



# Country Partnership Strategy

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Armenia  
2014–2018

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Asian Development Bank

## **CURRENCY EQUIVALENTS**

(as of 2 December 2014)

Currency unit	–	dram (AMD)
AMD1.00	=	\$0.0023
\$1.00	=	AMD441.20

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CPS	–	country partnership strategy
CSO	–	civil society organization
DMC	–	developing member country
DRM	–	disaster risk management
GDP	–	gross domestic product
IDA	–	International Development Association
IED	–	Independent Evaluation Department
IOS	–	interim operational strategy
KPS	–	knowledge products and services
MDG	–	millennium development goals
MFF	–	multitranches financing facility
PPP	–	public–private partnership
RCI	–	regional cooperation and integration
TA	–	technical assistance

## **NOTE**

In this report, "\$" refers to US dollars.

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## COUNTRY AT A GLANCE

<b>Economic</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
GDP (\$ billion, current)	8.6	9.3	10.1	10.0	10.4
GDP per capita (\$, current)	2,666	2,844	3,363	3,293	3,452
GDP growth (% , in constant prices)	(14.1)	2.2	4.7	7.2	3.5
Agriculture	5.9	(16.0)	14.0	9.5	7.2
Industry <sup>a</sup>	(29.2)	5.7	0.0	5.7	(1.5)
Services	(4.3)	4.7	6.1	6.9	6.2
Gross domestic investment (% of GDP)	34.7	32.9	27.3	25.4	21.7
Gross domestic saving (% of GDP)	18.0	14.6	16.1	11.6	15.5
Consumer price index (annual % change)	3.4	8.2	7.7	2.6	5.8
Liquidity (M2X) (annual % change)	15.1	11.8	23.7	19.5	14.8
Overall fiscal surplus (deficit) (% of GDP)	(7.6)	(5.0)	(2.8)	(1.5)	(1.7)
Merchandise trade balance (% of GDP)	(24.1)	(22.0)	(20.7)	(21.2)	(19.1)
Current account balance (% of GDP)	(17.6)	(14.2)	(11.1)	(11.1)	(8.0)
External public debt (% of GDP)	35.7	34.7	36.4	37.7	37.0

  

<b>Poverty and Social</b>	<b>Earlier Period</b>		<b>Last Period</b>	
Population (million)	3.22	[2005]	3.02	[2013]
Population growth (annual % change)	0.10	[2005]	(0.31)	[2013]
Maternal mortality ratio (per 100,000 live births)	19.0	[2005]	19.2	[2013]
Infant mortality rate (below 1 year/per 1,000 live births)	12.3	[2005]	9.7	[2013]
Life expectancy at birth (years)	73.5	[2005]	74.8	[2013]
Adult literacy (%)	99.4	[2001]	99.7	[2011]
Primary school gross enrollment (%)	91.8	[2005]	94.1	[2013]
Child malnutrition (% below 5 years old)	4.0	[2005]	4.7	[2010]
Population below national poverty line (%)	29.8	[2005]	32.0	[2013]
Population with access to safe water (%)	89.4	[2005]	98.7	[2013]
Population with access to sanitation (%)	65.1	[2005]	69.7	[2012]

  

<b>Environment</b>				
Carbon dioxide emissions (million tons)	4.4	[2005]	4.2	[2010]
Carbon dioxide emissions per capita (metric tons)	1.4	[2005]	1.4	[2010]
Forest area (million hectares)	0.32	[2005]	0.31	[2010]
Urban population (% of total population)	64.1	[2005]	63.4	[2013]

  

<b>ADB Portfolio</b> (sovereign loans, as of 31 December 2013)	<b>OCR</b>	<b>ADF</b>	<b>Total</b>
Total number of loans	1	6	7
Net loan amount (\$ million, cumulative)	170.00	222.86	392.86
<b>Disbursements</b>			
Total funds available for withdrawal (\$ million)	170.00	222.86	392.86
Disbursed amount (\$ million, cumulative)	20.33	81.08	101.41
Percentage disbursed (disbursed amount/total available)	11.96	36.38	25.81

( ) = negative, [ ] = latest year for which data are available, ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, M2X = broad money including currency in circulation and local and foreign currency deposits, OCR = ordinary capital resources.

<sup>a</sup> Including construction.

Sources: ADB. 2014. *Asian Development Outlook 2014*. Manila; Central Bank of Armenia; Ministry of Finance of the Republic of Armenia; National Statistical Service of the Republic of Armenia (NSS); NSS: Demographic and Health Survey for child malnutrition; NSS: Integrated Living Conditions Household Survey; and World Bank, World Development Indicators online database.

## I. DEVELOPMENT TRENDS AND ISSUES

### A. Country Background

1. Armenia has made considerable progress, especially in poverty reduction, since independence in 1991. Nonetheless, the country still faces development challenges, including constraints on regional and global integration, economic risks, governance problems, and the need to strengthen infrastructure and make growth more inclusive. The Armenia Development Strategy<sup>1</sup> and the new government program<sup>2</sup> squarely tackle these challenges. The country partnership strategy (CPS), 2014–2018 for Armenia of the Asian Development Bank (ADB) is based on the country's plans and ADB's Midterm Review of Strategy 2020.<sup>3</sup> The CPS sharpens ADB's operational focus and reorients it toward improving internal and external transport links, upgrading secondary towns based on integrated urban development plans, and strengthening energy security. The CPS will gradually shift ADB's role from public sector financing of infrastructure to leveraging private sector financing, and to an advisory and knowledge-based partnership. ADB will also contribute to regional integration in the South Caucasus.

2. **Development progress and challenges.** For a small, landlocked country facing geopolitical constraints, Armenia's economy grew fast from the mid-1990s until 2008.<sup>4</sup> Gross domestic product (GDP) per capita more than tripled in constant US dollar terms.<sup>5</sup> After 2005, growth was driven mainly by non-tradable sectors, especially construction.<sup>6</sup> High remittances—estimated at 16% of GDP in 2009–2013—make Armenia vulnerable to problems in the originating countries, in particular the Russian Federation, the source of most remittances. The boom years after 2005 led to a sharp rise in the current account deficit, from about 1% of GDP in 2005 to about 12% in 2008. In addition, the real effective exchange rate of the dram appreciated by 45% between 2003 and 2008, hurting competitiveness.<sup>7</sup>

3. The economic crisis of 2008–2009 exposed the vulnerabilities of Armenia's economy. Construction fell by about 40% in 2009, accounting for most of the 14.1% collapse in GDP that year.<sup>8</sup> The government's response mitigated the social impacts of the crisis, but also resulted in a sharp rise in external public debt, from about 16% of GDP in 2008 to about 36% of GDP in 2009.<sup>9</sup>

4. **Private sector development.** The private sector has grown significantly since independence, and foreign-owned companies operate in almost all sectors of the economy. Despite recent improvements in international rankings,<sup>10</sup> Armenia's business environment is challenging. Geopolitical constraints, bad roads, high trade costs, and energy insecurity are

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<sup>1</sup> Government of Armenia. 2014. *Armenia Development Strategy 2025*. Yerevan (April).

<sup>2</sup> Government of Armenia. 2014. *Program for the Government of the Republic of Armenia*. Yerevan (May).

<sup>3</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila. While Strategy 2020 (ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila) remains valid and relevant, the Midterm Review of Strategy 2020 was undertaken to sharpen and realign the operational focus in light of emerging challenges in the region.

<sup>4</sup> Excluding the small island states, Armenia is one of ADB's smallest developing member countries (DMCs) in land area, population, and size of the economy.

<sup>5</sup> With a current GDP per capita of about \$3,400, Armenia is now classified as a lower middle-income country. World Bank Country Classification (<http://data.worldbank.org/about/country-classifications>).

<sup>6</sup> Construction was growing by 28% annually in real terms and contributed about a third of GDP growth in 2002–2008.

<sup>7</sup> Economic Analysis (Summary) (accessible from the list of linked documents in Appendix 2).

<sup>8</sup> Armenia's recession was one of the world's most severe in 2009.

<sup>9</sup> To ensure debt sustainability, Armenia adopted the Law on State Debt, which limits total public debt (external and domestic) to 60% of GDP, and restricts the budget deficit to 3% once total public debt reaches 50% of GDP. At the end of 2013, total public debt was estimated at 44% of GDP.

<sup>10</sup> For example, Armenia's overall Doing Business ranking improved from 49th position in 2014 to 45th position in 2015. World Bank. *Doing Business 2015*.

compounded by governance issues, including weak tax administration, and real or perceived dominance of well-connected businessmen. In the World Bank's Doing Business reports, Armenia ranks low on trading across borders, getting electricity, and enforcing contracts.

5. **Regional economic integration.** The economy's small size and underdeveloped transport networks raise transportation and trade costs, limit income-earning opportunities, and impede economic development. In 2013, Armenia decided to join the Eurasian Economic Union. Although average tariff levels may rise as a result, economic integration should lower non-tariff trade barriers, cut energy prices, and streamline flows of labor and capital. Analysis of regional multimodal transport and trade patterns could guide hard and soft infrastructure investment to further strengthen economic integration.

6. **Poverty.** Poverty in Armenia fell considerably in the 2000s: the national poverty rate dropped from 54% in 2004 to about 28% in 2008.<sup>11</sup> The trend reversed in 2009, despite the government's response to the crisis: the poverty rate rose to 34% in 2009, and extreme poverty more than doubled. In 2013, 32% of the population was poor, and 2.7% extremely poor. Poverty is higher in secondary towns than in Yerevan (the capital city), and is higher in northern Armenia, since economic opportunities are limited in smaller urban areas and the urban poor do not have access to farming or other kinds of self-employment in rural areas. Only a small fraction of the poor in Armenia are employed; poverty in Armenia is a problem of unemployment, and the solution lies in creating jobs.

7. **Inequality.** Growth was inclusive after 2004, judging by the Gini coefficient by income, which fell from 39.5 in 2004 to 33.9 in 2008.<sup>12</sup> Inequality started to rise after 2009, with the Gini index reaching 37.2 by 2013. Like poverty, inequality varies across the country but is mitigated by migration.<sup>13</sup> While migration cuts unemployment and the resulting remittances reduce poverty, migration reduces the supply of skilled labor, and burdens the women left behind to take care of families. Armenia has recently made some progress in gender equality, including adopting a law on equal rights that reconfirms the government's commitment to gender equality. Nevertheless, gender inequality remains, including women's lack of political representation, skewed sex ratio at birth, gender-based violence, and lack of economic independence.

8. **Millennium Development Goals.**<sup>14</sup> Armenia is on track to achieve the Millennium Development Goals (MDGs) related to extreme poverty, universal primary education, gender equality in education, child and maternal mortality, malaria, and access to safe drinking water. The progress is mixed, however, on the MDGs related to employment and decent work, gender equality, tuberculosis, and access to centralized sanitation, especially in rural areas. Armenia is unlikely to achieve the MDGs related to biodiversity because of loss of forest cover.<sup>15</sup>

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<sup>11</sup> The incidence of extreme (food) poverty dropped from 4.4% to 1.6% over the same period. Poverty Analysis (Summary) (accessible from the list of linked documents in Appendix 2).

<sup>12</sup> The official Gini indices may underestimate the degree of inequality in the country. For further discussion of inclusiveness and inequality, see the Note on Inclusive Growth (accessible from the list of linked documents in Appendix 2).

<sup>13</sup> The large-scale outward migration of Armenians is mainly due to limited income-earning opportunities, but also to their comparative advantages, including language skills, good education, and contacts in the sizable Armenian diaspora in France, the Russian Federation, the United States, and many other countries.

<sup>14</sup> Country and Portfolio Indicators (Table 1: Progress Toward the MDGs and Targets) (accessible from the list of linked documents in Appendix 2).

<sup>15</sup> Forests came under intense pressure during the early 1990s when interruptions in electricity and gas supplies gave rise to illegal logging to harvest wood for heating. Repairs to the electricity grid and restoration of natural gas supply reduced the need for wood for heating. Illegal logging has fallen from its peak, but the forest has not yet recovered. The government program aims to increase forest cover. Environment Assessment (Summary), accessible from the list of linked documents in Appendix 2.

9. **Energy security.**<sup>16</sup> Armenia depends on imported fossil fuels and uranium, mainly from the Russian Federation. The aging electricity infrastructure poses additional risks to energy security. The Metsamor nuclear power plant generates about 30% of the country's electric power but is nearing the end of its economic life, and replacing the plant will be expensive.<sup>17</sup>

10. **Environment and climate change.** Armenia's environmental challenges include lack of proper waste management—all solid waste is disposed of in open dumps that leach pollutants into surface and groundwater. Climate change has caused the volume of glaciers in the Caucasus to shrink by half, and droughts and storms have become more common. Continuing climate change is expected to bring more extreme events in the future, with significant impacts on water availability, energy, and transport.

11. **Disaster risk management.** Armenia is located in one of the world's most seismically active regions.<sup>18</sup> Many structures are seismically unsafe. In a recent global ranking of risks to cities, Yerevan is in the top 10 cities for earthquake risk.<sup>19</sup>

## B. Economic Assessment and Outlook

12. **Recent economic developments and outlook.** The economy rebounded after the crisis, from 2.2% GDP growth in 2010 to 7.2% in 2012, but growth slowed to 3.5% in 2013. On the supply side, deceleration occurred in industry, reflecting the adverse effects of steep price increases in summer 2013 for electricity and imported gas, and in agriculture, mainly because of a severe hailstorm that hit several regions of the country. Construction fell by about 11%, reversing 4.8% growth in 2012. Slower growth continued in 2014.<sup>20</sup>

13. Growth should continue in the medium term if global economic conditions do not deteriorate and government policies for industrial development and export promotion take off. Risks to the outlook are mostly on the downside. Through remittances, exports, and foreign direct investments, Armenia is vulnerable to risks to the economy of the Russian Federation.<sup>21</sup> With public debt close to the statutory ceiling, Armenia has much less room for a fiscal stimulus if recession returns, and with a limited range of policy responses, recovery from a new recession could be slower and longer.

## C. Highlights of ADB's Previous Country Strategy and Program

14. ADB's interim operational strategy (IOS), 2006–2009 was aligned with the country's Sustainable Development Program, and directed ADB's initial program toward rural development, private sector development, in particular through finance sector development, and regional cooperation.<sup>22</sup> ADB's and the government's plans to issue a CPS in 2009 were derailed

<sup>16</sup> Sector Assessment (Summary): Energy (accessible from the list of linked documents in Appendix 2).

<sup>17</sup> The plant was constructed during the former Soviet Union and is one of the world's few remaining nuclear power plants without a containment structure. It is located in a seismically active zone 28 kilometers from Yerevan, where more than a third of Armenia's population lives.

<sup>18</sup> A global risk analysis of disaster hotspots caused by natural hazards places Armenia among the top 60 countries exposed to multiple hazards. More than 80% of the Armenian population is exposed to major disasters, and more than 30% is exposed to frequent disasters. December 2013 marked the 25th anniversary of the Spitak earthquake that killed 25,000 people (including 6,000 school children), injured 15,000, and left 517,000 people homeless.

<sup>19</sup> Swiss Re. 2013. *Mind the risk: A global ranking of cities under threat from natural disasters*. Zurich.

<sup>20</sup> According to preliminary estimates, GDP grew by 3.1% and 2.3% in the first and second quarters of 2014. Growth was driven by agriculture, manufacturing, and some services, while mining and utilities declined.

<sup>21</sup> The Russian Federation's GDP grew by 1.3% in 2013, down from an average annual rate of 7% in the mid-2000s. Although events in Ukraine may not have a direct impact on Armenia—exports (imports) to (from) Ukraine comprised only 1% (4.6%) of Armenia's total exports (imports) in 2013—they may have spillover effects via adverse impacts on the Russian economy, including the latest wave of western sanctions.

<sup>22</sup> ADB. 2006. *Armenia: Economic Report and Interim Operational Strategy, 2006–2009*. Manila.



by the country's deep recession, when the urgent need for economic stimulus forced the government to reset the priorities previously established in the Sustainable Development Program. The urgency prevented the government from formally issuing a new strategy, but the government's strategy was nonetheless clear: (i) bolster spending on social protection in the wake of sharply rising unemployment and poverty, (ii) support economic activity with shovel-ready public infrastructure projects, and (iii) address the underlying vulnerabilities of Armenia's economy by improving transport links to Georgia in the north. ADB responded with a crisis-recovery program to finance social protection, and with two multitranche financing facilities (MFFs) to support urban development and the improvement of the country's north-south road, which links Armenia to Georgia.

15. **Portfolio performance.** Armenia was an active borrower from ADB in 2007–2013. In that period, Armenia borrowed a total of \$622.6 million for public sector projects and programs, and \$130 million for private sector projects.<sup>23</sup> All completed projects in Armenia (two so far) were rated *successful*. Recent portfolio performance in Armenia has been marked by low overall disbursement ratios caused by delays of projects financed by MFFs.

16. **Final review and recommendations.** The final review of the IOS concluded that ADB's assistance was successful and that its strategy and operations were aligned with the government's priorities.<sup>24</sup> While some projects performed well, the final review rated the portfolio performance *less efficient* due to slow startup of projects financed by the MFFs. The main recommendations were to help the government strengthen sustainability (especially road maintenance), and to prioritize new lending in view of the large commitments in ongoing MFFs. The validation report on the final review by ADB's Independent Evaluation Department (IED)<sup>25</sup> endorsed the final review's recommendations while disagreeing with some ratings. The validation report identified three main lessons from ADB's experience in the country: (i) flexibility allowed ADB to respond quickly; (ii) while flexibility had benefits, it meant that ADB's positioning was accidental rather than planned; and (iii) a balance of lending and technical assistance (TA) is needed to overcome development challenges. The validation report recommended to (i) consider the debt situation in programming, (ii) complement the ongoing program with small grants for pilot projects, (iii) increase private sector operations, and (iv) produce knowledge products and services (KPS). The CPS fully adopts IED's recommendations.<sup>26</sup>

## II. THE COUNTRY STRATEGY

### A. The Government's National Strategy

17. The Armenia Development Strategy and the government program focus on the country's main development challenges. The government program aims for 5% economic growth over the medium term, and a decline in the poverty rate by 10 percentage points. To maintain growth, the government plans to promote and diversify export industries, including mining, attract foreign investment, and improve the business environment, particularly through lowering barriers and improving tax administration. Priorities for infrastructure include the north-south road, the Southern Armenia Railway through public-private partnerships (PPPs), and

<sup>23</sup> Considering all outstanding credits, ADB's portfolio in Armenia at the end of 2012 was at the median across all DMCs as a percentage of GDP. Armenia's total borrowing in 2007–2013 is among the highest as a percentage of GDP.

<sup>24</sup> Country Strategy Final Review (accessible from the list of linked documents in Appendix 2).

<sup>25</sup> IED. 2012. *Validation Report—Armenia: Validation of the Final Review of Country Operations, 2006–2011*. Manila: ADB (November) (accessible from the list of linked documents in Appendix 2).

<sup>26</sup> The following CPS sections address the IED's recommendations: (i) consider the debt situation: para. 18; (ii) small grants for pilot projects: paras. 33 and 35; (iii) expand private sector operations: paras. 28 and Private Sector Assessment (Summary) (accessible from a list of linked documents); and (iv) produce knowledge products and services: para. 32.

strengthening energy security through renewable energy sources and energy efficiency. To make growth more inclusive, key objectives are to create jobs, raise wages, improve education, cut regional disparities, and improve benefits and services for the poor and other vulnerable groups. To improve governance, the government will implement a new anticorruption policy, and fully adopt program-based budgeting, internal audit, and e-procurement. Disaster risk management (DRM) will include comprehensive risk assessments and early-warning systems, as well as efforts to improve building safety, reduce flooding, and manage landslide-prone areas. The government will also promote the education–science–industry nexus, and aims to build centers of engineering expertise. The government’s plans—investing in infrastructure, developing export-oriented industries, promoting PPPs, building a knowledge-based economy, fighting corruption, and improving the business environment—intersect with ADB’s Midterm Review of Strategy 2020.

## B. ADB’s Country Strategy

18. **Country partnership strategic framework.** The CPS aims to help Armenia integrate its economy regionally, and to rebalance it toward more resilient, inclusive, and environmentally sustainable growth. The CPS will therefore support improving transport links, upgrading secondary towns, and strengthening energy security. In addition to legal limits on the size of debt, Armenia may face harder lending terms for public sector borrowing.<sup>27</sup> To ensure that ADB-financed investments do not lead to debt stress, ADB will carefully analyze the marginal impact of new sovereign ADB lending on the country’s debt sustainability. While ADB will continue financing infrastructure, it will gradually shift toward catalyzing development through innovative private sector investments, introducing international best practices, and providing KPS. The shift from the previous focus on infrastructure finance to other areas will transform ADB’s relationship to one suited for a growing middle-income country.

19. ADB’s operations will be aligned with the strategic agenda outlined in the Midterm Review of Strategy 2020,<sup>28</sup> and will support the three pillars of inclusive economic growth.<sup>29</sup> First, to support high and sustainable economic growth, ADB will help build needed infrastructure, improve the business environment, and strengthen economic integration. Second, to broaden access to economic opportunities, ADB will work with the government to improve both external and internal transport links, including those between Yerevan and other urban areas, and to catalyze new economic opportunities in the secondary towns where poverty is highest through improved urban environments and business conditions, especially for small and medium-sized enterprises. Third, to strengthen social protection, ADB’s TA and other KPS will help use information technologies to improve social protection systems and the government’s family benefits program.

20. Armenia’s small size makes regional cooperation and integration (RCI) essential to its development, but geography and geopolitics pose major challenges (para. 5). For the

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<sup>27</sup> In March 2013, the International Monetary Fund board graduated Armenia from the list of countries eligible for concessional funds. (International Monetary Fund. 2013. *Eligibility to Use the Fund’s Facilities for Concessional Financing*. Washington, DC.) The World Bank has graduated Armenia from International Development Association (IDA) eligibility from 1 July 2014. (World Bank. 2013. *Follow-up on IDA’s Graduation Policy and Proposal for Transition Support for Graduating Countries*. Washington, DC: IDA’s Resource Mobilization Department). In August 2014, ADB’s Board of Directors approved the reclassification of Armenia for the purpose of access to ordinary capital resources and graduation from the ADF resources, effective 1 January 2017.

<sup>28</sup> The CPS is also consistent with ADB’s commitments to the Paris Declaration, Accra Agenda, and Busan Partnership. Key features of the CPS include (i) supporting DRM; (ii) forming new and diverse partnerships, including leveraging new sources of finance; (iii) strengthening the resident mission; and (iv) strengthening country systems.

<sup>29</sup> Details of ADB’s contributions to inclusive economic growth through the proposed ADB operations are in the Note on Inclusive Growth (accessible from the list of linked documents in Appendix 2).

foreseeable future, Armenia's best prospect for RCI is with Georgia. ADB will continue supporting the north–south road corridor, and will help improve other roads to Georgia. Under the CPS's knowledge-related activities, ADB will invigorate economic cooperation between the two countries, including between official and technical bodies, and civil society organizations (CSOs). ADB may also contribute to regional integration by bringing countries of the region together for technical discussions on transport, power trade, and other regional economic issues. To facilitate Armenia's integration into the Eurasian Economic Union, as requested by the government, ADB will introduce best practices from the Central Asia Regional Economic Cooperation Program to Armenia, including from transport, logistics, and trade-related activities. ADB will maintain a high percentage of operations supporting RCI.<sup>30</sup>

21. Armenia's environment is a valuable resource for the country's future development.<sup>31</sup> To help achieve environmentally sustainable growth, ADB will work with the government to develop national strategies for waste management, and will finance investments in waste management at the government's request. ADB will include climate change measures in infrastructure projects to increase the country's resilience to climate change. ADB will also support adoption of environmental safeguard measures and institutional capacities for their enforcement.

22. In 2014–2018, ADB will focus on three sectors: (i) transport, (ii) water and other urban infrastructure and services, and (iii) energy. These sectors are among the government's priorities, and are in line with ADB's strengths and experience. ADB will stress operational and financial sustainability of infrastructure. Although public sector management is not a priority sector in the CPS, ADB will complement its support for infrastructure with TA and policy-based lending to support reforms that will build public sector capabilities and efficiently allocate public finances to ensure infrastructure sustainability through planning, governance, and adequate funding for operation and maintenance.

23. Considering existing support from other development partners and ADB's limited resources, ADB's sovereign operations will not be significantly involved in finance, health, education, and natural resources.<sup>32</sup> Although challenges remain in education and natural resources, the small program in Armenia (one or two loans per year) and the need for sustained, long-term engagement in other sectors will limit ADB's support for education and natural resources to TA and other KPS.

24. **Transport.** Support for sustainable transport continues from the IOS and ADB's current program. ADB's support for transport will focus on (i) improving implementation of ongoing projects, especially the North–South Road Corridor Investment Program; (ii) when ongoing projects are on track, financing further improvements in the north–south road, including urban transport links, through the MFFs; (iii) improving transport links between and within secondary towns, especially towns with the highest poverty rates or along the north–south road, to transform transport corridors into economic corridors; (iv) developing capacity in the Ministry of Finance and Ministry of Transport and Communications to strengthen resource allocations and management of road maintenance; (v) promoting results-based sector management to ensure that all investments in Armenia's road network are sustainable; and (vi) potentially strengthening Armenia's railway network to cut transportation costs and boost exports. Road safety, reducing

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<sup>30</sup> The percentage of operations supporting RCI was 64% at the end of 2013.

<sup>31</sup> As a mountainous, lightly populated country with a long history and unique culture, Armenia's natural and historic environment has significant and still-unexploited potential as a tourist attraction.

<sup>32</sup> The CPS discontinues the IOS's aim to support the finance sector through sovereign operations, since other development partners are already providing adequate support. ADB will consider continuing its previous program in support of women's entrepreneurship as part of its programs in gender and private sector development (i.e., not mainly as finance). Otherwise, ADB will support finance sector development only through private sector operations. ADB will consider Armenia's participation in regional TA related to education.

greenhouse gas emissions, and shifting to more environment-friendly transport will be integrated into transport and urban development projects. To strengthen project implementation and avoid overloading project management units, ADB will limit the number of transport projects that are simultaneously ongoing. Public and private sector operations will complement each other, as ADB's private sector lending aims to develop logistics services to maximize the benefits of better roads. In ADB's knowledge program, TA will focus on developing a strategy for strengthening regional connectivity, road maintenance, a long-term road master plan and PPP, while its policy dialogue will focus on road safety, urban traffic management, and energy efficiency in transport.

25. **Water and other urban infrastructure and services.** Support for this sector also continues from the IOS and ADB's current program. Due to higher poverty in secondary towns and the importance of boosting development outside of Yerevan and complementing ADB's transport program, the CPS shifts from rural development in the IOS to urban development, especially urban areas along the north–south road. Improving urban environments in secondary towns is key to inclusive growth in Armenia. Solid waste management and wastewater treatment are also vital to environmentally sustainable growth. ADB will support integrated interventions in municipal services guided by well-conceived urban development plans that will promote safe, green, low-carbon, and modern cities. In ADB's knowledge program, TA will focus on integrated urban development planning, sustainability of water supply systems, and PPPs, while ADB's policy dialogue will feature seismic safety and small-scale solid waste management for remote communities. ADB will also capture the knowledge embedded in operations, including PPPs in water supply, and reforms to promote sustainability.

26. **Energy.** Energy was indicated as a key sector in the IOS, but ADB started operations in the energy sector only in 2012–2013, with TA for energy infrastructure and private sector lending for power generation. The CPS therefore continues the previous strategy, and aims to build the energy program in 2014–2018. ADB will help enhance energy security by diversifying energy sources and rehabilitating and upgrading electricity transmission and distribution networks. ADB will also help Armenia attract private investment in energy and work with other development partners to expand power trade with Georgia. While private sector operations will finance investments in renewable resources, sovereign operations will support rehabilitation and upgrading of transmission and distribution infrastructure, and development of connections with Georgia in cooperation with other development partners. Energy projects will include mitigation of greenhouse gas emissions and accounting measures when appropriate. In ADB's knowledge program, TA will focus on renewable energy and reforms to create a strong regulatory environment for private sector investment, while ADB's policy dialogue will stress succession planning for aging assets.

27. ADB will support **DRM** by providing TA and policy advice, and encouraging the government to invest in strengthening the country's preparedness for earthquakes and other disasters. Support for DRM will focus on assessing the seismic safety of schools, hospitals, and other public buildings, demonstrating cost-effective approaches to seismic strengthening, and raising public awareness of risks and solutions. ADB will stand ready to finance investments in seismic safety at the government's request.<sup>33</sup>

28. **Private sector operations.** ADB will expand its private sector operations to help the private sector play a greater role in export-oriented industry, trade, logistics, and infrastructure development. ADB will consider financing projects in the natural resources sector, whose export potential, significant scales, and associated domestic business could transform the economy.

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<sup>33</sup> The proposed support is in line with ADB. 2014. *Operational Plan for Integrated Disaster Risk Management, 2014–2020*. Manila.

ADB's participation in natural resources would be instrumental in promoting awareness of environmental and social best practices as well as state-of-the-art extraction and processing techniques. ADB's presence will facilitate the adoption of international standards in due diligence, governance, and transparency by these projects. For projects in other sectors, ADB may be one of the few sources of finance available given the nascent state of these sectors in Armenia. Private sector operations will seek to leverage third-party funding whenever possible.

29. ADB's public sector operations will seek to strengthen the enabling environment for private sector development by promoting logistics and connectivity, developing secondary urban areas, enhancing energy security, and supporting reforms that improve the business environment. ADB will prioritize private sector participation to help the government implement its program while keeping debt within legal limits. ADB will explore and, to the extent possible, help the government develop PPPs, starting with an assessment of the institutional environment and preliminary identification of potential PPP projects.

30. ADB will support **governance and capacity development** through strengthening project design and implementation, infrastructure management, and delivery of public services. A crosscutting program of TA and lending will aim to strengthen the government's capacity to sustainably finance and manage the country's infrastructure. As part of ADB's initial efforts in the education sector, ADB will consult with local universities to explore opportunities for strengthening the training of the next generation of civil engineers who will design and maintain the country's infrastructure. ADB will support urban development strategies and tariff policies to strengthen sustainability of municipal services, and ADB's ongoing regional TA projects will continue to help strengthen Armenia's safeguard systems. ADB will focus on strengthening governance and capacity development, based on lessons learned, in project implementation, particularly procurement and due diligence. These interventions will have crosscutting impacts to help improve management and performance of ADB's entire portfolio of projects.

31. ADB will continue to promote **gender** equity through women's economic empowerment, and through direct and mainstreamed gender-equity components in projects. Project preparatory TA in Armenia will identify how gender can be mainstreamed, and sex-disaggregated data will be included in gender action plans. Whenever feasible, projects will include features to ensure that women benefit fully. For example, transport projects will include provision of stopping areas where women can sell goods, better sanitary facilities, and a share of jobs for women. In energy and municipal services projects, women will be included in user groups, and as primary users of these services they will be trained to promote efficiency and provide consumer feedback. ADB will promote women's involvement in the economy through financing pilot projects, policy analysis and advice, and other KPS. ADB will consider extending the ongoing program in women's entrepreneurship if it proves successful. Pilot projects financed by small grants will strengthen women's involvement in regional connectivity and value chains by connecting cross-border economic hubs for greater trade and commercial opportunities.

32. **Knowledge solutions** will become more important as the country advances to upper middle-income status. ADB will mainstream knowledge as an integral part of the country program, with the knowledge program led by ADB's Armenia Resident Mission. Given the small size of the country, few ADB staff can work exclusively on Armenia, but using the approach of "One ADB", ADB will engage staff from ADB's communities of practice and specialized knowledge departments to support knowledge solutions for Armenia, including possible extended missions from knowledge departments to the resident mission. To further support knowledge solutions, the resident mission will develop and coordinate knowledge partnerships with think tanks and research institutes. ADB will capture the knowledge embedded in operations and disseminate it through workshops, publications, or other knowledge products and services, including sharing Armenia's successful experience with PPP in water supply, and key reforms that improved the business environment. In ADB's own diagnostics and outlooks that are essential to the program, ADB will update sector road maps to provide strong

continuing guidance to programming and strengthen economic forecasting to support the Asian Development Outlook and economic monitoring. ADB will support the government in developing a national strategy toward a knowledge and innovation economy. Advisory technical assistance to develop the strategy will be provided, and will guide ADB's future KPS program.

33. ADB will seek to strengthen **partnerships** with other development partners in Armenia, and with civil society. ADB will aim to include cofinancing in all future projects. ADB will work to engage other development partners in financing the north–south road, and will consider further support for water supply in Armenia through a sector-wide approach. ADB has held wide consultations with civil society in Armenia,<sup>34</sup> and will further engage reputable CSOs with common interests. ADB will sign memorandums of understanding with a small but diverse set of CSOs beyond the official development partners, to engage the CSOs directly in ADB's annual country programming and project development, and to position ADB as a member of the broader development community in Armenia. ADB will also continue processing small grants to fund pilot projects initiated or implemented by CSOs.<sup>35</sup>

### III. STRATEGY IMPLEMENTATION

#### A. Indicative Resource Parameters

34. Armenia is presently a Group B country and will graduate to be a Group C country starting from January 2017 (footnote 27). Armenia is expected to fully utilize its Asian Development Fund (ADF) allocation of the 2013–2014 biennial period. The indicative ADF allocation for the 2015–2016 biennial period amounts to \$116 million.<sup>36</sup> The final country allocation of ADF resources will be subject to available ADF commitment authority and the outcome of the country performance assessments. The indicative ordinary capital resources (OCR) available for Armenia are \$404 million for 2014–2017.<sup>37</sup> The OCR allocation for 2017 has been increased to compensate for loss of access to ADF resources. To respond to the government's request to minimize commitment fees, ADB will advise the government on ADB's financing options during annual programming. ADB will use OCR for the ongoing MFF for the north–south road, since the government's additional financing needs are beyond available ADF allocation for Armenia. To keep lending within the government's capacity, ADB will limit the number of new loans per year.<sup>38</sup> Armenia received an average of \$1.0 million per year in TA grants from 2007 to 2013, and that level of TA funding is expected to continue.

#### B. Program Overview

35. Implementation of the CPS will be closely monitored in country programming, project development, and project implementation. Improving the quality of operational performance will be ADB's top priority. Annual programming and portfolio reviews will be simultaneous so that programming can respond to issues in project implementation. To ensure development effectiveness, ADB will strengthen executing agencies and implementing agencies in project management, including safeguards and procurement. ADB will use its reputation for safeguards

<sup>34</sup> Country Partnership Strategy Formulation (accessible from the list of linked documents in Appendix 2).

<sup>35</sup> ADB. 2013. *Technical Assistance for Civil Society Participation for Development Effectiveness*. Manila (TA 8595-REG).

<sup>36</sup> The actual ADF allocation for 2015–2016 will be made available in January 2015 using the 2014 country performance assessment ratings and revised estimate of ADF XI commitment authority.

<sup>37</sup> This includes \$100 million for 2014, \$88 million each for 2015 and 2016, and \$128 million for 2017. The annual sovereign lending level is subject to confirmation in the context of ADB's annual work program and budget framework.

<sup>38</sup> During recent [November 2014] high-level consultations, the government requested flexibility from ADB for possible additional financing to meet emerging needs. ADB will consider such requests conditional on (i) limitations on public debt and its prudent management, (ii) satisfactory implementation of ongoing projects, and (iii) availability of suitable investment proposals in line with the CPS's focus.

and financial controls to attract grant cofinancing for small pilot projects from the Armenian diaspora. Sovereign operations will prioritize promoting private sector participation in ADB-financed projects and mobilizing cofinancing among development partners.

#### IV. RESULTS MANAGEMENT

##### A. Monitoring

36. ADB and the government will use the CPS results frameworks to track progress toward results.<sup>39</sup> The results framework will be updated annually during the country operations business plans and portfolio review. The strategic priorities will be revisited through regular consultations to ensure that the program is responsive to Armenia's evolving economic and social context.

##### B. Risks

37. The main risks relate to governance, project implementation, sustainability, and possible diversions from the strategy in response to economic crises, natural hazards, and other unexpected events. In public financial management, Armenia has adopted program budgeting, but implementation has been limited by weak capacity and poor information flows. ADB's Infrastructure Sustainability Support Program will help strengthen capacity and improve program budgeting.<sup>40</sup> The government's procurement procedures are complex and not fully in line with best international practices. ADB will provide TA to strengthen the government's overall procurement capacity<sup>41</sup> and to train executing and implementing agencies on procurement and due diligence.<sup>42</sup> Spot reviews of proposals will ensure the accuracy of bid evaluations. Armenia faces macroeconomic risks because of its geopolitical constraints, large current account deficit, and vulnerability to foreign exchange inflows. To strengthen ADB's response to economic crises, ADB will improve economic monitoring and forecasting for Armenia, and will develop the analytical foundation for any needed response.

38. Insufficient institutional capacity, including lack of awareness of ADB's procurement policies, and lack of experience in project procurement and contract management, creates risks in project implementation and procurement. ADB will help to mitigate these constraints through a capacity development program, including regional TA. As ADB engages with different parts of the government, it will need to thoroughly assess executing and implementing agencies to ensure adequate project management capabilities. TA for preparing investment projects will include procurement capacity assessments of executing agencies and propose mitigating measures. The government has growing experience with ADB's policies for land acquisition and resettlement, but little experience with ADB's environmental safeguards. ADB will need to proceed cautiously in projects that involve significant land acquisition and environmental impacts, but will continue to provide TA to strengthen the government's capacity in land acquisition<sup>43</sup> and environmental safeguards.<sup>44</sup> ADB will mitigate risks in project implementation by providing additional or advanced training for national staff at the resident mission, outposting international staff from headquarters to the resident mission, and using the approach of "One ADB" to strengthen coordination with and support from ADB headquarters.

<sup>39</sup> The country partnership strategy results framework is in Appendix 1.

<sup>40</sup> ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Technical Assistance Grant to the Republic of Armenia for the Infrastructure Sustainability Support Program*. Manila.

<sup>41</sup> ADB. 2012. *Technical Assistance for Developing Procurement Capacity for Improved Procurement Outcomes*. Manila (TA 8262-REG).

<sup>42</sup> ADB. 2014. *Technical Assistance for Improving the Capacity and Integrity of Procurement Processes in Central and West Asia*. Manila (TA 8665-REG).

<sup>43</sup> ADB. 2009. *Technical Assistance for Mainstreaming Land Acquisition and Resettlement Safeguards in the Central and West Asia Region*. Manila (TA 7433-REG).

<sup>44</sup> ADB. 2013. *Technical Assistance for Improving the Implementation of Environmental Safeguards in Central and West Asia*. Manila (TA 7548-REG).

## COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK

<b>Country Development Goals</b>			
<ol style="list-style-type: none"> <li>1. Annual real gross domestic product growth of 5.5%–6.5% in 2014–2025.</li> <li>2. Targets of employment growth in non-agriculture sector: 60,000 by 2017 versus 2012; 135,000 by 2021 versus 2012; and 220,000 by 2025 versus 2012.</li> <li>3. Reduction in the proportion of people living below the upper-general poverty line to 13.0% in 2025 from 35% in 2011.</li> <li>4. Environmental risks associated with economic growth reduced.</li> <li>5. In 2017, Armenia shall rank 65th–70th with an overall international competitiveness index of 4.20–4.25 and, in 2025, its rank shall be 50th–55th with an overall index value of 4.35–4.40.<sup>a</sup></li> <li>6. The business environment improved (with Armenia's ranking in the World Bank's Doing Business reports rising to one of the top 20 countries in 2017 and one of the top 15 countries in 2025).</li> <li>7. Target values for public administration system indicators in 2017 are fixed at the 2010 average level of Eastern European and Baltic states.</li> </ol>			
<b>Sectors Selected for ADB Support</b>			
<b>Government Sector Objectives</b>	<b>Sector Outcomes that ADB Contributes to and Indicators</b>	<b>ADB Areas of Intervention</b>	<b>ADB Indicative Resource Allocation in the Next Pipeline and Strategic Priorities<sup>b</sup></b>
<b>1. Transport</b> (Core area 1: Infrastructure, and Core area 3: Regional integration)			
Improved internal and external transport links	<p>Increased, more efficient, and safer movement of goods and people</p> <p>Road freight traffic increases to 770.0 million ton-km by 2018 (2012 baseline: 400.9 million ton-km)</p> <p>Road passenger traffic increases to 2,770 million passenger-km by 2018 (2012 baseline: 2,611 million passenger-km)</p> <p>Number of road collisions falls to 2,400 by 2018 (2012 baseline: 2,602)</p>	<p>Interstate and local roads</p> <p>Road transport policies and reforms</p> <p>Pilot projects and other KPS on road safety</p>	<p>\$256.1 million of total CPS envelope, of which:</p> <p>IEG: 100%</p> <p>GCD: 11%</p> <p>ESG: 0%</p> <p>GEM: 0%</p> <p>PSD: 50%</p> <p>RCI: 39%</p> <p>PAR: 11%</p>
<b>2. Water and other urban infrastructure and services</b> (Core area 1: Infrastructure, and Core area 2: Environment; Other areas of operations: disaster and emergency assistance)			
More even urban development	<p>More people use improved water supply, sanitation, and municipal services</p> <p>Share of population connected to the centralized water supply system increased to 50.0% by 2020 (2013 baseline: 44.7%)</p> <p>Share of the population connected to centralized sewerage system increased to 50.0% by 2020 (2013 baseline: 44.7%)</p> <p>90% of solid waste generated disposed of in sanitary landfills by 2018 (2012 baseline: 0%)</p> <p>7,750 pupils in seismically strengthened schools by 2016 (2012 baseline: 0)</p>	<p>Urban infrastructure (water supply, solid waste management, urban transport)</p> <p>Urban governance, planning, and environmental policies</p> <p>Pilot projects and other KPS on seismic safety and rural waste management</p>	<p>\$135.1 million of total CPS envelope, of which:</p> <p>IEG: 100%</p> <p>GCD: 68%</p> <p>ESG: 80%</p> <p>GEM: 32%</p> <p>PSD: 0%</p> <p>RCI: 0%</p> <p>PAR: 53%</p> <p>KNS: 0%</p>



Government Sector Objectives	Sector Outcomes that ADB Contributes to and Indicators	ADB Areas of Intervention	ADB Indicative Resource Allocation in the Next Pipeline and Strategic Priorities <sup>b</sup>
<b>3. Energy</b> (Core area 1: Infrastructure, Core area 2: Environment, and Core area 3: Regional integration)			
<p>Enhanced energy security through, in particular, greater utilization of domestic renewable energy and improved reliability of the electricity system</p> <p>Deeper regional integration, with expanded cross-border electricity trade</p>	<p>Increased and more efficient use of energy (including renewable energy)</p> <p>Unplanned power interruptions reduced to 4–5 times per year in 2018 (2011 baseline: average of 8–10 times per year);</p> <p>Per capita consumption of power increases to 2,500 kWh by 2018 (2011 baseline: 1,950 kWh)</p> <p>Annual CO<sub>2</sub> emissions (tCO<sub>2</sub> per year) decreased by 20,000 tons by 2018 (2008 baseline: 5.5 million tCO<sub>2</sub>)</p> <p>Exports of electricity increased to 2.5 billion kWh by 2018 (2011 baseline: 1.6 billion kWh)</p>	<p>Electrical power transmission</p> <p>Renewable energy subsector development</p> <p>Rehabilitation work and dams</p> <p>Energy trade</p>	<p>\$92 million of total CPS envelope, of which:</p> <p>IEG: 100%</p> <p>GCD: 78%</p> <p>ESG: 62%</p> <p>GEM: 0%</p> <p>PSD: 22%</p> <p>RCI: 0%</p> <p>PAR: 40%</p> <p>KNS: 0%</p>

ADB = Asian Development Bank, CO<sub>2</sub> = carbon dioxide, CPS = country partnership strategy, EGM = effective gender mainstreaming, ESG = environmentally sustainable growth, GCD = governance and capacity development, GEN = gender equity, IEG = inclusive economic growth, KNS = knowledge solutions, km = kilometer, KPS = knowledge products and services, kWh = kilowatt-hour, PAR = partnerships, PSD = private sector development, RCI = regional integration, t = ton.

<sup>a</sup> The Global Economic Forum's Global Competitiveness Index score ranges from 1.00 to 7.00, with a higher score corresponding to greater competitiveness.

<sup>b</sup> Indicative resource allocations based on the country operations business plan for 2015-2017 (accessible from the list of linked documents in App 2).

Sources: Government of Armenia. 2014. *Armenia Development Strategy, 2014–2025*. Yerevan; and Asian Development Bank analysis.

**LIST OF LINKED DOCUMENTS**

<http://adb.org/Documents/CPS/?id=ARM-2014>

1. Economic Analysis (Summary)
2. Poverty Analysis (Summary)
3. Gender Analysis (Summary)
4. Environment Assessment (Summary)
5. Private Sector Assessment (Summary)
6. Sector Assessment (Summary): Transport
7. Sector Assessment (Summary): Energy
8. Sector Assessment (Summary): Water and Other Urban Infrastructure and Services
9. Risk Assessment and Risk Management Plan (Summary)
10. Country and Portfolio Indicators
11. Country Performance Assessment Ratings
12. Country Cost-Sharing Arrangements and Eligible Expenditure Financing Parameters
13. Country Partnership Strategy Formulation
14. Country Operations Business Plan, 2015–2017
15. Country Strategy Final Review
16. Validation Report of the Final Review of Country Operations, 2006–2011

**Supplementary Documents**

17. Note on Inclusive Growth
18. Disaster Risk Management (Summary)
19. Overview of Armenia's Public Sector Management