis of legal ownership, rights and responsibilities. Now, USAID and the World Bank have begun efforts to develop a property registration program which will strengthen lending as owners pledge collateral for business loans.

USAID enlisted the support of its technical assistance PVOs, the Peace Corps and the USAID-funded USDA extension program to focus on markets and support collateralized lending. Now, the major focus of technical assistance is to increase the number of credit-worthy entrepreneurs and small business loans. This refocus on credit-worthiness (vs providing general business "advice") has contributed to greater clarity of purpose as we dialogue with PVOs, and government and business leaders.

Commitment and Capacity of Development Partners

USAID's principal partners are the World Bank, Ministry of Economy, USDA, Peace Corps and EU/TACIS. However, the Ministry of Economy is the principal coordinator of policies and programs that affect private enterprise. USAID's principal avenue for economic policy dialogue and commercial legal reform is the Ministry of Economy and the National Assembly's Permanent Commission on Banking, Finance and Economic Reform. Issues related to business development, access to domestic credit by small and medium enterprises and increased access to markets, contacts and information are usually discussed with USDA, Peace Corps, EU/TACIS and the various USAID-funded PVO grantees who work in the field with small and medium enterprises. Generally, there is lack of coordination on private enterprise policy and ground-truthing policy decisions with businesses and donors. The U.S. Embassy sponsors two scheduled discussion roundtables--one for agriculture and one for economic reform. Farther behind, but with a better chance for collaboration is the role that CEPRA has taken on to coordinate economic policy and commercial legal reform--principal partners include the Ministries of Economy and Justice, the National Assembly's Permanent Commission on Banking, Finance and Economic Reform and the IMF. USAID cooperates closely with the World Bank on housing privatization, real property laws and the registration of real property. USAID and the Ministry of Economy, which is using World Bank institution rehabilitation loan funds, are implementing the Property Registration Demonstration. USAID has considered cooperation with the EBRD and the EU/TACIS on various credit schemes for small and medium businesses.

Illustrative Approaches

A Economic Policy, Legal and Regulatory Reform. The USAID-funded Center for Economic Policy Research and Analysis (CEPRA) was established to provide technical assistance and training to better enable policy makers (Government, Parliament and Executive branches) to formulate economic policies based on accurate measurement of key macroeconomic indicators and projected impacts of alternative policies, and then, to develop plans, policies, and laws and regulations to support the transition to a market economy. Western economists and Armenian counterparts at CEPRA undertake economic analyses, identify policy options and assist in the formulation of policy in the areas of comparative advantage and export growth potential, provide training in the areas of public project appraisal and development planning, develop new measures for national income and product

accounts, and, train Armenians to carry out economic analyses and formulate policies CEPRA will also provide policy and legal assistance to develop a commercial code (probably as part of civil codes), enabling legislation to support private enterprise, and provide training for lawyers, judges and business persons in adjudication of commercial disputes

USAID will continue to provide the Ministry of Economy with a resident macroeconomic advisor to develop policies to promote privatization, and formulate post-privatization, restructuring and industrial development policies This technical assistance will be integrated into CEPRA in FY 97

B Real Property Rights A unified system of land and real property rights is important to establish a formal market for land and property ICMA is assisting the GOA to clarify in law, basic land tenure rights in a form which satisfies the requirements of private investors, owners and lenders To accomplish this objective ICMA will assist the Government to design, test and develop (1) a unified system of property registration based on a cadastre system for urban, suburban and rural areas, and, (2) a service to legally register property, convey title and record property values based on market prices ICMA will develop procedures to record, analyze and report sales to facilitate the development of a real estate market based upon supply and demand, titles and their transferability

C Urban Policy Reforms ICMA will assist the GOA and local governments to develop unified urban planning and development policies (e g , zoning ordinances), building ordinances, public property auctions and real property laws These reforms will also include enabling legislation and procedures to ensure that public land and real property are managed, sold and developed according to market principles The activities will start with Yerevan where a city real estate department will be developed to manage and dispose of municipal land and buildings and the purchase of land and buildings for the city's use This model will be extended to other municipalities

D Firm-level assistance To access credit and take advantage of new market opportunities, enterprises need to expand their management and technical capacities The USAID-financed International Executive Service Corps (IESC) will continue firm level assistance to strengthen business operations and make firms more competitive VOCA will continue work with agribusinesses, farm groups and villages on technology changes to raise quality to international standards

E Enterprise Fund FY 1996 legislation mandates establishment of a Trans-Caucasus Enterprise Fund, which is expected to concentrate operations, at least initially, in Armenia While the management structure is yet to be determined, this fund will support the objectives of increased access to domestic credit and linkages to foreign investors and markets through debt and equity investments Other Enterprise Funds in the ENI region have been successful in directing resources to small and medium enterprises, and this may be an appropriate focus in the Caucasus

Sustainability

Summary accomplishments USAID has made progress in preparing existing entrepreneurs to identify new markets and qualify for business loans. USAID-funded CEPRA is a major contributor to economic policy dialogue at the microeconomic level, an area that has not received enough attention but is important to small and medium enterprise performance and growth.

Growth of the private sector is assured whether USAID assists or not. However, accelerated growth to ensure sustainability will not occur unless access to competitive technology and foreign and domestic credit occurs in a narrow window of opportunity within the next five years. After that time, the government must begin to draw upon tax revenues and foreign investors to rebuild or replace its archaic infrastructure which a modern market economy needs to flourish. After a less than successful effort two years ago to jump-start private enterprise by providing advice about business management, USAID now concentrates on getting the legal and regulatory environment right and facilitating access to market information and contacts, then facilitating access to affordable credit, then aiding access to western technology, especially management. There is probable disagreement between the position that USAID will take viz-a-viz that of the IMF on the tax rates and structure and their effect on private enterprise growth. The tax structure is generally satisfactory, but the rates discourage new start-ups and encourage existing business activity to remain in the informal sector. After Armenia has incorporated readily accessible technology from abroad to develop products and services for export markets over the next two to four years, Armenia must then rebuild its applied research and development capability in order that its scientists and engineers can develop their own technologies which are appropriate for export and domestic markets. Finally, an overarching concern is the disintegration of the basic and vocational educational system: teachers are underpaid and undertrained, the exclusive use of Armenian language is largely inappropriate for economic activity which focuses on sophisticated technology and external markets (e.g., computer software marketing or precision engineering), and, school plants are decrepid.

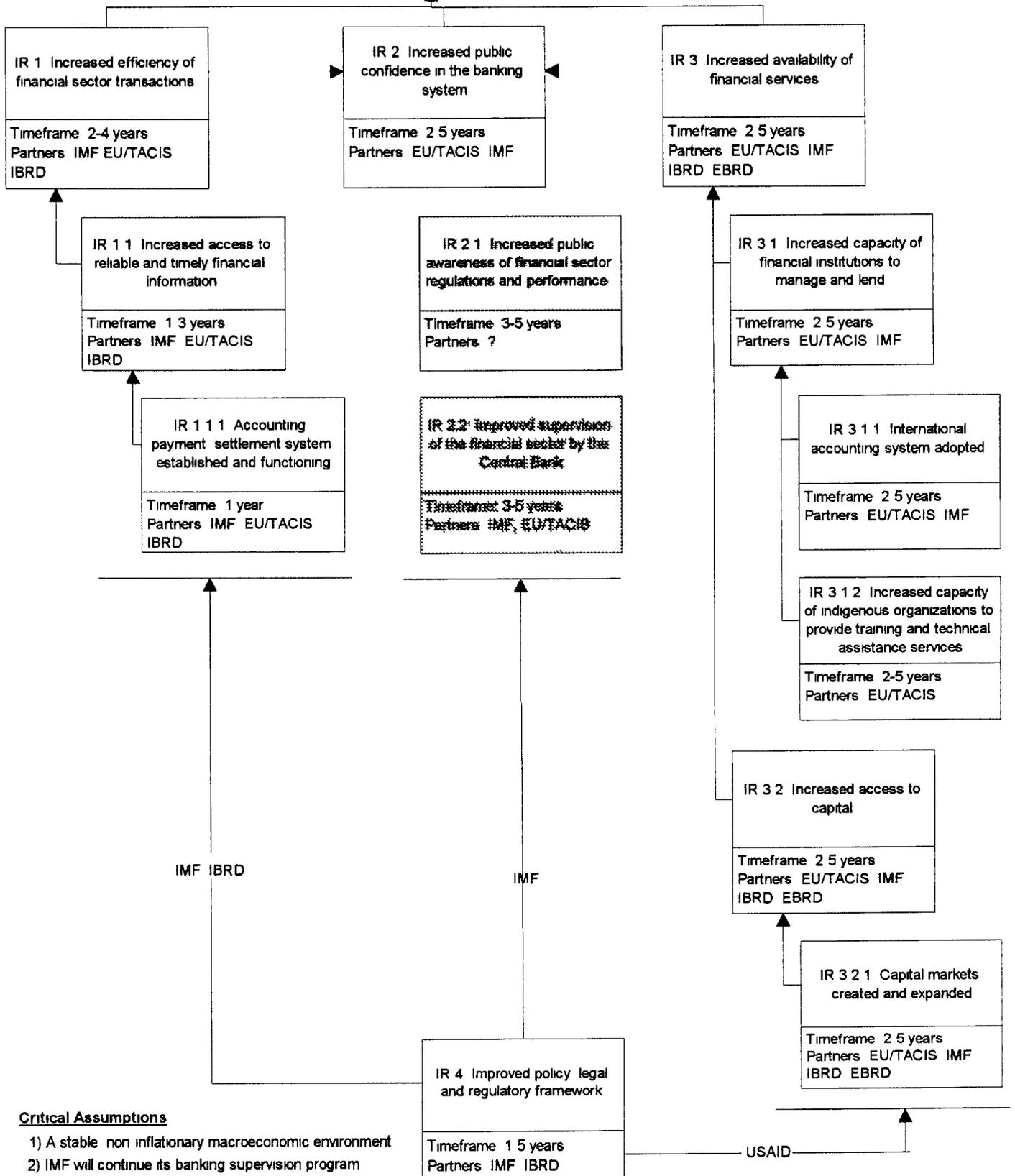
Achievement of accelerated growth and development of private enterprise requires success in four intermediate results: increased foreign investment, transfer of technology, access to credit by domestic enterprises, and access to export and domestic markets. If the underlying enabling environment is achieved, foreign investors should be attracted, bringing with them access to capital, technology and markets, and this SO should largely be achieved in the planning period. Key assumptions include:

-- -- That the national education system trains a highly productive labor force to meet an increasing demand by private enterprises for workers with appropriate skills. USAID is not currently contemplating any direct intervention in this area.

-- -- That the private sector will have increased and reliable access to energy and other productive inputs. USAID efforts under SO 1.5 are helping create a more sustainable energy system, and progress in peace negotiations would improve access to energy and other inputs when the embargo is lifted.

Strategic Objective 1.4
A more competitive and
market responsive financial sector
Timeframe 2-5 years

 No USAID Resources
 No USAID or Partner Resources
(projected as potential area of
future USAID involvement)



Critical Assumptions

- 1) A stable non-inflationary macroeconomic environment
- 2) IMF will continue its banking supervision program

27a

-- -- That the entrepreneurial spirit and know how in Armenia will grow substantially Increased contact with international markets and investors, and recognition of new opportunities, should spark this spirit

The estimated USAID funding level for this SO is \$90 million between FY 1996 and 2000 Substantial achievement of the SO should be possible with this level of resources and if the above assumptions and issues permit

Strategic Objective 1.4 A More Competitive and Market-responsive Private Financial Sector

Problem Analysis

Economic recovery will depend upon an increased capacity to mobilize savings and the capacity of commercial banks to serve as financial intermediaries between savers and investors Improvement in Central Bank operations over the past 14 months has been responsible for reducing inflation and increasing trade, both domestic and regional However, the formation of a viable banking sector is hindered by (1) absence of a modern electronic payments system (EPS) to conduct timely financial transactions, (2) an outmoded Soviet accounting system, (3) managers untrained in modern portfolio management, (4) a regulatory environment that discourages lending to the private sector, and (5) financial institutions that are either lacking or do not respond to market forces Financial sector reform will need to be accompanied by domestic and foreign resource mobilization to generate capital to loan at market terms to small and medium sized enterprises seeking resources for investment in new products and services

Armenia's current macroeconomic policies, legal-regulatory framework, and corresponding institutions are inadequate to fully support the transition to a market economy GDP has begun to increase (23.8% for the last three quarters of CY 95), however, total trade levels are but a fraction of those levels reached before independence The growth has come largely from increased trade with the non-CIS (Commonwealth of Independent States) countries (about 63.5%) Light manufacturing, agribusiness, housing construction, services and high technology have strong development potential, but are unlikely to attract risk capital until there are in place enforceable commercial laws and regulations to boost investor confidence Compounding these impediments to the growth of the private sector is the inability of the current judicial and administrative systems to enforce and/or adjudicate existing commercial laws and regulations Enabling legislation and procedures to formulate new commercial laws and regulations to support private enterprise and encourage foreign investment are absent and need to be developed

Results Framework

See R4, Part II

Judging Performance

See R4, Part II for Performance Assessment Data

Overall Progress

There is very little confidence in the banking system in Armenia. During 1993 and 1994, several "Ponzi" schemes resulted in depositor runs, and about two-thirds of all commercial banks were dissolved by the Central Bank. More than two-thirds of all commercial banks in Armenia have less than \$1 million dollars in capital assets. The Central Bank of Armenia (CBA) is the most important Government financial institution in Armenia working towards economic restructuring at this time. The CBA has been completely restructured. Enthusiastic, knowledgeable officers enforce existing bank laws and regulations and continue to nudge weak banks out of business. The installation of a modern electronic payments system will become the basis to communicate accounting, payments and settlement decisions among domestic banks and to corresponding banks overseas.

Reform in the commercial banking sector is minimal at this time. Commercial banks are under-capitalized and their officers are undertrained. A large portion of commercial banks' assets are fictional or under-performing. The IMF and the World Bank have placed priority on strengthening the capital base of commercial banks by revising loan-loss regulations for write-offs and stopping dividend payments from unrealized gains or from banks that do not meet prudential requirements. Work continues to improve the legal framework for banks, however, financial legal reform is not well-coordinated between the Government and the National Assembly, exacerbated by the general lack of knowledge about market-oriented bank laws and regulations.

Real interest rates for commercial loans remain high (30-40 %/month), short term and commercial banks still require 100 percent or more in highly-liquid assets as collateral. Hence, the informal sector continues to be the lender of choice. However, real interest rates should decline in the next three to five years as monetary policy tools and legal reforms begin to take effect and commercial bank officers increasingly learn market-oriented bank management and lending procedures. Banks, depositors and lenders will soon need a system of economic courts to provide lenders, savers and borrowers with legal recourse. Finally, the commercial banks must convert to international accounting systems to complete financial transactions and financial management decisions.

Midland Bank of Hong Kong opened a commercial branch in Yerevan in early 1996-- savings deposits for the first week exceeded \$600,000, mostly small depositors. Therefore, it appears that gaining public confidence is possible if western banking services are offered. Midland will focus on financial services, e.g., savings deposits, ATM, lending will commence in the future.

ENI's Significant Contributions

USAID, the European Union and the World Bank have cooperated to design and implement a modern electronic payments system for the Central Bank and commercial banks. The payments system should be fully operational within Yerevan's commercial banks by mid-1996 and throughout Armenia by the end of 1996.

A USAID-funded grantee opened Armenia's first commercial lending facility in Armenia for small and medium-sized enterprises. To date approximately 20 loans worth \$400,000 have been made to manufacturers and agroprocessing firms. USAID's program works through two commercial banks, thus strengthening management skills and providing lending experience to bank officers, additional banks will be added as loan reflows permit expansion.

A USAID-funded contractor began implementation of the conversion of the Soviet-era accounting system to an internationally accepted accounting system in 1996. Under its program, USAID and the Ministry of Finance will design, install and test accounting practices and supporting automation systems and rules which comply with codified international practices. USAID's program will cooperate with the IMF's program of accounting system which is being installed concurrently in the Central Bank. Accounting conversion training will include selected state-owned and privatized enterprises to provide a full range of clients and further testing of the accounting model and training materials.

USAID began a commercial bankers' training program in 1994. This bankers' training program was premature in that the market-oriented reform instituted by the CBA was not in full-effect and the amount of investment capital to lend was virtually nil. In 1996 USAID will redesign its bankers' training program to focus on commercial lending and other financial services to be provided by commercial banks, now that the Central Bank can provide the prudential support and control of the commercial banking sector.

Commitment and Capacity of Development Partners

The development of a modern, market-responsive financial sector is a top priority of USAID because it is the keystone to a robust export-driven growth strategy, built on foreign investment and domestic savings. USAID's principal partners include the Central Bank of Armenia, IMF, EU/TACIS and the World Bank. All are collaborating to design and implement an electronic payments system to increase the efficiency of financial sector transactions for accounting, payments and settlements for the domestic banking sector and foreign accounts. Focusing on central bank functions before commercial banks and lending has proven prudent--USAID's bankers' training program that began two years ago was premature until now when stronger, viable private banks are beginning to emerge. The IMF has three resident advisors in the Central Bank (bank operations management, bank supervision, and, accounting) who have worked closely and easily with USAID to develop the payments system. We will continue to work with the Central Bank, the IMF and the World Bank to develop an international accounting system that is articulated with the IMF Chart of Accounts, commercial banks, the national budget system and enterprises. The IMF, World Bank, American University of Armenia, USAID and possibly EU/TACIS may collaborate to establish a continuing education program to train commercial bank officers and managers. USAID, the IMF, the Ministry of Finance, the Central Bank and the Commission on Banking, Finance and Economic Reform of the National Assembly will need to increase their cooperation to review and revise banking laws that affect bankruptcy, financial disclosure (sunshine laws), share registries, collateral, prudential norms and secured transactions.

The installation of the EPS is a joint undertaking with the IMF, EU/TACIS and the IBRD. The IMF and EU/TACIS are financing other programs in the Central Bank under IBRD's Institutional Building Loan to improve Central Bank management. USAID's assistance with accounting conversion is part of its commitment under the IBRD Loan.

USAID assistance for accounting conversion is coordinated with the IMF's Accounting Advisor to the Central Bank who is assisting with the installation of the IMF Chart of Accounts. USAID's assistance with accounting conversion is focused upon commercial banks. EU/TACIS' short term accounting advisors coordinate with USAID in the development of training programs in the area of accounting conversion.

Illustrative Approaches

A Electronic Payments System USAID is providing technical assistance and commodities to design and install a modern electronic payments system for the Central Bank and to modernize commercial banking sector operations. The EPS will permit more timely financial transactions to take place among domestic banks, will improve banking supervision, permit timely international transactions, and provide financial market data to bank managers and their clients.

B Accounting Conversion A key to financial sector reform will be the adoption of a western-oriented, internationally accepted accounting and financial reporting system. USAID will provide technical assistance to the Central Bank and Ministry of Finance to establish a new national accounting system based on their extensive testing of internationally-accepted accounting standards and practices that are appropriate for Armenia, including an accounting practices law or decree, and modernized operating practices for an automated system. The new accounting system will be implemented in commercial banks and selected enterprises, both state-owned and private. Laws establishing internationally accepted accounting procedures and policies for the Central and Commercial Banks, Ministries of Finance and Economy, State Tax Inspectorate and industry will be enacted by the GOA. Reference and training materials will be developed, accounting trainers and advisors to be involved in the conversion to the new accounting system will be trained.

C Portfolio Management/Lending Procedures After the accounting conversion is well underway USAID will embark upon a program of bankers training. The focus of bankers' training will be portfolio management including savings mobilization, debt management, strengthening of prudential relationships between the Central Bank and commercial banking sector, plus the development of sound lending procedures and systems of loan recovery.

D Creation of Capital Markets To facilitate the creation of capital markets USAID has funded the Eurasia Foundation to establish a commercial lending facility for small and medium enterprises (SMEs), through a competitively selected local bank. Personnel from the lending bank receive training from Western bankers and other technical experts in banking operations, accounting and lending procedures. With additional resources through a combination of a second year USAID grant and the start of reflows from lending operations Eurasia Foundation will select one or more additional local banks to receive training and initiate a second phase of the lending program. To help stimulate the demand for such loans,

USAID grantees (VOCA, IESC and Peace Corps) will identify and assist potential clients to prepare viable investment and business plans to the benefit of both the borrower and lender

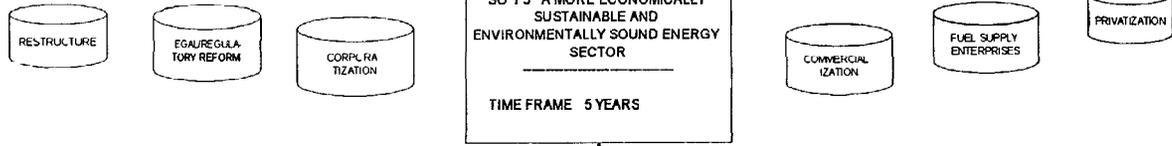
Sustainability

Summary accomplishments Although not yet completely operational, the electronic payments system will catalyze the development of a modern financial service sector for Armenia. The adoption of international accounting standards will open up many new communication channels for the development of the financial sector.

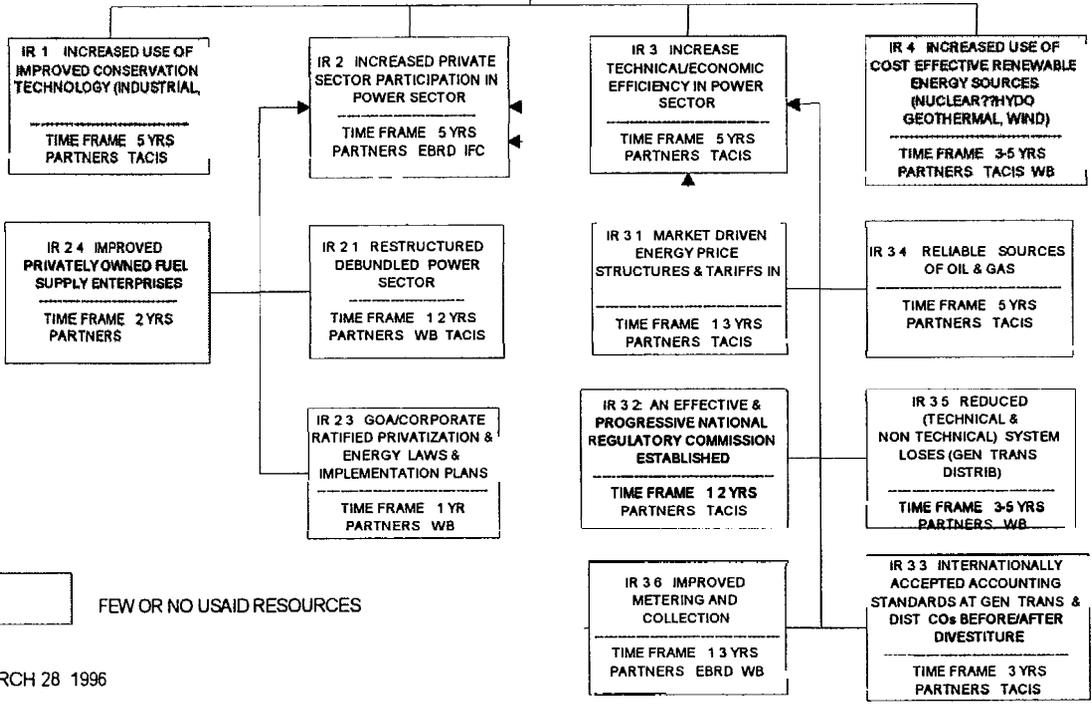
The electronic payments system (EPS) is state-of-the-art for about 20 years of service. It will (1) provide sufficient capacity for all commercial banks and other financial institutions to clear payments, settlements and transmit accounting information in a secure manner, (2) facilitate foreign financial transactions, and, (3) provide access to international financial markets and information. Fully articulated and functioning accounting standards are required to establish the credibility of the financial sector for foreign investors, domestic savers and entrepreneurs. All such functions will enable the Central Bank to carry out its prudential functions and efficiently enforce monetary policy. USAID will devote considerable resources to establish international accounting standards, beginning with the commercial banks, however, other donor support and government resources will be required. USAID will reinstate its training program for commercial bankers, but focus on institutionalizing it at the onset. USAID's approach to institutionalizing accounting and bank and lending competency in the financial sector will be to work with the financial industry and Government to adopt international standards, build indigenous capacity to train officers and managers to teach towards those standards, and assist the industry and Government develop a rewards system for those who develop full competency to manage, lend and function as efficiently as bankers in a market-economy. USAID will look for other ways and means to create and expand capital markets--the Trans-Caucasus Enterprise Fund can be used as a tool to strengthen the capacity of financial institutions to manage and lend.

Achievement of a more competitive and market-responsive financial system depends on success in reaching three intermediate results: increased efficiency of financial sector transactions, increased public confidence in the banking system, and increased availability of financial services. With these shifts, Armenia's financial sector can facilitate an expanding economy. When a state of the art electronic payment system is operational, reliable and timely financial information is available, financial institutions' capacity to manage and lend is improved, and capital markets are developed, then many of the pieces will be in place to achieve the SO. This complex array of changes will require the full strategy planning period of five years.

Two critical assumptions will affect achievement of this SO. First, a stable, non-inflationary macroeconomic environment must persist in order for public confidence to grow and financial services to expand. Armenia has made recent progress in bringing inflation under control, stabilizing the currency, liberalizing prices and trade, but continuing attention will be required to assure macroeconomic stability. Second, the bank supervision program of



- CONSTRAINTS AND PROBLEMS SYSTEMIC**
1. ABSENCE OF IN-COUNTRY SOURCES OF FOSSIL FUELS (POWER SYSTEM AND LONG-TERM COST STRUCTURE ?)
 2. LIMITED AND/OR PROBLEMATIC ALTERNATIVE ENERGY SOURCES (ENVIRONMENTAL IMPACT AND HIGHER COST STRUCTURE OF ALTERNATIVES??)
 3. LACK OF ECONOMIC DEMAND DUE TO DEINDUSTRIALIZATION (COUNTRY BELOW GENERATION CAPACITY BUT CAPITAL ASSETS RAPIDLY DETERIORATING)
 4. COST INCOME DISTORTION (LEGACY OF SOVIET SYSTEM NOW WELL ENDS)
- RELATED TO CURRENT CRISIS**
1. CUSTOMER NON-PAYMENT
 2. POWER RATIONING
 3. UNOFFICIAL DISTRIBUTION (PRIORITY POWER ABUSE) (ELECTRICITY LEFT UN)
 4. TARIFFS
 5. LACK OF METERING
 6. MANAGEMENT SKILL BASE



- PARTNERS**
- ARMENERGO
 - ARMGAS
 - MINISTRY OF ENERGY
 - MINISTRY OF ECONOMY
 - MINISTRY OF FINANCE
 - OFFICE OF PRIME MINISTER
 - WORLD BANK
 - EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT
 - ELITACIS

FEW OR NO USAID RESOURCES

2200

the IMF must continue successfully for public confidence in the banking system to blossom. This SO in particular is closely linked to success in the programs of the IMF and IBRD.

In addition, there are cross-linkages to intermediate results under other SOs which are also key. As in SO 1.3, the policy, legal and regulatory framework is instrumental, and is the foundation for the strategic approach to financial sector strengthening.

The estimated USAID funding level is \$13.7 million from FY 1996 to 2000. Substantial achievement of the SO should be possible with this level of resources and if the above assumptions and issues permit.

Strategic Objective 1.5 A more economically sound and environmentally sustainable energy sector

Problem Analysis

Armenia's energy situation is extremely grave. For reasons ranging from the breakup of the Soviet Union, the economic blockade, and the extensive damage to the infrastructure caused by the 1988 earthquake, a significant portion of the country's fuel supply and electric generating capacity has been severely impaired. The shortage of power has been a major cause of the rate of economic decline. The continuing shortage of energy has caused great hardship, impedes the transition to a market economy, endangers public health, and could threaten political stability.

The Medzamor nuclear plant, shut down in 1989 for environmental safety following the 1988 earthquake, re-opened Unit #2 which is currently operating at approximately 75% of its full 400 MW capacity. Although hydro power has virtually saved Armenia's energy infrastructure from complete breakdown over the past 7 years, it has had adverse effects on the environment. In particular, Lake Sevan's shoreline and ecology have been drastically altered. With the reopening of Medzamor's Unit #2, the Government plans to decrease its dependence on the Lake Sevan chain and allow the water reserve to build up. In addition, Azerbaijan has cut its direct natural gas supplies to Armenia. At the same time the only pipeline through Georgia has often been sabotaged and gas flow disrupted. As a result, the relatively clean burning gas used for generating plants and industries increasingly has been replaced by mazout (heavy oil) which has a high sulfur content and thus is a potential pollutant. For this reason, an environmental impact survey is contemplated.

Over the past few years, 38% of the country's electric generation capacity has been lost and much of the rest of the generating capacity has been indirectly affected by the shortage of gas as a boiler fuel. Because of heavy state subsidization of energy prices during the Soviet era, there was no incentive to conserve and as a result energy consumption is highly inefficient. With price reform now underway, adjustment to a more energy-efficient economy is a high priority, albeit a daunting task. Because of the country's heavy reliance on natural gas as a primary energy source for residential and commercial use, as well as its use for power generation, every sector of the economy has been affected by gas supply curtailments. During winter, most of the few factories that otherwise might be functioning are likely to be closed. The shortage of electricity (an average of 6-8 hours per

day provided to residences), and blackouts have virtually affected every sector of the economy and society

Results Framework

See R4, Part II

Judging Performance

See R4, Part II, for Performance Assessment Data

Overall Progress

The Ministry of Energy has begun restructuring the energy sector. Armenergo, the state-owned electric utility, has been divided into generating, transmission, and distribution companies. The GOA expects that these companies will eventually be partially or fully divested. Plans are also underway to restructure Armgas into two state enterprises (transmission and distribution). The restructuring will be an on-going process with plans for spinning off non-power production enterprises (design, construction, etc.) into private joint stock companies. It is planned that in the next 5 years the power companies will also be candidates for privatization. A major problem has been the shortage of funds for purchasing fuel, plant maintenance and plant rehabilitation. While some rehabilitation needs will be met by upcoming World Bank loans, part of the solution to this problem is to increase tariffs and dramatically improve metering and collection functions. Continued assistance in the restructuring and privatization of the energy sector will be provided by USAID as the Ministry of Energy implements its restructuring plan.

ENI's Significant Contributions

To date, USAID's energy program has assisted the Ministry of Energy in achieving some major accomplishments in the restructuring of the energy sector. Armenergo, the power utility previously responsible for electricity generation, transmission, and distribution has been effectively broken up. Its current responsibilities involve primarily transmission, dispatching, and some limited power generation. Approximately 51 distribution companies have been established as separate state enterprises and it is expected that in 1997, these firms will be consolidated into ten joint stock companies open for partial or full privatization. The same is planned for the two to three generation companies. USAID's 1997 program will build on these accomplishments and continue in assisting the Ministry of Energy in its reform efforts.

Commitment and Capacity of Development Partners

The World Bank is currently processing a \$14 million IDA loan for power maintenance and rehabilitation and a \$35 million loan that will cover the rehabilitation of the transmission and distribution network. A Japanese grant of \$600,000 through the World Bank funds TA to the Ministry of Energy which will help in the preparation of the terms of reference for the \$35 million loan. The conditionalities for both loans have been coordinated

with USAID and USAID's contractors are helping the Ministry of Energy meet some of them including the enactment of the draft energy law and the establishment of a regulatory agency. The World Bank has been a serious partner and their program, with some minor exceptions, has been progressing on schedule. During the last three years, USAID has developed close ties with the World Bank, which it has found to be a dependable and cooperative partner. In turn, the World Bank continues to appreciate and request technical assistance support from USAID on issues ranging from institutional reform to pre-loan analyses in the energy sector.

European Union technical assistance is examining energy demand and supporting the formulation of energy efficiency policies and legislation. EU/TACIS is also assisting with a pilot project for improved billing and collection although USAID is taking lead efforts in this area with its metering/collection system task. EU-funded activities are closely coordinated with USAID initiatives in industrial conservation as well.

Illustrative Approaches

There are four main sub-sectors of intervention planned, some having already been initiated.

1 Improvement of Energy Efficiency

a) Develop a long-term district heating rehabilitation plan for Armenia. As a separate task, implement a short-term district heating (D) plan for Yerevan for winter 1996/97 with funding for limited key commodities and equipment. This will increase the efficiency of the heating system and decrease use of electric heat which is more inefficient and overloads the electric system.

b) Identify technical assistance and equipment needs to improve the efficiency of gas storage facilities. In addition, provide technical assistance and critical commodities for the Yerevan gas distribution system, upgrade maintenance capacity/efficiency, including the recommissioning of currently dormant operations.

c) Perform an energy sector environmental assessment to identify and describe existing environmental degradation factors attributable to energy. Define the norms and standards being applied, identify the regulatory agencies involved, and define remedial actions required over the medium and longer term, undertake an assessment of the potential environmentally safe energy options such as wind, solar water heating, hybrid systems, and other alternatives. Support one or more cost-effective alternative energy options.

d) Create the enabling environment to encourage the formation of energy service firms able to conduct energy audits and work on energy savings for private and public entities. Also identify local providers capable of manufacturing weatherization supplies.

e) Provide technical assistance and commodities to improve electric distribution, monitoring and control system maintenance for Yerevan.

2 Improving the Institutional Framework to Promote Market Reform

a) Continue technical assistance aimed at the restructuring and corporatization of state energy companies - Armenergo, regional electric distribution companies and ArmGas

b) Continue technical assistance in the area of legislative and regulatory reform and complete drafting and encourage passage of specific energy laws that support restructuring and commercial energy market development while safeguarding the environment

c) Develop a new billing, collection and metering system for the electric sector and, once completed, continue to provide similar assistance to Armgas to lay the foundation for their eventual commercial operation

d) Review financing options for energy sector projects (use of debt financing, revolving funds, etc), develop and implement a public/private financing mobilization plan to finance private and public investments in the energy sector

e) There is much interest in developing these activities, but there remains the problem of mobilizing long-term project financing. An option, among others to be evaluated, is the potential to establish an energy enterprise fund. Such a fund could support hydro power development and the local manufacture of solar water heaters, wind turbines, and weatherization material manufacturing

3 Indigenous Fuel Promotion

a) Continue with the coal exploration and assessment study being implemented by USGS. The US Geological Survey will provide assistance to the Ministry of Environmental and Internal Resources and initiate the coal exploration program in 1996

b) Implement the Seismic Study for areas targeted for oil/gas exploration. This will complement the TACIS-funded promotional task for attracting private US and European investors and oil companies

c) Prepare pre-loan studies for rehabilitation of hydro and thermal power plants, provide selected critical commodities and technical assistance needed for rehabilitation of key facilities

4 Regulatory Nuclear Safety

Support the development and implementation of an energy supply and demand plan that will allow the closure of the Medzamor nuclear plant by 2002, in coordination with other G-7 countries, consider supporting safety related assistance

Sustainability

Several conditions need to exist in order to increase the likelihood of achieving the SO of "A More Economically and Environmentally Sound Energy Sector" over the next five

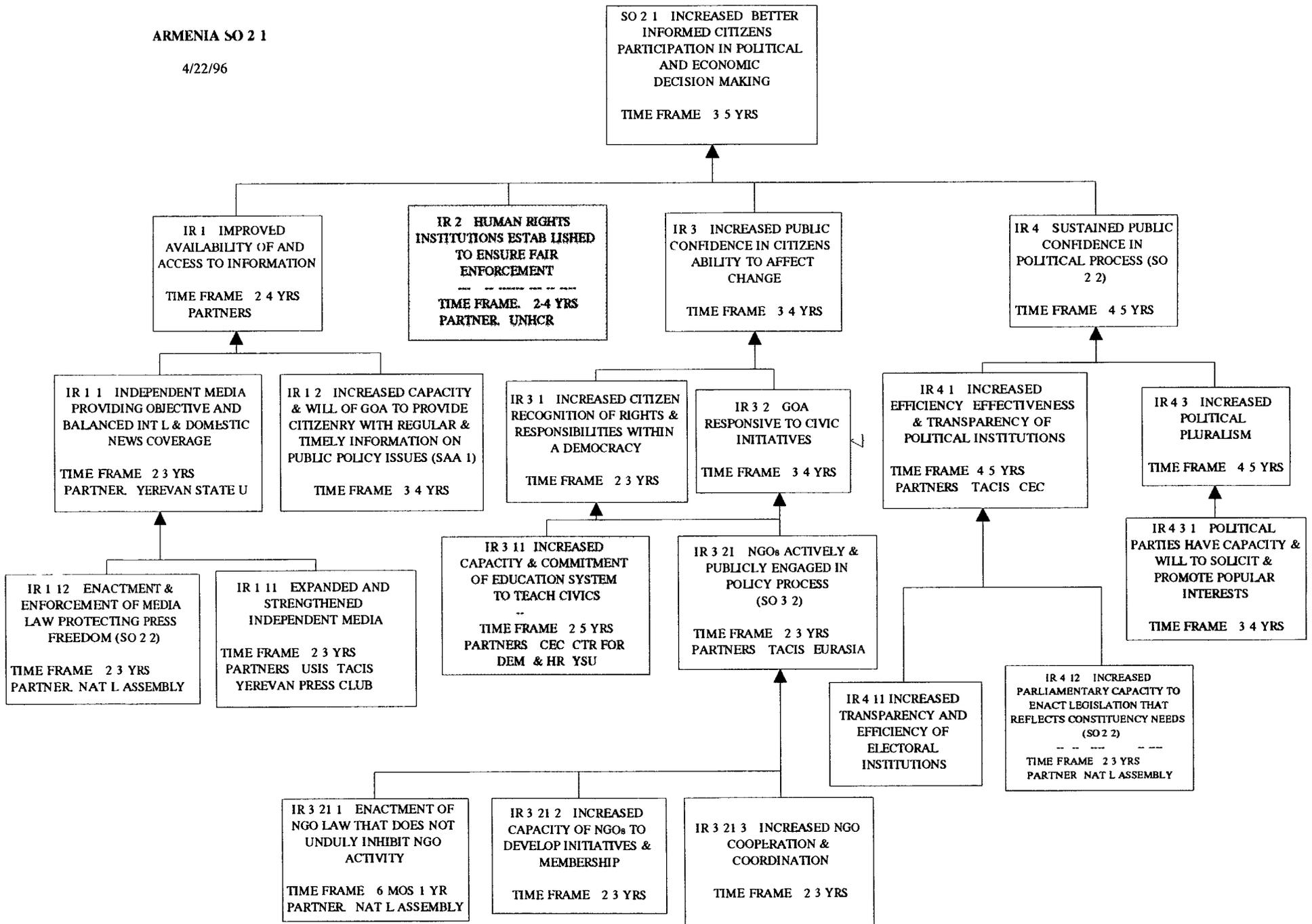
years. They include an end to regional conflicts - especially in Karabakh, open borders and an end to the blockade by Azerbaijan and Turkey, and improved, more reliable transportation links through Georgia. If these conditions are met, the environment for promoting a faster transition to a market driven energy sector will improve. Achievements which will signal progress towards meeting the SO objectives include a functioning independent regulatory agency, privatization well underway in the generation and distribution sector using IAS standards, IDA and IBRD loans of up to \$50 million being successfully implemented and processed, an average collection rate of over 90% from industry and residences, sound legislation for promoting international investment, energy efficiency, privatization, and petroleum/coal/gas exploration. If the conditions are met, these achievements may be reached over the next 5-6 years.

USAID should continue to assist Armenia's energy sector at the current level and beyond for at least the next three to five years. As the state enterprises convert to joint stock companies, there will be additional needs and opportunities for assistance in setting up corporate structures, management training, and provision of management systems at the generation, transmission, and distribution level. Furthermore, with additional projected World Bank assistance, USAID can provide valuable technical assistance to leverage new loans. Due to the continuing good relations with the World Bank, the Bank continues to request technical assistance support from USAID on issues ranging from institutional reform to pre-loan analyses in the energy sector. This is increasingly evident in the current \$35 million loan by the Bank to the power sector which will concentrate on improving the financial and technical management of the electric distribution companies, an area in which USAID is currently active and where it can continue to coordinate with the Bank.

The estimated USAID funding level is \$20-23 million over the next 3 years. Such progress is possible even if current conditions (blockade, etc.) prevail, although the time frame for achieving them may increase to 5-6 years at an additional \$12-\$20 million from USAID for the extra 2-3 years.

ARMENIA SO 2 1

4/22/96



2/10

DEMOCRACY AND GOVERNANCE

Strategic Objective 2.1 Increased, better-informed citizens' participation in political and economic-decision making.

Problem Analysis

A critical requirement for a sustainable post-Soviet Armenian transition to competitive market democracy is the emergence of a domestic political dynamic for maintaining steady progress on a broad range of reforms. Democratic governance requires that the dynamic comes primarily from civil society due to Armenia's inherited political culture. Relatively few citizens have an unwavering commitment to, or interest in, the full range of reforms necessary to propel Armenia down the democratic path during this difficult transition period. It will take dedicated groups of individuals within Armenia's civil society, particularly, political parties, NGOs and an independent media, to provide and sustain the necessary impetus for democratic reform.

Armenia has a long history of political party activity. The Dashnaksutiun and Ramgavar Parties were already well organized at the time of the first republic (1918-1922), and they continued to operate abroad during the Soviet era. Since independence, several new parties have emerged. The largest and strongest is the ruling party, the Armenian National Movement (ANM). Leading up to the July 1995 parliamentary elections, the major opposition party, Dashnaksutiun, was suspended. With the exception of the Ramgavar party, most of the remaining parties have not been well organized. They also tend to be driven by personality rather than substantive platform issues. The July election, which was judged free but unfair by the international community, left the ANM and its allied parties with about 3/4 of the seats in parliament. Other potentially democratic parties have been poorly represented and quite fragmented, with many of their best people scattered among NGOs. Finally, the country's institutional base for citizen participation through the election of citizen representatives, that is, the National Assembly, is both constitutionally guaranteed independence from the executive branch, and at the same time authoritatively circumscribed in its power by that same constitution. Though this, and the fact that the body only meets part-time, are obstacles to institutional democratic development, there is real room for progress if targeted and timely assistance can be provided in supporting the development of a professional and independent cadre of parliamentary deputies.

Given the particular hardships Armenia has faced in the initial years of independence, the majority of NGOs to emerge are humanitarian/service delivery-oriented organizations. The development of a non-governmental sector in Armenia has been both fast and shaky. A proliferation of duplicative humanitarian assistance NGOs, as well as the advent of "shady" NGOs - whether real or perceived - has kept this crucial element of civic participation as yet from developing a firm foothold in the country's political mechanics. As Armenia accelerates its political and economic development, there is increasing need to strengthen independent organizations which seek to play an active role in public policy. In order to participate effectively in the political process, these groups will need to build organizational capacity, increase inter-NGO collaboration, and improve their links to population at large.

One of the most trying obstacles to active citizen participation in the country's political and economic activities has been the lack of adequate -- and objective -- information. Given limited electricity, government monopoly over the country's media technology (printing presses, radio and television frequencies, etc.) and the depressed state of the economy, it has been difficult for independent media to provide professional, objective news coverage or to achieve commercial viability. Those independent media outlets that had sprung up since 1991 saw tremendous setbacks following the December 1995 Dashnak shutdown of media outlets associated with the party. Those which were not closed became increasingly cautious, effectively self-censuring to avoid controversy. The country's state media outlets have not seen substantial change since independence. Armenia's new leaders use state radio, television and print press much in the same manner of their communist predecessors, i.e., as public relations tools. Though the political environment has improved substantially for independent media (see "Progress" below), the need is still great for improved technical and journalistic skills, sustainable freedom of the press, and access to technology and resources.

For Armenia's sustained democratic and market development, Armenian's citizens must have a role and a voice in the changes being made. The combined efforts of strong and diverse political parties (and elected representatives) representing the needs of constituents, active and non-governmental organizations encouraged to voice public and private views, and an independent media capable of providing Armenians with the information they need to participate in their country's transition, will solidify the foundation of a democratic market-oriented society, which has taken seed but not root in Armenia's soil.

Results Framework.

See R4, Part II

Judging Performance

See R4, Part II for performance assessment data

Overall Progress

As noted above, the period leading up to the July 1995 parliamentary elections and constitutional referendum, and the elections themselves, indicated a marked turn from the progressive path to democratic institutions that Armenia had been on prior to December of 1994. Many elements of Armenia's burgeoning civic society suffered setbacks, including political parties, the NGO community, and independent media. However, signs of recovery of a strong, albeit unfocused, civic society have been visible in the last six months.

The National Assembly itself, mindful of the constraints noted above, has been making small but impressive strides towards functioning as an independent legislature. Although the vast majority of elected deputies are of the ruling ANM Party, or an affiliate through faction, there is one avowedly opposition faction, and groups of "non-affiliated" deputies (those who were elected on the majoritarian ballot, rather than party list) who have begun to speak with an independent voice on areas of legislation or legislative practice of

particular interest. Deputies appear both interested in developing relationships with their constituencies, and in learning more about western parliamentary practices, particularly as relates to committee structures and hearings. Though the current legislative agenda is unrealistically ambitious, and not particularly well prioritized, deputies are taking their roles as legislators seriously, and are open and eager for western advice and expertise.

Despite the constraints noted above, the development of an active non-governmental sector in Armenia is slowly coming to fruition. Humanitarian assistance NGOs are making efforts to better coordinate their activities, and are showing an interest in the larger issues of democratic reform. There are currently only a handful of strong advocacy-oriented NGOs, such as the human rights organization Avangard, and the equally active, if slightly less progressive, Young Lawyers' Union. However, as the political environment has cooled somewhat since the December 1995 shutdown of the Dashnak party, civic organizations have begun to recognize the role they might actively play in a democratic society. Contact with more advanced NGO leaders and communities - both post-Soviet and western - has proven to be a boost to Armenia's non-governmental sector, in allowing glimpses of the potential for civic participation in the country's struggle towards democratic transition. Though much will be required to nurture and sustain the growth of an NGO sector motivated and capable of playing a role in public policy debate, a foundation for such growth is in place.

The political "cool-off" of the last six months has been particularly positive for the independent media sector. Existing independent print and television outlets have been producing openly critical pronouncements of government activities, and both existing and new outlets (particularly television) have begun to recognize the role of investigative journalism in a democracy. Though skills for this type of activity, both technical and creative, are still limited, the desire to provide quality western-style news coverage exists, and appears to be growing. The only current government impediment to this type of growth is not censorship or threats thereof, but the government monopoly on the technical needs of media, i.e. printing press, television and radio frequencies, etc. Though this is still a serious obstacle, the government has made promises to privatize media technology within a year's time.

ENI's Significant Contributions

Work with independent television stations throughout Armenia over the last six months has led to the development of an independent television network, a stronger understanding and capacity for objective professional journalism, technical improvements, improved managerial skills and focus on financial sustainability, and broad discussion of the importance of cooperation and journalistic ethics.

Work with NGOs over the past six months has focused on capacity building, including advocacy and democratically-oriented NGOs. A core group of NGOs has been encouraged and strengthened in their pursuit of democratic reform initiatives, and have actively lobbied the GOA on several occasions related to legislation and decrees which might suppress civic participation, with some success in particular on work to revise the new NGO law (SO 3 2).

Parliamentary development work over the last three months has been aimed at enhancing the capacity and transparency of the National Assembly. In addition to developing working dialogues with NA factions, a series of workshops have been developed, focused on constituency relations, effective coalition building, and the importance and utility of public hearings.

Work over the last three months with drafters of revised electoral laws has had impressive results. By first reading in the National Assembly, 4 out of 10 recommendations for improvement of transparency/efficiency/fairness within the electoral process have been incorporated into the new presidential and municipal electoral laws.

Commitment and Capacity of Development Partners

No other international donor is providing long-term technical assistance in the area of parliamentary/political party training. However, both the British Embassy and EU/Tacis are currently contemplating providing resource assistance to the parliament, such as equipment, texts, and serials. Plans have not been finalized for this assistance. USAID will maintain regular communication with these and other donors as relates to this type of assistance.

The donor community has designated assistance to NGOs as a priority area. EU/TACIS under its democracy program provides small grants to human rights groups and other advocacy NGOs who can find EU partners to work with. The UNHCR is committed to establishing a human rights educational resource center and supporting it with technical assistance and resources. USAID will coordinate closely with other donors to insure program synergy and resource maximization.

In the area of media development, EU/TACIS, the UN organizations, and the British and German Embassies are providing limited programs of assistance. EU/Tacis and the two embassies have provided training in their home countries, as well as limited equipment provisions. Both EU/Tacis and UNDP support (different) Press Clubs, with USIS providing complementary assistance to the Yerevan Press Club which Tacis is currently supporting. These donors' efforts have focused in large part on print media development, whereas USAID's are largely focused on independent television. USAID's continued programs in this area, and programs in the area of print and radio development as they are established, will be closely coordinated with on-going international donors' assistance efforts.

Illustrative Approaches

- A Establishment and Operation of Independent Media Train staff and provide equipment to independent TV to prepare state-of-the-art productions, news broadcasts, and documentaries for general audiences.
- B Establishment and Strengthening of Media Associations and Networks Promote the establishment of professional associations for press, TV and radio. Provide training in self-sustainability, coalition building, and legal rights and responsibilities. Develop broadcasters' capacity to communicate their views, and influence parliamen-

tarians and government decision-makers to adopt legislation and regulations safeguarding freedom of the press

- C Election Assistance Provide legislative drafting assistance for the development of the new presidential and municipal elections laws, provide technical and advisory assistance on reform of electoral processes, provide training for poll-workers, support and develop voter education programs, in coordination with the Central Election Commission, local NGOs, and international donors, and support and training for domestic monitoring organization
- D Political Party and Parliamentary Development Provide training to political parties, both in and outside of the current parliament, on building organizational capabilities, operating as effective parliamentary factions inside the legislature, upgrading parliamentary skills, strengthening party-constituency linkages, and building substantive political platforms Training will include, as applicable, parliamentary staff
- E Support for Democracy-oriented NGOs Help to increase the organizational capacity of human rights, advocacy and constituent-focused NGOs (e.g., women's and consumers' rights groups, etc.) The goal of this support is to improve the management and communications capacity of these organizations and strengthen their ability to assist in developing and promoting reform legislation related to their respective areas of interest Small grants will be provided to democracy-oriented NGOs with demonstrated capacity and will develop self-sustainable programs focused on civic, political, and public market reform efforts
- F Improve Linkages Among NGOs and Between NGOs and the Press Assistance will aim at improving inter-NGO coordination and developing effective strategies for communicating NGO interests/positions to the press and the general public

Sustainability

Armenia's civil society has reached an important cusp in its development USAID targeted assistance at this time, in coordination with other international donors, may prove the crucial factor in sustaining the impetus for growth

Parliamentary development and the strengthening of political pluralism will benefit tremendously from USAID technical assistance, but for long-term sustainability, much will depend on sustained political will on the part of the GOA, as well as a gradual revision and restructuring of the legal framework in which these institutions and organizations function If political will for reform remains at its current level, USAID assistance will materially affect accomplishment of the intermediate results noted in the strategic framework within the time frame established, but full achievement of these goals could take as long as ten years If political will improves, the possibility for achievement within the time frame will increase, and if it worsens, we will see the latter

The continued development of the NGO community also depends on sustained political will, but less so. With sufficient resources, USAID assistance in developing the capacity and strength of these organizations over the time frame noted in the strategic framework, and with continued parallel and complementary assistance from other donors, will in fact be able to sufficiently entrench "grass-roots" democratic initiative in Armenia. In fact, if GOA political will should worsen over time, a solid grass-roots foundation will be well positioned to prevent serious democratic backsliding.

The same is also true for the development of independent media. USAID and other international donor assistance - and sustained contact - over time will both develop sufficient self-sustainable capacity on the part of independent media outlets, and enough international recognition and support for freedom of the press in Armenia will allow the media to move forward with less and less governmental and technical impediments to the provision of domestic and international news coverage for the widest possible range of Armenian citizens.

One of two caveats to the above analysis is related to the establishment of human rights organizations. As noted in the strategic framework, USAID resources are not currently dedicated to such activities. Though human rights provisions are to be found in the constitution, and USAID assistance under strategic objective 2.2 will support the development and passage of implementing legislation to support those provisions, without the existence of institutions such as a human rights' ombudsman, or its like, lack of adequate enforcement of human rights laws could severely impede citizens' participation in political and economic decision-making. As noted, UNHCR is focusing on this issue in Armenia. UNHCR's failure to successfully achieve its goals in this area could substantially slow the pace of USAID's achievement of strategic objective 2.1.

The second caveat is related to the development of civic education in Armenia. Though USAID's assistance within SO 2.1 may make substantial in-roads with this generation of Armenia's citizens', for long term sustainability of democratic reform in Armenia, future generations must be inculcated as early as possible with understanding of citizens' rights and obligations within a democratic society. Though the Armenian education system, both on a university and secondary school level, appears to have the will to provide this type of education, the materials, resources, and teaching methodologies are not available or known. Partners noted in the strategic framework are focused in this area, but again, failure on their parts to achieve substantial impact in this area may affect the long-term sustainability of USAID's assistance in the areas covered under SO 2.1.

The estimated USAID funding level is \$9.9 million from FY 1996 to 2000. Substantial achievement of the SO should be possible with this level of resources if the above assumptions and issues permit.

Strategic Objective 2.2 Legal systems that better support democratic processes and market reforms

Problem Analysis

Armenia inherited a Soviet legal infrastructure and political culture which present substantial obstacles in the country's evolution toward a market-oriented society based on the rule of law. Though Armenia has recently made some progress in drafting and enacting commercial laws, little progress has been made on concomitant laws related to civic/human rights and criminal codes. Further, little headway has been made in developing a reformed judicial system capable of effectively implementing and enforcing new laws. There exists only a marginal foundation of western legal concepts and methods in the public and private sectors.

The new constitution, which passed by popular referendum on July 5, 1995, provides a launching point for legal reform, but has established a powerful presidency, weak parliament, and potentially impotent judiciary. Some of these shortcomings may be partially remedied through enabling legislation that would implement some promising democratic provisions in the constitution.

The task of drafting, implementing and enforcing appropriate civil and economic legislation necessary for developing a legal system capable of supporting Armenia's integration into the world economy, and interaction with other democratic societies on an equal footing is enormous. Discussion of the development of a commercial legal and regulatory framework can be found under SO's 1.3 and 1.4.

As noted above, the judicial system in Armenia, as in other former Soviet republics, is inadequate to meet the needs of a democratic market system. The system suffers for a lack of legislation under the constitution establishing a well-defined judicial court system, and areas of responsibility between courts (such as the as yet established economic courts). Judges and judicial staff, as well as legal practitioners generally, do not have adequate training provisions for either general concepts in western legal traditions, nor training for general administrative skills. The courts lack resources and adequate facilities, including the lack of a system for distributing new legislation. The judicial system is impeded by the constitution's establishment of the heavy hand of the executive branch over it, as well as the continued ability of the procuracy (prosecutors' office) to exert control. And finally, the court system utterly lacks the respect of Armenian citizens.

In addition to developing an enabling environment for democratic institutions and functions, Armenia's population at all levels will need to undergo a dramatic change in attitude towards the letter and the institutions of the law. The Soviet legacy has left citizens of the former soviet republics with not only a pronounced apathy towards the law, but a pronounced disrespect for laws and legal institutions. Under the old regime, many felt that violating the law was in fact either an act of "good faith", in violating a system so corrupt and unfair, or merely, part of the reality of survival. Citizens of a democratic Armenia will not only need to be aware of their rights and responsibilities within this new system, but have a respect for the laws and legitimate limitations the a rule of law system places on them.

Thus, for Armenia to establish itself as a society based on a firm rule of law, appropriate laws must be established, appropriate means for enforcement must be established,

and citizens must be given the means (and reason) to understand and respect the legal establishment

Results Framework

See R4, Part II

Judging Performance

See R4, Part II for Performance Assessment Data

Overall Progress

Though the obstacles and needs for reform in these areas are great, the political will appears to be strong to take the steps necessary

The National Assembly and its permanent committees have been active in soliciting advice and comments from international legal experts on a range of legislative acts pending. There is a realistic recognition on the part of individual deputies, committee chiefs and parliamentary leaders that their skill levels are currently unequal to the task at hand. On the commercial side, though much initial legislation had been haphazard and inconsistent, recent iterations of the same laws have been painstakingly crafted to fulfill IFI conditionalities, this precedent may do much to increase the level of professionalism on more civil-oriented legislation. Finally, the executive branch, since the establishment of this new parliamentary membership (and its inherent ruling party leaning), has not taken the measure of interference in legislative processes that it has by right of the constitution to take. Whether this is because the National Assembly has yet to push forward legislation at odds with the executive, or whether there is a limited degree of respect for the independence of the institution itself remains to be seen.

Though the judicial system is in shambles, and is not as yet, as noted above, supported by appropriate legislation, again, political will seems to be strong to move forward with reform and restructuring. The constitutional court, after much delay, has been appointed, and its role and responsibilities are currently under discussion on all levels of government - ministry of Justice, the National Assembly, and judicial incumbents themselves. Judges and legal practitioners appear to be receptive to western legal concepts and practices, and eager to absorb those international norms which best suit Armenia's situation.

No progress can be seen on the front of citizen respect for legal systems. Not only is there no trust for the judicial process, there is a pervasive fear of the procuracy, based on both the Soviet legacy, and continued manipulation of the legal system. Citizens' also appear to be fairly skeptical about their elected officials' capacity and will to reflect their interests in developing the laws of the land, and where there is not skepticism, there is at least apathy.

ENI's Significant Contributions

Work over five months on advising the drafters of the Civil Code, resulting in draft Civil Code of high quality/based in large part on international democratic and market norms,

Judicial conference in July 1995 brought judiciary together to discuss issues of commercial arbitration in a market system, court reform, judicial ethics and independence,

Judicial training program to begin September, 1996

Commitment and Capacity of Development Partners

USAID's primary partners in this area include German supported organizations such as GTZ and others, EU/TACIS, French legal expertise, and to a lesser extent, the UN organizations. German assistance is focused primarily on specific commercial legislation, but the Embassy is apparently contemplating an expansion of assistance in this area. EU/TACIS provides legal commentary in a responsive fashion to sectors of the GOA. UN organizations, though the full scope of their programming is not available as yet, appear to be focusing primarily on human rights laws, and rather than providing drafting advice, generally focus on seminars and workshops to discuss specific areas of legal reform. Donor coordination to date has been extremely poor, but USAID is in the process of developing regular coordination channels to rectify the situation.

Illustrative Approaches

- A Constitutional Implementing Legislation Design and implement training workshops on legislative drafting for parliamentarians, government officials, and their respective staffs. Also, provide short-term consultative expertise on specific legislative drafting requirements.
- B Civil Code Drafting Assistance Help draft and encourage the enactment of a new civil code and targeted commercial laws through key parliamentary committees, the Ministry of Justice, and the business and NGO community, in coordination with economic restructuring programs.
- C Strengthen Armenia's Private Legal Profession and Legal Advocacy Organizations A technical assistance program for reform-oriented Armenian lawyers will help revitalize and legitimize the legal profession, particularly in the areas of commercial law and human rights. Training will focus on developing an indigenous capacity for continuing legal education, private law-practice management, curriculum reform and development, as well as the development and strengthening of legal advocacy organizations, in conjunction with activities implemented under Strategic Objective 2.1.
- D Judiciary Strengthening and Training Building on the July 1995 Judicial Conference which brought U.S. Supreme Court Justice Scalia together with key members of the Armenian judiciary, develop and implement a program of technical assistance to help professionalize and strengthen the judiciary and thereby foster greater institutional independence and effectiveness. Training will focus on enhancing the capability of

judges to interpret and enforce new civil and commercial laws, as well as improve administrative capacity

- E Support the development of indigenous Bar and Judicial Associations. Support the development of these organizations and their capacity to provide information and training both to their members, and to the public at large. This activity will also focus on developing citizen respect for the legal system and its practitioners

Sustainability

As political will was crucial to the sustainability and achievement of USAID objectives under SO 2.1, it is doubly so for SO 2.2

USAID assistance in this area must be focused both on the institutional side of development, i.e., with the legislature, ministries and judicial system, but also on the "grass-roots" side, that is, working with the practitioners and participants in the reform of the system

Though USAID assistance will not be able to assure that every piece of legislation related to democratic and market development is appropriate, non-conflicting, and based on international norms, assistance can be targeted at those pieces of legislation which are deemed crucial to the solidification and enforcement of civil and economic rights

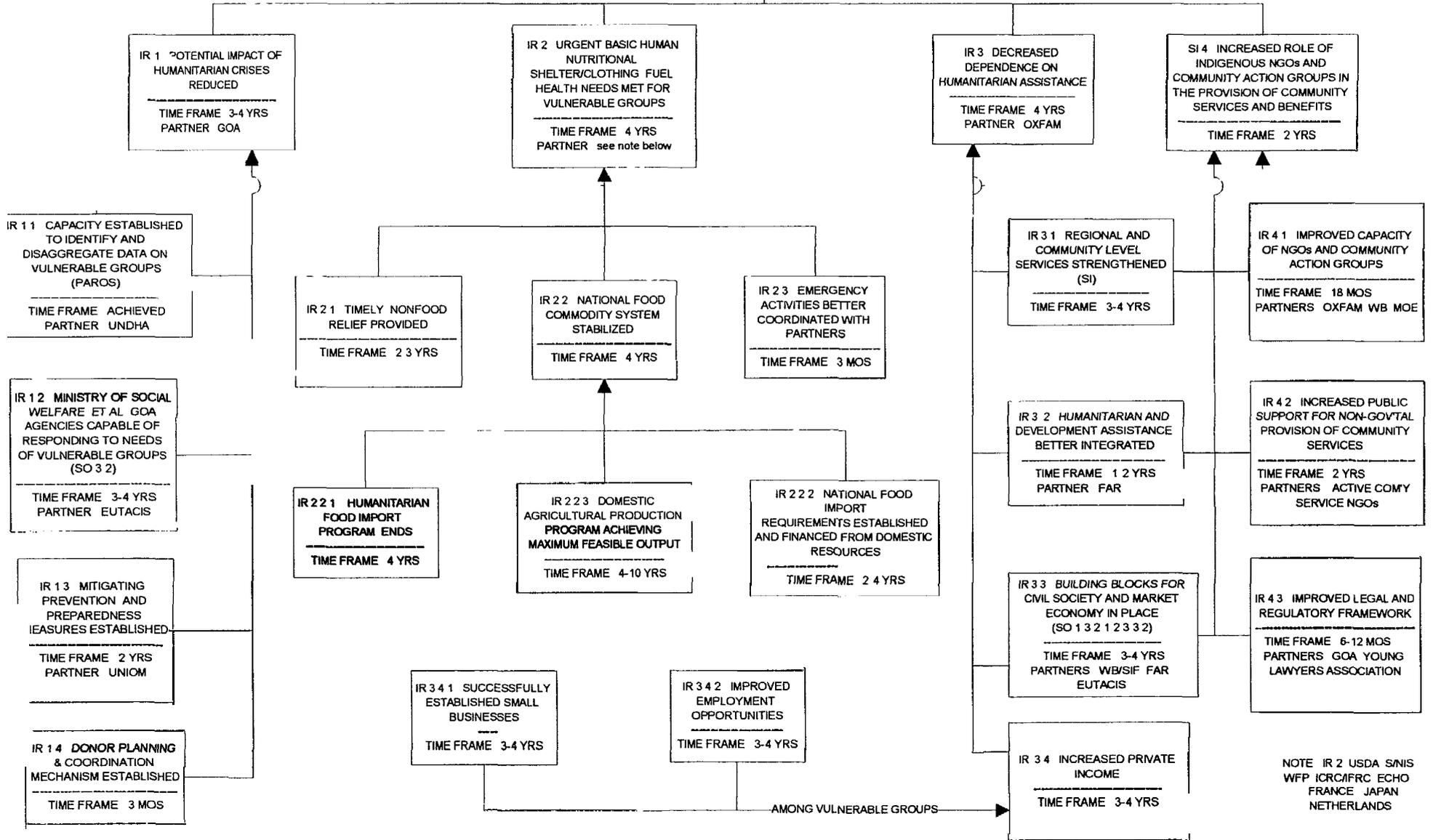
Both judicial reform and the evolution of popular behavior towards the legal system are long-term goals - not only for USAID assistance, but for the Armenians themselves. While USAID will be able to materially affect the intermediate results noted in the strategic framework within the period to the year 2000, and those results, so long as political will is steady, will not be eroded over time, for full achievement of the SO, a minimum of 10 years will be required

The estimated USAID funding level is modest - \$5.8 million from FY 1996 to 2000. Significant progress and achievement of intermediate result 1 of the framework is possible with these resources, achievement of IR 2 is very dependent on social developments independent of USAID assistance, and IR 3 would require significantly more resources for full achievement

ARMENIA SO 3 1/SI 4 1

MARCH 29 1996

SO 3 1 REDUCED HUMAN SUFFERING AND CRISES IMPACT
 TIME FRAME 4 YRS



NOTE IR 2 USDA S/NIS WFP ICRC/FRC ECHO FRANCE JAPAN NETHERLANDS

112a

HUMANITARIAN ASSISTANCE AND SOCIAL SECTOR RESTRUCTURING

Strategic Objective 3.1 Reduce Human Suffering and Crisis Impact.

Problem Analysis

As a result of an earthquake in 1988, followed by economic deterioration associated with the break-up of the Soviet Union and a trade blockade, a large proportion of the population in Armenia live below the poverty level. According to the United Nations, the cost of food alone to sustain an average Armenian family is \$141.00 per month, whereas the average wage is about \$7-8 per month in the public sector and \$21-23 per month in the private sector (estimated). Remittances from the diaspora, massive humanitarian aid and income from informal economic activity not captured in the statistics, as well as reliance on extended families, have been essential to survival. Until economic conditions improve, generating significant employment and household income, the vulnerable population will not decline significantly.

Following the break-up of the Soviet Union, Armenia experienced total disruption of existing social services, which were quite comprehensive under the old socialist regime. The Government and USAID have determined that it is not useful or productive to rely on the old Soviet system for the distribution of humanitarian assistance or the provision of social services. That system comprised thirteen categories which, at best, only provided a probability for vulnerability. What is required is the verification of poverty among identifiable households through an assessment and ranking of household poverty levels.

Donors and the GOA agree that the public and civic organizations have an important role in identifying social needs and implementing activities to benefit vulnerable groups. However, civic organizations, both local NGOs and community action groups presently lack the experience and capacity to perform this role. To enable donors and the central government to move beyond provision of direct humanitarian services and develop a more sustainable approach, it is necessary to build this indigenous capacity. While this is a critical requirement, USAID resources in this area are not of a magnitude to permit treatment of "Improved sustainability of Social Benefits and Services" as a separate Strategic Objective. Rather, efforts here are considered a Special Initiative closely associated with SO 3.1 and is discussed in this discussion.

Results Framework

See R4, Part II

Judging Performance

See R4, Part II for performance assessment data

Overall Progress

Between 1992-1995, USAID and other donors primarily focused their resources on humanitarian assistance. Provision of food and fuel by donors, including the United States, enabled Armenia to get through the past four winters without serious loss of life. Humanitarian assistance will still be required for several more years, but at much diminishing levels, as the economy has bottomed out, and opportunities for jobs and incomes are again increasing. USAID is transitioning its efforts to provide continued bridge financing for humanitarian assistance, while increasingly focusing on the establishment of broad-based competition and economic growth. The long term answer to the humanitarian crisis is the creation of productive income opportunities - job creation in the private sector.

Working on behalf of the GOA, donors and relief agencies have concentrated on meeting food and fuel shortages for vulnerable groups. They have improved shelters for the refugees and homeless in the earthquake zone and assisted vulnerable populations to meet emergency winter needs through food and fuel distribution. The GOA's approach to addressing humanitarian needs has been to allow donors and relief agencies wide operating discretion, an approach which has achieved highly positive results.

ENI's Significant Contributions

Seventy-percent of USAID assistance to Armenia since FY 1992 has been humanitarian -- predominantly foodstuffs and heating fuel. More than 175,000 families, 35,000 shelters and 1,100 schools received kerosene during the winter of 1995/96 through the USAID-funded Winter Warmth program. The school heating program allowed schools to remain open in winter, increasing school attendance by fifty-four percent during the winter of 1994/1995. Food aid was provided before winter to approximately 71,000 vulnerable Armenian families along with desperately needed basic commodities (stoves, soap, clothing, blankets, agricultural products, etc.) for perhaps as many as fifty thousand vulnerable families. Bridging activities are creating employment opportunities for hundreds of unemployed workers in both the agricultural and light industrial sectors. This assistance will also help shift local expectations from humanitarian assistance to development through self-help activities.

Since 1993, out of a total population of 3.4 million, there have been over 1,500,000 recipients of USAID-funded food assistance through direct grants to CARE and sub-grants to U.S. PVOs under the Save the Children Federation (SCF) Cooperative Agreement. Under the SCF agreement, two projects provided pharmaceutical coverage to 368,000 women in Yerevan and children nation-wide under the age of fifteen.

Until recently, however, humanitarian aid in Armenia was distributed to the population based on less than satisfactory social categories established during the Soviet era. The Ministry of Social Welfare is now working to put in place the USAID-funded needs-based voluntary registration program (PAROS) which is increasing the ability of the GOA and donors to target assistance to the most vulnerable groups. In July, 1994, USAID provided a grant to the Fund For Armenian Relief to assist the GOA to improve the capacity of the PAROS registration data base. The program is also improving the criteria used to calculate the vulnerability ranking of each household. Government social workers are being

trained to manage the data base, verify the vulnerability status for individual households, and design interventions for the most vulnerable households

During the first phase of the program, the Ministry of Social Welfare registered 600,000 households. The program's first application was in April, 1995 as part of the USAID funded kerosene distribution activity for winter heating. Since that time, several other humanitarian activities has used the program to compile vulnerable population lists. All major international donors are using the PAROS program (e.g., WFP, ECHO, UNHCR)

Since April, 1994, USAID has funded an NGO Training and Resource Center to promote the formation and development of local NGOs. Forty-three NGOs have graduated from a core management training program. Several NGO Center graduates have become implementing partners with international organizations or have received international funding to manage programs of their own.

USAID funding to U.S. and local NGOs is also being used to provide management training, technical assistance and grants to local NGOs and civic action groups in order to increase local NGO and civic action group capacity to assess community needs and provide humanitarian and social services.

Commitment and Capacity of Development Partners

The strength of the donor community in working together has enabled this comprehensive program to operate effectively. USAID is working closely with the World Food Program (WFP) and other donors in providing food aid to the vulnerable population. WFP estimates that it will distribute food assistance to 65% of the most vulnerable while USAID and other donors will provide the balance of support (20% and 15% respectively). Save the Children Federation and PVOs/NGOs under the SCF Cooperative Agreement are leveraging support from other international NGOs (e.g., International Committee of the Red Cross (ICRC), the United Methodist Committee, etc.) to obtain non-food commodities such as candles, blankets, clothing, soap, and detergent.

In addition to direct assistance, USAID also supports humanitarian assistance through international organizations. Support through UNICEF, helps control diphtheria through the provision of vaccines to immunize the population at risk, including children and adults. USAID-funded assistance through the International Committee of the Red Cross, supported internally displaced persons and victims of conflict in the Nagorno-Karabakh region. Also, the Caucasus Logistics Advisory Unit (CLAU - under the World Food Program) manages the rail, port, and communications network throughout the Caucasus and has made the difference between chaos and the efficient delivery of humanitarian assistance. The CLAU operation, U.S. Center for Disease Control, and PVO programs - all financed by USAID - helped to build GOA and local NGO capacity to manage and respond to human crises and emergencies.

USAID is working closely with the World Bank in the development of a Social Investment Fund (SIF) to stimulate micro-enterprise development and employment creation. In FY 95 USAID designed and implemented the pilot SIF program, to test 15 micro-projects.

and to develop project selection criteria for the World Bank's SIF Operations Manual. The lessons learned have been integrated into the Operational Manual and the IBRD has committed \$20 million for the expanded SIF which was launched in November 1995.

EU/TACIS is working closely with the Ministry of Labor and Social Services to formulate new legislation to reform the social security system. TACIS is also working with the National Research Institute for Labor and Social Affairs to develop a graduate-level university-based training curriculum for social workers.

Illustrative Approaches

USAID's strategy for 1996-99 with regard to delivery of humanitarian assistance is to provide emergency assistance (fuel, food and basic non-food commodities) at sharply reduced levels, as economic improvements permit, and finance bridging activities to support domestic production of items needed by vulnerable groups such as food preservation materials, stoves, clothing and blankets, and domestically processed food, thus gradually decreasing dependency on external aid.

To improve the sustainability of social services, USAID's emphasis is two-fold: (a) through technical assistance, training, and limited commodities provide assistance to transform Armenia's system of family allowances and benefits so that only the most vulnerable receive humanitarian assistance, and (b) through technical assistance and training under the SCF Cooperative Agreement promote civic action and NGO capacity building, permitting domestic organizations to begin to provide social services and thereby gradually decreasing dependency on external aid.

A. Assistance to Vulnerable Groups. The 1995-96 kerosene program (the third year) provided 25,000 metric tons of kerosene to vulnerable families, shelters and schools. This activity will again be implemented during the winter of 1996-97 in partnership with the GOA and a US PVO. The level of fuel assistance provided beyond 1997 will mainly depend upon the extent to which there is a continued improvement in electricity supply in the short to medium term and the fate of the prevailing trade embargo, which if lifted would increase the prospects for commercial fuel imports at more competitive prices.

In light of reduced program resources, and expected increases in domestic agricultural production within the medium term, USAID will continue to fund food imports at a reducing level over the period 1996-97 through the Georgia-Armenia Nutritional Supplement Project (GANSP). Under this activity in FY 96, CARE International, working closely with the Ministry of Health will distribute wheat flour, vegetable oil, kidney beans, dry whole milk to pregnant and lactating women and wheat flour, vegetable oil, and Farina to targeted beneficiaries, and DWM to needy children from 6 months to five years of age.

In addition to assistance under GANSP, USAID financed wheat imports will continue over the plan period subject to availability of funds. Certain non-food commodities will be provided under the SCF Cooperative Agreement in the period 1996-97 and will primarily be directed toward meeting the winter needs of the most vulnerable. It is anticipated that sub-

grantees will continue to leverage some commodity support from international organizations and PVOs

B Bridging Activities USAID will provide through Volunteers in Overseas Cooperative Assistance (VOCA), technical assistance to increase food production of rural households and improve food security of the urban poor by enabling them to purchase at reasonable prices locally produced basic agricultural products. Commodities will include cooking oil, potatoes, processed meats, dairy products, fruits and vegetables.

Under the SCF Grant bridging activities will focus on providing assistance to locally produce food, preservation materials, stoves, clothing and blankets. Such activities aim to generate local employment and gradually decrease dependency on humanitarian aid.

C Transforming Existing System of Family Allowances and Benefits USAID will continue to work closely with the GOA to transform its family allowance/benefits system by expanding the PAROS (BEACON-II) Project. It is anticipated that the following activities will be completed during the life of this project:

- * Establishment of a national data entry and information management network,
- * Updating registered household information including data on gross earnings,
- * Establishing objective criteria for ranking households contained in the project data base, and
- * Conducting system tests of the project's database by making distributions to beneficiaries to verify that the most vulnerable have been properly ranked.

D Strengthening Community Development and Enhancing NGO Capacity USAID will fund activities under the SCF Cooperative Agreement to strengthen community development and enhance NGO capacity. The first activity will promote civic action by developing the capacity of community groups. Micro-projects (up to \$5,000) will offer a mechanism to stimulate organized civic activity around priority community needs, and the ability to address those needs. SCF will seek to help "graduate" communities to larger initiatives (up to \$150,000 under the World Bank Social Investment Fund) through assistance with assessments and application procedures. For the second activity, small grants to local NGOs (up to \$25,000) will serve as a method of instituting activities for larger, more complex projects in order to increase the capacity of indigenous organizations.

These two activities under the SCF Grant will strengthen the capacity of NGOs and community groups to (a) assess the needs of their members, constituencies, or local populations of vulnerable groups, (b) to develop solutions to problems, and (c) to mobilize a range of resources (governmental/nongovernmental, private donors and voluntary donations of time, money, and materials) in order to effect measurable change. Assistance will also be provided to facilitate and promote partnerships and collaboration between local and

international NGOs, international organizations, and governmental institutions through joint programs, information sharing and resource pooling

Sustainability

Ultimately Armenia should no longer need direct donor-provided humanitarian assistance when incomes and employment rise to the level that domestic resources can meet remaining requirements of vulnerable groups which exist in all societies - pensioners, unemployed, handicapped, etc Because the blockade-produced economic dislocations are the principle cause of the humanitarian crisis, lifting of the blockade is a critical assumption for this transition

Within the current political environment, this strategic plan, and particularly the associated Special Initiative on indigenous capacity-building, incorporates activities designed to increase the sustainability of social services improving Armenia's governmental capacity to target its social benefits programs, bridging activities to produce essential goods locally while creating jobs, strengthening community and NGO capacity to provide services But ultimately the resolution of political conflict in the region and the creation of a vibrant private sector-led economy are required for Armenia to achieve sustainable social systems

B Homestretch Strategic Objectives

Section B is not applicable for the Armenia Strategy

C Special Objectives

- 1 Increasing the Role of Indigenous Non-Governmental Organizations and Community Action Groups in the Provision of Social Services and Organizations

Closely associated with SO 3 1 is this Special Initiative to improve sustainability of social services. Its causal linkages and expected results are described within the results framework for SO 3 1, and progress to date as well as planned and ongoing activities are described within the narrative discussion of SO3 1 because the two are inextricably linked. No separate budget is established for this initiative, rather funds will be allocated from within the SO 3 1 budget.

- 2 NIS Exchanges and Training. Training and Exchanges funds are considered as cross-cutting activities, as they contribute to all strategic objectives. As such, their objectives, intermediate results, indicators, time frame and criteria for judging performance fall within the strategic objectives which they support.

D. Environmental Issues:

Section 118/119 does not apply, there are no tropical forests in the Caucasus

PART III. RESOURCE REQUIREMENTS

A. Program Funding Requirements

The Budget Tables are attached The Program Funding Narrative will be sent via e-mail tomorrow, on 04/26/96

B. OE/Workforce Requirements

Guidance has not been provided by USAID/W for development of this section

C. Discussion of Programming Options

Impact of funding Options in FY 1998

A cut in FY 1998 funding of 20 percent below the request level would significantly affect Strategic Area 3, "reduced human suffering and crisis impact, and improved sustainability of social benefits and services" Because of the importance of continuing Armenia's transition away from humanitarian assistance to activities directly promoting economic and democratic reform, the budget, even at the full request level, proposes a significant decline in humanitarian assistance Funding for economic restructuring and democratic transition objectives is fully protected at a 20 percent cut, whereas FY 98 funding for strategic area 3 would be cut from \$12.6 million to but \$5.4 million If the political crisis in the region is resolved and the embargo is lifted, reductions in humanitarian assistance of this magnitude could be undertaken If the political stalemate and Armenia's isolation continue, this assumption would have to be reexamined

The second area to be cut in the event of a 20 percent cut is other agency activities These activities do not directly contribute to the achievement of our strategic objectives

Impact of Funding Option for FY 1999, and 2000

- Decreased funding for Strategic Objective 1.3, Trade and Investment TA, year 2000
- Lower level funding for Strategic Objective 1.5, Energy Sector, year 2000
- Accelerated Phase out of Strategic Objective 3.1 with substantially less funding in years 1998-1999
- Elimination of funding for Cross Cutting Initiative -Other Agency Programs

Overall, however, this Programming Option doesn't seriously affect the attainment of the Armenia Strategic Plan

ARMENIA Resource Requirements by SO
(in 000s)

STRATEGIC OBJECTIVE	FY 96 Approved OYB	FY 1997	FY 1998 Plan	FY 1999 Plan	FY 2000 Plan
	ARM	ARM	ARM	ARM	ARM
Economic Restructuring					
1 2 Increased soundness of fiscal policies and fiscal management practices	2,000	1,700	1,200	1,200	1,200
1 3 Accelerated development and growth of private enterprises	13 750	15 500	18 400	19 500	23 700
1 4 A more competitive and market responsive private sector	2,250	4,000	2,500	2,500	2,500
1 5 A more economically sustainable and environmentally sound energy sector	6 800	8 000	8 000	10 000	10 000
Democratic Transition					
2 1 Increased better informed citizens participation in political and economic decision making	2,300	2,000	2,800	2,800	2,800
2 2 Legal systems that better support democratic processes and market reforms	1,200	1,000	1,200	1,200	1,200
2 3 More effective responsive and accountable local government					
Social Stabilization					
3 1 Reduced human suffering and crisis impact	49,850	15,700	12,600	9,000	0
3 2 Improved sustainability of social benefits services					
Special Initiatives/CrossCutting Issues					
Medical Partnerships					
NET Training & Exchanges	1 000	1 100	500	1 000	1 000
Other Agency Transfers	5 600	6 000	2 800	2 800	2 600
Warsaw Initiative	250				
TOTAL COUNTRY	85,000	55,000	50,000	50,000	45,000

ARMENIA Resource Options/Levels by SO
(in 000s)

STRATEGIC OBJECTIVE	FY 96 Approved OYB	FY 1997 Plan	FY 1998 Plan (-20%)	FY 1999 Plan(- 20%)	FY 2000 Plan (-20%)
	ARM	ARM	ARM	ARM	ARM
Economic Restructuring					
1 2 Increased soundness of fiscal policies and fiscal management practives	2,000	1,700	1,200	1,200	1,200
1 3 Accelerated development and growth of private enterprises	13 750	15 500	18 400	19 500	20 000
1 4 A more competitive and marker responsive private sector	2,250	4,000	2,500	2,500	2,500
1 5 A more economically sustainable and environmentally sound energy sector	6,800	8,000	8,000	10,000	8,000
Democratic Transition					
2 1 Increased better informed citizens participation in political and economic decision making	2 300	2 000	2 800	2,800	2,800
2 2 Legal systems that better support democratic processes and market reforms	1 200	1 000	1 200	1 200	1,200
2 3 More effective responsive and accountable local government					
Social Stabilization					
3 1 Reduced human suffering and crisis impact	49,850	15,700	5,400	1,800	0
3 2 Improved sustainability of social benefits services					
Special Initiatives/CrossCutting Issues					
Medical Partnerships					
NET Training & Exchanges	1 000	1 100	500	1 000	300
Other Agency Transfers	5 600	6 000	0	0	0
Warsaw Initiative	250				
TOTAL COUNTRY	85,000	55,000	40,000	40,000	36,000

ARMENIA Strategic Plan Budget Sheet
(in 000s)

PROJECTS	SO	FY 1996 OYB ARM	FY 199 ARM	FY 1998 ARM	FY 1999 ARM	FY 2000 ARM
110-0001 Special Initiatives	31	48 550	15,700	12,600	9,000	0
110-0002 Energy	15	6 800	8 000	8 000	10 000	10 000
110 0003 Environment						
110 0004 Health Care		1 300	0			
110-0005 Private Sector	13	550	1 000	800	1 900	3 500
110 0006 Food Systems	13	0	0			
110-0007 Democratic Reform	2122	3,500	3 000	4 000	4,000	4,000
110 0008 Housing	13	750	2 000	1,000	1,000	1,000
110-0009 Econ Restructuring	12131	5 200	6 700	8,800	8 800	11,700
110-0010 Eurasia Foundaton	13	1 500	1 500	1 500	1,500	1,200
110-0011 Enterprise Funds	13	10,000	10 000	10 000	10,000	10,000
110 0012 Exchanges & Training		1 000	1 100	500	1,000	1,000
Performance Fund						
632(A) Transfers (including)		5 850	6 000	2 800	2,800	2 600
Direct Trade and Investment		0	1 800	0		
USIA Training and Exchanges		1 500	1 000	1,000	1,000	1 000
Warsaw Initiative		250				
Other		4,100	3 200	1 800	1 800	1,600
Transfers to G Bureau		0	0	0	0	
TOTAL COUNTRY		85 000	55 000	50,000	50,000	45,000