

## Policy Based Lending in Armenia

### Project Name and start and end date:

- *Rehabilitation Credit (P008275, 3/7/95 – 6/30/96)*
- *Structural Adjustment Technical Assistance Credit (P044387, 3/22/96 – 12/31/99)*
- *Structural Adjustment Credit (P042793, 3/22/97 – 12/31/97)*
- *Structural Adjustment Credit II (P044796, 9/22/97 – 6/30/99)*
- *Second Structural Adjustment Technical Assistance Credit (P051026, 9/22/97 – 12/31/02)*
- *Third Structural Adjustment Credit (P051171, 12/28/98 – 6/23/01)*
- *Fourth Structural Adjustment Credit (P065189, 6/12/01 – 3/31/03)*
- *Fifth Structural Adjustment Credit (P075758, 4/17/04 – 6/30/04)*
- *Poverty Reduction Support Credit (P078673, 12/23/04 – 12/31/05)*
- *Second Poverty Reduction Support Credit (P093459, 4/5/06 – 6/30/07)*

### Project Description:

These 10 projects – spanning a dozen years -- supported the economic reform program of the Government of Armenia whose principal goals were to restore and maintain macroeconomic stability, create conditions for economic growth, and improve living conditions. The projects targeted a broad set of areas in order to lay a solid foundation for transformation of the economy from a centralized model to a market-based one. The reforms supported by the IDA-funded adjustment program can be grouped into three categories: (i) improving financial discipline and strengthening public sector management, (ii) enterprise reform and private sector development, and (iii) advancing reforms in social protection, health, and education. The program included two technical assistance projects which supported the implementation of the eight adjustment operations by providing the necessary expertise for strengthening institutions. Through these loans IDA was therefore able to help lay out a strong medium-term, and sequenced framework for policy reforms across multiple sectors, coupled with technical assistance and advisory work and complementary project investments in particular sectors.

**Impact:** *Over this 12-year period, Armenia has achieved spectacular income growth—by about 10 percent on average per year, rising to 13-14 percent in 2005 and 2006—and poverty reduction—from 56 percent in 1998 to 30 percent in 2005).*

### Some Highlights:

#### Financial Discipline and Public Sector Management

- Economic stabilization (inflation fell to 0.6% in 2005 from 176 percent prior to the adjustment program; the budget deficit fell from 9 percent to 1.9 percent, growth has averaged about 10 percent per annum)
- Improving budget management through the adoption of a rigorous Medium-Term Expenditure Framework (MTEF). The MTEF provided a framework to scale up sector reforms in a managed manner.
- Improving customs and tax administration and broadening the tax base

- Improved payment discipline in energy (collections increased from 30 percent to 85 percent)

#### Private Sector Development

- Removal of nearly all price controls and trade barriers
- Adoption of key financial legislation early in the program: a real property code, bank insolvency law, bankruptcy law, collateral law
- Reduction in bureaucracy – Armenia now ranks 34 overall in the World Bank's *Doing Business report*.
- Privatization of nearly all state-owned enterprises

#### Social Development

- Adoption of a poverty reduction strategy that provides a powerful tool for policy formulation
- Significant increase in budget allocations for health and education, doubling from 2002 to 2006.
- Family poverty benefit and pensions increased by more than 50 percent during 2002-2004

#### **Total Financing:**

The 10 projects totaled \$410 million of which \$382 million came from IDA financing and \$28 million was donor support, principally from the Netherlands, as well as from Argentina.

#### **IDA Contribution:**

The series of operations followed rapidly one on the other providing sustained financial and technical support to the Government and generating a critical mass of reforms that helped to raise living standards. The individual operations provided benchmarks that allowed the Government to pace its reform measures and gauge its success. The first three operations focused on stabilizing the economy and supporting basic financial legislation. The thrust of the reform program then evolved to supporting an enabling environment for the private sector (e.g. strengthening the power and irrigation sectors) and building human capital through health, education and upgraded safety nets. More than just providing critical deficit financing, the projects also provided a genuine opportunity for the Government to benefit from external expertise.

#### **Linkages**

The policy lending was accompanied by technical assistance operations, as well as technical assistance from IDA and donors, with significant support from the Japanese Policy and Human Resources Development fund. Technical Assistance brought in the transition experience of international best practices. Parallel investment operations in water, health, education and power were mutually reinforcing. For example, improved energy regulation and ownership policies supported by policy-based credits were matched by investment lending in energy. Finally, these policy operations were closely linked to IMF stabilization and poverty reduction programs.

#### **Next Steps:**

As envisaged in the Country Assistance Strategy, IDA plans to complete the series of Poverty Reduction Support Credits with a PRSC-III and a PRSC-IV, focusing on strengthening corporate and public governance, including tax and customs, and deepening competition policy and human development. As in the past, these policy-based projects are closely linked to on-going sector operations. The completion of the PRSC cycle will coincide with the coming parliament and presidential elections in 2007 and 2008. Future policy-based lending will depend upon budgetary needs and the Government's commitment to pursuing a reform agenda.