

AMERICAN UNIVERSITY OF ARMENIA

**THE ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS
IN RURAL DEVELOPMENT IN ARMENIA**

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LIST OF ABBREVIATIONS

ACBA	Agricultural Cooperative Bank of Armenia
ADB	Asian Development Bank
ADF	Asian Development Fund
CIS	Commonwealth of Independent States
CSO	Civil Society Organization
FSU	Former Soviet Union
GDP	Gross Domestic Product
GoA	Government of Armenia
HS	Household Surveys
IBRD	International Bank for Reconstruction and Development
IDA	International Development Agency
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
LRIP-AF	Lifeline Road Improvement Project for Armenia
MCC	Millennium Challenge Corporation
NSS	National Statistical Service
PRSP	Poverty Reduction Strategy Paper
RCS	Rural Community Survey
RRRP	Rural Roads Rehabilitation Project
SCWM	State Committee for Water Management
SME	Small and Medium Enterprises
US	United States
WB	World Bank

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Abstract

After gaining independence (September 21, 1991) Armenia's economy experienced severe shocks which caused a sharp fall in Gross Domestic Product (GDP), fiscal crisis and hyperinflation. As a result of economic collapse the poverty incidence grew dramatically throughout the country. However, Armenia initiated and implemented political, structural and economic reforms, which prevented a larger decline.

Though Armenia's economy has had a significant growth over the last decade and now Armenia has steadily growing GDP, the population does not have equal social and economic opportunities, since economic growth is not equally enjoyed by entire population of the country. Unfortunately, throughout most of rural Armenia, people continue to live in very poor conditions, often without access to basic services.

Indeed the Government of Armenia (GoA) puts a stress on rural and agricultural development and considers this as one of its policy priorities. However public funds are in great shortage and financing for rural development to larger extent still comes from foreign assistance and international loans provided to the GoA.

This Master's Essay aims to examine the current situation and challenges in rural areas, identify the key aspects of development in Armenia that should be considered to improve living standards in rural communities and promote rural development, to review the Government policy in this sector. Further, this paper aims to identify and assess the role of major International Financial Institutions (IFIs) that make investments in Armenia for rural development. The first chapter describes economic situation in Armenia after independence, transition to market economy and impact of reforms since 1991. The second chapter discusses the current situation in rural areas, identifies the key factors that play a strong role in Armenia's rural economy, and examine the main shortcomings in key rural sectors. The third chapter identifies the major donors that make investments in Armenia for rural development, describes the strategies they adopted, and discusses whether those strategies match with the country's development needs, and whether the development programs of the major donors have achieved their objectives and had a substantial impact on the rural development during the last 5 years. The final chapter summarizes the findings and provides policy recommendation.

Introduction

Rural productivity, employment, and income growth are critical drivers for lifting the national economy. Furthermore, rural development aims to achieve sustainable growth that benefits the whole society. Addressing rural development issue should be of utmost importance because of its economic, ecological, socio-cultural and political-institutional aspects. Moreover, according to international experience, from the viewpoint of poverty reduction it is more appropriate to develop and implement comprehensive programs for rural and agricultural development.

Since 1994, the Armenian economy has experienced positive growth, however, most of the improvements were noticed in urban areas and predominantly in the capital city, and, unfortunately, rural poverty continues to remain high. Poor living conditions, poor access to economic and social activities, deteriorated social and physical infrastructure in a large number of rural communities continue to be among the most urgent issues in Armenia that should be a special area of attention.

The 2008-2012 national program of the GoA emphasizes the importance of augmenting rural development and increasing the country's supply level with domestically produced agricultural products in the development of economy. Furthermore, the Government's objectives in the agricultural sector are specified in the Strategy for Sustainable Agricultural Development (adopted in April, 2004) with overall objective to promote sustainable agricultural development, to ensure greater food security and to increase rural incomes. Moreover, the improvement of rural infrastructure is recognized explicitly by the GoA as a key element for rural poverty alleviation, acting as a catalyst for development and enhancing access for rural communities to a broad range of essential social and commercial services.

Though the GoA emphasizes rural and agricultural development and considers this as one of its policy priorities, public funds are in great shortage and financing for rural development

to larger extent still comes from foreign assistance and international loans provided to the GoA.

In this respect, it is important to assess the significant role of IFIs that are actively involved in this field implementing a number of projects aimed at solving the most urgent problems in the rural sector, and have had huge contribution in addressing the countries development needs in the rural sector by providing loans, grants, technical and advisory assistance. This study identifies the three major donors that have been making huge investments in Armenia for rural development -the World Bank (WB), Asian Development Bank (ADB), and Millennium Challenge Corporation (MCC), describes their strategies and compares those strategies with the development needs of the country.

The purpose of this study is: a) to examine the current situation and main shortcomings in rural areas; b) review the Government's strategies and objectives for rural development; c) assess the role of IFIs, particularly WB, ADB, and MCC that make investments for rural development, and d) to find out whether the development programs of the major donors have achieved their objectives and had a substantial impact on the rural development. Taking into consideration the above-mentioned, this paper poses the following research questions:

- ✚ What are the key areas of rural Armenia that should be considered to improve living standards in rural communities and promote rural development?
- ✚ What are the Government's strategy and goals related to rural development?
- ✚ What are the major IFIs financing rural development in Armenia and what are terms of financing?
- ✚ What objectives have been achieved in the rural sector in Armenia through IFIs in the last 5 years?
- ✚ What is the future strategy of the GoA to substitute IFI's funding with more sustainable mechanisms?

The **methodology** of this study is based on primary and secondary data collection and analysis: relevant literature and legal documents have been reviewed; necessary information has been obtained through in-depth interviews (the interview questionnaire can be found in Appendix 1).

Chapter 1. Economic Development in Armenia since 1991

Since independence Armenia's economy has been affected by several factors: transition to a market-based economy, the large Diaspora, economic blockade and closed borders with neighbors, military conflict with Azerbaijan, heavy remittance flows, injections in the form of foreign aid, grants and loans, privatization, economic reforms that followed privatizations, the need for post earthquake recovery and so on. Poverty and income inequality were high throughout the decade (Armenia Competitiveness Assessment, 2004).

Independence in 1991 and the break-up of the Soviet Union left Armenia saddled with many distortions from the command economy. The loss of traditional Soviet markets, severe shortages of foreign exchange, an enormous increase in imported energy prices, and a sharp reduction in credit caused a fall of more than 50 percent in GDP between 1990 and 1993. The collapse of the economy precipitated an unprecedented fiscal crisis and hyperinflation. Poverty increased dramatically. In 1996, every second Armenian resident was poor, while every third – extremely poor. After independence, funding for education virtually collapsed. The energy situation was dire: electricity was supplied to many areas only 4 hours a day; the frequency of the electricity supply varied, which sometimes damaged electrical equipment; and natural gas supplies were interrupted by periodic closure of supply pipelines (World Bank 2004a).

In the early years of transition from centrally planned economy many industries were shut down, lost their markets and became obsolete, therefore, leaving a large number of

population unemployed. High unemployment rate was in all sectors of economy. According to the Poverty Reduction Strategy Paper (PRSP) (2003), 645,000 jobs were cut in all sectors of the economy except agriculture. Agriculture and food-processing were sectors that survived and gained central importance for employment and rural incomes, and functioned as a safety net employing nearly three times as many people as prior to independence.

However, the large inflow of labor into the agricultural sector after independence is associated largely with collapse of non-agricultural income sources, rather than the economic attractiveness of the agricultural sector. The subsequent growth in the sector has been driven by productivity gains, due largely to liberal market mechanisms, private ownership of land, export increases and some investments in deteriorated infrastructure (World Bank 2005).

Moreover, public sector capacity was very weak, the salaries of public employees were low. Wages in the public sector ranged from USD22–29 per month from 1998–2001, compared to USD40–60 per month in the private sector. The weak public sector prevented development in several ways. First, the low salaries and position of public employees increased the propensity for employees to seek bribes, thereby placing severe constraints on private firms. Second, low-quality staff and weak financial management did not assure that expenditures would be used efficiently and in line with Government priorities (World Bank 2004a).

Armenia's indicators in the 1990s reflected the difficult political, economic and human transitions of the period including disruption of supply chains, the loss of traditional markets and difficulties in restructuring the economy from central planning to a market economy. However, Armenia's strong export and investment performance, GDP growth, and performance in certain areas of policy, trade regimes and financial sector regulation provide basis for optimism (Armenia Competitiveness Assessment, 2004). The PRSP (2003) indicate that poverty has declined by four percentage points, but still remained high at 51 percent;

extreme poverty has fallen from 27 percent to 21 percent. However, nearly all improvements were among the urban poor, and rural poverty remained high.

Impact of the Reforms since 1991 and Transition to Market Economy

Though domestic and external shocks after independence caused a sharp fall in GDP between 1990 and 1993, some important reforms (in 1991-1992) prevented a larger decline. Some important reforms were carried out in prices, land, and housing policy in 1991 and 1992, which softened the impact of these shocks. After 1995, Armenian economy entered a new stage of development. In this respect, it is important to assess the significant role of international community that have played a crucial role in the recovery process of the Armenian economy by providing loans and grants for reform implementation.

Between early 1991 and mid-1992, the government freed the prices of most commodities, with the exception of bread and some public services. In 1991-1992 the Government transferred property rights on land to farmers (all farmland and cattle were privatized), deregulated marketing channels for agricultural products, and liberalized retail and producer prices for agricultural goods. Early steps were taken to privatize most housing (privatization of apartments in Armenia started in 1993, when the Parliament of Armenia adopted the Law on Privatization of State and Public Housing).

By 1994, a ceasefire was reached with Azerbaijan and a more comprehensive stabilization and reform program was initiated with support from the international community. The reforms comprised policy actions on many fronts, including elimination of wage and price controls, creation of a liberal trade regime, and privatizations, as well as improvements in areas such as the social benefits system, education and energy availability. By 2002, GDP had reached 84 percent of its 1990 level. The incidence of poverty declined

slowly, from 55 percent in 1996-98 to 51 percent by 2002, but remained high. Nevertheless, continuing risks of regional instability, reliance on substantial international financial assistance and a large structural trade deficit all pose significant challenges to sustaining growth (World Bank 2004a).

The household surveys, regularly conducted since 1998 on the annual basis, witness that the inequality and the number of poor, including very poor population gradually decrease. The most tangible poverty reduction took place in Yerevan – from 54.7% in 1999 to 27.3% in 2005. The poverty has been reduced also in other towns of Armenia (Sustainable Development Program, 2008). Higher growth rates were recorded in industry (15.4 percent) and transport and communications (8.2 percent). 3.1 percentage points out of the total 13.9 percent growth were contributed by industry (21.5 percent of total GDP), 5.7 percentage points by construction (15.8 percent of GDP), and 1 percentage point by the agricultural sector. Domestic demand grew faster than external demand, as compared to the previous year. Exports and imports grew at quite high rates in 2003: 34.2 and 28.6 percent respectively (Petrosyan 2004).

However, there has been less progress in restructuring of large firms, enforcement of contracts, and availability of adequate financing for private firms. Also, in the public sector, a lack of reform has contributed to bureaucratic obstacles and corruption. These obstacles are hindering the formation and growth of small and medium-sized firms, which in many transition economies have been found to make a major contribution to employment growth and poverty reduction (World Bank 2004a).

Goals and Objectives of the GoA in the Rural Sector

Though Armenia's economy has had a significant growth over the last decade, the population does not have equal social and economic opportunities, since economic growth is not equally enjoyed by entire population of the country. Unfortunately, throughout most of rural Armenia, people continue to live in very poor conditions, often without access to basic services.

Taking into consideration the characteristics of the rural sector and the fact that rural and agricultural development has the capacity to serve as a catalyst for economic growth in Armenia, since rural development has significant impact on national economy, and, furthermore, the largest portion of the population is employed in agriculture (see Table 1); it is extremely important to develop and introduce public policies that could alleviate poverty and improve living standards in rural communities, and promote rural development.

Table 1: Average Annual Number of Employed in the Economy by the Economy Branches

	1000 persons			Compared to the total, %		
	2002	2003	2004	2002	2003	2004
Total	1106.4	1107.6	1081.7	100	100	100
Industry	143.1	138.8	132.0	12.9	12.5	12.2
Agriculture	500.8	509.0	507.1	45.3	46.0	46.9
Construction	36.1	37.2	33.3	3.3	3.4	3.1
Transport and Communication	40.2	41.8	46.5	3.6	3.8	4.3
Trade	99.6	105.0	103.8	9.0	9.5	9.6

Source: Statistical Yearbook of Armenia (2005)

In this respect, it is important to identify the strategies and goals of the GoA related to rural development. In 2008, the RA Government adopted its national program for 2008-

2012, which emphasized the importance of augmenting rural development and increasing the country's supply level with domestically produced agricultural products in the development of economy.

According to the Government Program (2008), one of the main priorities of the GoA in the rural sector is to encourage a progressive growth of export of agricultural products and to ensure the increase of their specific weight (compared to the current weight of agricultural products). This policy would be implemented within the framework of an overall strategy for promotion of foreign trade, improvement of customs administration, reduction of transportation costs and elimination of technical barriers for trade as well as by encouraging the establishment of integrated private structures and enterprises for primary processing of agricultural products and ensuring the availability of credit financial resources for them.

Moreover, the Government's objectives in the agricultural sector are specified in the Strategy for Sustainable Agricultural Development (adopted in April, 2004) with overall objective to promote sustainable agricultural development, to ensure greater food security and to increase rural incomes. Key priorities in support of sustainable growth in the sector are to: 1) continue and deepen agrarian reform; 2) ensure food safety and improve food security; 3) promote the application of advanced agricultural technologies; 4) promote pedigree breeding and the improvement of animal health; and 5) promote agricultural processing and the development of associated supply and service infrastructure. In order to develop more commercially oriented agriculture the following issues are considered:

- ✚ Promoting organizational models like producers' association and improving vertical coordination between processors and farmers.
- ✚ Assuring sufficient and adequate availability of services to farmers and processors like advisory services, financial services, information services.

- ✚ Investing in the dissemination, transfer and generation of productivity-enhancing technologies at the farm level.
- ✚ Investing in infrastructure improvements that serve agricultural and rural businesses.
- ✚ Encouraging the environmentally sustainable use of natural resources by reducing grazing pressure.
- ✚ Facilitating the access to export markets.
- ✚ Ensuring food safety and promoting food quality standards in a cost-effective and phased fashion.

Furthermore, the RoA Government Program (2008) implies, that the full implementation of agricultural productivity and production-processing chain and, therefore, increasing the incomes of the farmers, should be the cornerstone of the national program in order to meet the future challenges. Therefore, the Government, taking into consideration the characteristics of the sector, envisages directing the agricultural policy towards both enlarging assistance to producers, and improving the business environment by developing production, social and market infrastructures. According to Government of Armenia Action Plan for 2008-2012, Government will move from providing agricultural tax privileges to implementing multilateral assistance tools. Government gives privileges to transcoding agriculture in the adverse weather conditions, which will help the efficient use of resources. Serious steps will be taken to eliminate the existing obstacles in the banking sector, to invest in financial insurance systems, and encourage production of those outputs that have relatively high competitiveness and export orientation. By emphasizing the importance of implementing new productivity-enhancing technologies and methods at the farm level, Government will focus on preparing and retraining skilled personnel, improving professional advisory services. Government will focus on pedigree and seed development. Government

envisages doing noticeable investments in infrastructure improvements that serve agricultural and rural businesses, highlighting improvement, advancement, and enlargement of irrigation systems. Through improvement of legal bases and financing of categorical programs, Government will promote development of different types of cooperation in the agrarian sector, enlargement of non-agricultural employment in the rural communities, increasing initiative capacities in the private sector. One of the main directions of the Government policy is the accomplishment of state programs in the forest preservation, protection, reproduction and utilization area. In the water supply sector Government highlights improvement of the quality of supplied water, sustainable water supply, reduction of waste of water, as well as incremental provision of twenty-four-hour water supply.

Chapter 2. Key Areas of Importance for Armenia's Rural Development and Rural Poverty Alleviation

In general, rural development aims to achieve sustainable growth that benefits the whole society. Rural development helps to create employment opportunities and generate income and is thus the precondition for successful economic development.

In Armenia, addressing rural development issues is of utmost importance because a large proportion of the population lives in the rural communities and most of them live in very poor conditions, often without access to basic services: out of the total population of Armenia, about one third (36%), nearly 1.2 million, are recorded as living in rural areas, out of a total of 934 communities, 871 are rural. Rural Community Survey (2008) by the RA NSS conducted in 263 rural communities shows that most of the social infrastructure facilities in the surveyed villages are in poor condition (an example of educational facilities - see Table 2) and most of those facilities are functioning in old buildings (20 years and older). Physical

infrastructure and utilities (with the exception of electricity) are in need of improvement. Roads within villages are mainly dirt (70 percent) and are in bad condition (see Table 3).

Table 2: The Condition of Education Facilities in the Surveyed Villages

Education Facility	Percent of villages where education facilities exist	Percent of villages where education facilities are in need of repair
Pre-school/kindergarten	57	75
Elementary school	0.4	0
8-grade school	9	91
Secondary School	92	74
College (VET institution)	2	40
Musical School	15	74
Art school	6	75
Fine art school	1	33
Sports	5	71

Source: National Statistical Service, 2008

This table shows that education facilities (except for secondary school) in most of the surveyed villages do not even exist, and wherever they exist are in poor conditions.

Table 3: Armenia. Type and Condition of Roads in Surveyed Villages

Type of Road	Type of roads (percent)			Condition of roads (percent)			Average number of months when these roads are not useable
	Dirt	Gravel	Asphalt	Good	Average	Poor	
Roads within villages	70	13	17	0	26	74	0.9
Roads to regional towns or markets	15	4	81	18	39	43	0.6

Source: National Statistical Service, 2008

Further, rural productivity, employment, and income growth are critical drivers for lifting the national economy. In many cases rural poverty problems become urban poverty problems

through raising pressure on cities. Rural population because of poor living conditions tends to abandon their localities and move to already overcrowded cities thus increasing urban poverty and putting more pressures on urban infrastructures and services.

Moreover, rural areas are the place where agricultural production is performed, which is the basis of country's food security; therefore migration of rural population puts that security at risk. On the other hand successful agricultural production can become an export industry bringing additional income to country and improving its trade balance. Furthermore, rural development has a social and cultural aspect - it helps to preserve cultural practices and traditions which are part of national identity. Rural development also has a strong impact on environment conservation and pollution reduction since modern agriculture deploys lots of unsustainable practices and hazardous substances (fertilizers, pesticides, herbicides). According to international experience, from the viewpoint of poverty reduction it is more appropriate to develop and implement comprehensive programs for rural development.

It becomes evident from the above mentioned that rural development should be a priority direction in addressing economic development in the country like Armenia.

In Armenia, rural poverty has different levels across the different regions (see Table 4).

Table 4: Poverty in Armenia (as percent of total population)

Poverty Indicators	1999	2004
Incidence of Poverty	55.1	39.0
Extreme Poverty	22.9	7.2
Poverty Levels by Marzes (Rank)^a		
Yerevan	58.4 (5)	29.2 (10)
Aragatson	60.5 (4)	35.4 (6)
Ararat	52.3 (7)	32.7 (7)
Armavir	41.7 (9)	36.0 (5)
Gegharkunik	49.9 (8)	41.9 (2)
Lori	62.6 (2)	31.3 (8)
Kotayk	61.7 (3)	39.3 (3)
Shirak	75.8 (1)	48.8 (1)
Syunik	53.1 (6)	36.5 (4)
Tavush	29.3 (11)	30.5 (9)
Vayots Dzor	34.7 (10)	28.9 (11)
Urban Poverty	58.3	38.0
Urban Extreme Poverty	23.2	8.6
Rural Poverty	50.8	40.6
Rural Extreme Poverty	22.6	5.0

Source: NSS

Table 4 presents the different levels of poverty across the regions in Armenia and shows that the highest levels of rural poverty are recorded in Shirak and Gegharkunik.

The 2003 Poverty Assessment (by the WB) suggests that the unfavorable performance of the rural economy is associated with several factors: small, relatively unproductive landholdings, unfavorable farm input and output price developments, volatile weather conditions, and an absence of alternative employment opportunities outside agriculture. Further common indicators of rural poverty are large shares of refugees from Azerbaijan in the total population (as a result of ongoing conflict with Azerbaijan over Nagorno-Kharabakh), with the proportion particularly high in the communities of Gegharkunik, Vayots Dzor, Tavush and Ararat marzes (World Bank 2004b).

The Sectors that Play an Important Role in Armenian Economy

This study focuses on Armenia's key rural development issues by emphasizing rural sector performance, agricultural services and infrastructure support, rural employment and poverty, financial markets and public sector.

In the 21st century, agriculture continues to be a fundamental instrument for sustainable development and poverty reduction. Three of every four poor people in developing countries live in rural areas - 2.1 billion living on less than \$2 a day and 880 million on less than \$1 a day- and most of them depend on agriculture for their livelihoods. Given where they are and what they do best, promoting agriculture is imperative for meeting the Millennium Development Goal of halving poverty and hunger by 2015 and continuing to reduce poverty and hunger for several decades thereafter. Agriculture alone is not enough to massively reduce poverty, but it has proven to be unequal powerful for that task. Agriculture has features that make it a unique instrument for development - it can work in concert with other

sectors to produce faster growth, reduce poverty, and sustain the environment. Agriculture contributes to development in many ways - as an economic activity, as a livelihood, and as a provider of environmental services, making the sector a unique instrument for development (World Bank 2008).

The agricultural sector plays a strong role in Armenia's economy, as well. Through production, employment and consumption linkages, agriculture and the rural economy strengthen each other, leading to wide growth of employment, incomes, and poverty reduction (World Bank 2005).

Moreover, the agricultural sector is the main source of income for rural livelihoods. According to the NSS (2008), 77 percent of working-age adults are employed and agriculture is indicated as the main occupation by 57 percent of working-age adults (see Table 5).

Table 5: Armenia. Working-age Adults Employment by Sector in the Surveyed Villages
Percent

	Total	Including	
		Male	Female
Employment of working-age adults	77	54.5	45.5
<i>Of those, main occupation was:</i>			
Agriculture	57	52.6	47.4
Businesses/enterprises	3	66.7	33.3
Services including government public servants (e.g. teachers, health service providers), utility workers (gas, electricity, irrigation), etc	11	45.5	54.5
Other activities	6	83.3	16.7

Source: National Statistical Service, 2008

Agriculture shows encouraging signs of growth and productivity improvement for both primary production and agro-processing industries. Data on the 2004 sector performance suggest a strong upward trend in the agriculture sector, with a growth rate of about 14 % and an overall contribution of the agricultural sector to GDP growth of more than 3 % – the biggest single contributor to GDP growth. Growth in commercialized farming started to pick

up. While grains and other low value crops maintained their significance for subsistence, the production of value added crops (fruits, grapes and some vegetables) accelerated (World Bank 2005).

It is clear, that raising agricultural productivity is a key issue for income growth in the rural areas, where alternative employment opportunities are very few. Private farming, access to effective support services such as extension, credit, input providers and processors is pre-eminent for the development of a viable agricultural economy. Farm productivity, agro-processing, marketing and trade potential, rural financial services, agricultural supply chains and food safety issues are considered to be the key areas of importance for Armenia's rural economy over the coming years (World Bank 2005).

Another important sector for Armenia's economic development is rural infrastructure. The improvement of the rural infrastructure is recognized explicitly by the GoA as a key element for rural poverty alleviation, acting as a catalyst for development and enhancing access for rural communities to a broad range of essential social and commercial services. Infrastructure improvement is also specified in the Poverty Reduction Strategy Paper, since the Government of Armenia considers rural infrastructure development as a cornerstone of its poverty reduction strategy. The following priorities are defined in the PRSP (2003): the construction and rehabilitation of rural roads to increase the efficiency of the agriculture, provide access to markets, optimize the distribution of health and educational facilities; the enhancement of accessibility to drinking water for the population, ensuring 24 hour water supply and improving the quality of the water supply; and an irrigation program aimed at increasing the share of irrigated land and regulation of irrigation water supply systems

Social and physical infrastructures have vital impact on agricultural growth and are considered as a crucial element for rural poverty alleviation. Infrastructure provision has a positive impact on rural economic growth through the following mechanisms: it helps

increase productivity of the traditional sector (farm activity) and to move it from subsistence agriculture to higher-productivity commercial farming; it helps diversify the rural economy. If traditional farming can survive without easily accessible and reliable infrastructure services, non-farm businesses are not viable without it (World Bank 2004b).

Infrastructure provision brings more equitable growth for poor. For instance, investments in roads are twice as effective in targeting and reducing rural poverty as any other form of intervention, because better rural roads lead to increased traffic, therefore, improving market access, reduce costs and so on. According to Brennenman and Kerf (2002) (quoted in WB 2004b), the provision of reliable energy supply is a determining factor in the establishment of small businesses. In addition, the higher efficiency of modern energy sources can lead to significant financial savings for the poor, and engender health improvements due to the greater cleanliness of the fuels. Improving water supply, in the form of clean drinking water and improved sanitation, can also have indirect impacts on economic growth, through the attainment of improved health, thereby increasing the amount of working time, and reductions in the time expended in non-productive activities, such as collecting water. The provision of reliable water supply can also provide financial savings to households, in that they no longer have to purchase bottled water, fuel to boil water (World Bank 2004b). As Mirzakhanyan (2005) concludes, households without drinking water taps inside or outside their dwellings, have to spend additional time, efforts and money in order to obtain drinking water, which makes such households more vulnerable and increases their risk of poverty. This underlines the importance to access to and availability of drinking water, as well as the quality of water supply, as factors with a direct impact on people's living standards.

The Current Situation and Shortcomings of Key Rural Sectors in Armenia

It is important to identify the primary obstacles that hinder the economic growth in Armenia's rural sector. According to many researches and surveys, the main obstacles for rural development are the following: poor agricultural experience (lack of basic knowledge of production technologies, insufficient match of product varieties and processor and market preferences, outdated machinery etc.), deteriorated infrastructure, remoteness from the market centers, institutional constraints, poor financial and public services, little or no non-agricultural sources of income. In this respect, this study describes the current situation and key challenges in key rural sectors.

Infrastructure. In general, deteriorated infrastructure, poor roads, lack of water and telecommunications, as well as poor access to healthcare, education, gas and electricity are considered as major obstacles for quality of life and for economic development (Rural Poverty Eradication, 2006). Armenia's rural infrastructure has largely deteriorated and poor infrastructure continues to be a major problem. According to the recent surveys conducted in some administrative regions in Armenia, poor infrastructure is the most important factor hindering rural businesses, especially roads and telecommunications, and with more than half of the surveyed businesses indicating it is a major problem. Road travel is slow and sometimes seasonally intermittent, telephone communication both land lines and cellular, are spotty and costly, while in some districts village water and sewerage systems have deteriorated. Some improvements have been made, but remaining needs are high (World Bank 2005).

The Rural Infrastructure Study concluded that investments to rehabilitate rural roads ranked highest among rural infrastructure investment priorities in Armenia. With regional variation, more than half of the rural roads are in poor condition and some roads have become entirely impassable (World Bank 2005).

According to RCS carried out by the RA NSS (2008), the main type of roads within villages is dirt (70%). Roads to regional towns or markets are asphalt (81%). As a result of the survey, roads within villages are assessed as poor in 74 percent of villages. Roads to regional towns or markets are assessed as poor in only 43 percent of the villages. In Surveyed Villages education facilities are in need of repair. Most cultural/recreation facilities need repair (from 73% to 96%). The terrible condition of educational facilities is mainly due to the age of the buildings. Particularly 8-grade schools (91%), art schools (75%), secondary and music schools (74%), and sport schools (71%) are in bad condition. The age of education facilities in the surveyed villages in most cases is more than 20 years. The same situation is observed in the case of pre-school/kindergarten buildings (86%). Theatre/cinema facilities (100%) are more than 20 years old. The same situation is observed for stadiums/gyms (95%), cultural centers (94%), activity centers for elderly and libraries (93%).

Business. Weaknesses in the rural business environment continue prevent development of the agro-processing sector. Business advisory services are weak in Armenia. Access to timely and sufficient short-term credits, for procuring throughput and for financing imported supplies, is difficult. Shortages in the availability of investment financing continue to prevent modernization of the processing industries (World Bank 2005).

There is another constraint to business development, which is related to implementation of enabling legislation and regulations, such as:

- ✚ the perceived complexity and non-transparency of government policies, a perception that is considerably more pronounced in rural areas than in urban locales;
- ✚ inconsistent application of commercial and investment codes, laws of contract, contractors and suppliers liability and the like;
- ✚ burdensome tax administration and erratically enforced tax and customs rules, which also are frequently modified;

- ✚ cumbersome and complicated licensing and certification procedures, and inspections;

and

- ✚ very imperfect information exchanges with the business community, by policy makers and local administrators.

(World Bank 2005)

The business environment is underdeveloped in many villages. Sales prices are low and local markets are limited. In comparison to the cost of production, the price of farm produce is very low. Most of the villagers are unable to take their agricultural and animal produce to the market due to high transportation costs. The villagers are discontented about the fact that they are not in a position to reap the price they want (and should reasonable get) on their produce in the market. Whereas dealers that buy agricultural produce in villages pay paltry amounts for the produce they get. As there are no shops in many villages, and the villagers cannot afford to transport their crops/produce to be sold elsewhere, they barter. But again barter is not a profitable proposition: the villagers do not get the actual worth for their crops or dairy products. There are very few small shops in the locality that are stocked primarily with the only essential goods for local residents who for the most part buy on credit. In the available few kiosks in the villages, goods are very expensive and only basic necessity goods are purchased (Mukherjee 2007).

Agriculture. There are a number of inefficiencies that, if addressed, could allow primary producers of agricultural products to realize more value for their products and encourage the expanded production and distribution of these products. Safety and quality insufficiencies in the agro food sector are sensible barriers for increasing the exports of agro-processed products from Armenia to European and U.S. markets. This mandates a focus on developing sustainable agricultural practices, and on producing safe and high quality export products of sufficient quantity which would be competitive in these markets. The Commonwealth of

Independent States (CIS) remains the main trading partner for agricultural products. While Armenia's trade with FSU states has declined for agro-food imports (from 52 percent in 1994 to 30 percent in 2002) and exports (from 73 percent in 1994 to 19 percent in 2002), the share of agricultural products exported to the CIS remains high. The alcoholic beverages sector is the driving force behind agro-processing sector, and the main agricultural based exports from Armenia are beer, wine and brandy/vodka (World Bank 2005).

Agricultural support services need further improvements. Outdated machinery is a major impediment for productivity and profitability increase, accompanied with low level of farming skills and lack of basic knowledge of production technologies. For continued sector growth sustainable financial services are required that are more adjusted to the needs and peculiarities of agricultural production. Working capital, small investments and operating capital, long term financing, leasing, and other financial tools need to be introduced. On the product assembly side, the lack of physical marketing infrastructure, transport, logistics and trade financing problems remain serious constraints. There are, however, encouraging exceptions, such as the recent growth in contract farming arrangements between wine, cognac, juice and tomato paste producers and farmers where in-kind credit (seeds, fertilizers) flows one way and primary products the other (World Bank 2005).

There is an acute shortage of modern agricultural machinery in the agricultural sector and wherever equipment is available, they are not functioning. The machinery left from Soviet times is outdated and worn out. It is also not suitable for using on small-size land plots. Most of the farming is done by traditional means and hand labor is widely used. There is acute shortage of tractors. The farming equipment is obsolete and has been in use for 22 years already in many villages. In many villages, new equipment is not available even on leasing terms. The old equipment is not leased, because there are no spare parts to repair it. In some villages the agricultural machinery is now privatized and the farmers have to lease it

from the owners. The farming community also has problem with the availability of qualified operators of agricultural machinery. Hence the importance of reopening secondary technical education institutions is also a related issue that is worth pondering (Mukherjee 2007). Another problem is the small size of land parcels which needs small scale equipment: mini-tractors, combines etc.

Demand from agro-processing is beginning to outstrip supply in the primary goods sector. In some areas, farm output has not been able to keep up with increased demand. For example, the processing of wine and cheese are outstripping rural Armenia's capacity to deliver the required raw material inputs in the quality and quantity needed, causing domestic price increases across the country – creating regional pockets of shortage. In fact, the main issue in many of the commercialized commodity lines does not appear to be farmers identifying markets, but processors facing difficulties in procuring necessary throughputs – whether buying directly from farmers, setting up purchasing networks or other contract farming arrangements. The start up and expansion of businesses in the agricultural sector is hindered by the following problems:

- ✚ lack of knowledge or understanding of basic business practices, including accounting, cash flow projection/management, and contracting;
- ✚ lack of access to appropriate financial tools;
- ✚ lack of knowledge of marketing, production planning, and profitability assessment;
- ✚ lack of investment in transport and storage facilities and innovative, low-cost processing technologies;
- ✚ insufficient match of product varieties and processor and market preferences

(World Bank 2005)

There is a lack of ability to purchase seeds and chemical fertilizers, pesticides, diesel, fuel, there is a need to improve farmers' access to quality seeds and seedlings, including

introduction of new highly productive, pest and disease resistant varieties. Due to expensive seeds, fuel and agricultural machinery many villagers find it difficult to cultivate land, and hence use it as pasture. Indeed the *high cost of inputs* has made agriculture an unviable livelihood option, given the low returns reaped by the farmers from agricultural produce. Discounted fertilizers that are provided by the provincial authorities are not sufficient for returning soil nutrition and the farmers have to buy additional amounts of fertilizers at market prices. Pesticides provided are of poor quality and their use is not effective (Mukherjee 2007).

It is widely recognized that the availability of good quality seed and planting material of cereal and grain crops, forage crops, potatoes, fruit and grapes is a major constraint to improved productivity of Armenian farmers. There is also limited capacity within Armenia to produce high-generation (super-elite and elite) seed for multiplication by private Armenian seed producers. Presently, there are about 100 private seed production/marketing enterprises, distributing both imported and domestically produced seeds. In the last decade, Armenia's seed industry has operated with little regulation and the border essentially is open for the importation, propagation without scientific testing, and sale to farmers of any seed variety available in the international marketplace. Without certification and registration, neither the rights of the farmer (against fraud and misrepresentation) nor of the importer/producer can be identified in law and protected. A new seed law has just been approved that will form the basis for the development of a private seed production sector that can be active in the international seed trade (World Bank 2005).

Another problem is the common occurrence of *drought and hailstorm and lack of related services*. Natural calamities have taken their toll on yield and productivity in agriculture and have damaged and destroyed crops and made farmers' livelihoods vulnerable. The farmers find it difficult to cope with the natural calamities in the absence of either an effective

government mechanism to tackle drought/hailstorm or insurance to compensate the loss to animals, crops and agricultural implements. The farmers, thus, either are not compensated for crop loss or find the compensation from the Government as insufficient. As farmers imply, mechanism to tackle hailstorm was better in the Soviet times as compared to recent periods. In Soviet times hail was tackled quite successfully carried out by cannons that dispersed hail clouds (Mukherjee 2007).

Rural *financial markets* remain limited and lending to the agricultural sector continues to be low. In 2003, total lending to agriculture was only 2.5 percent of agricultural GDP. The majority of farmers finance investments from own savings, borrowing from family and friends, and credits from donor funded projects. The demand for rural lending is high, accompanied with reluctance of banks and non-banking financial institutions to enter to this market segment. (World Bank 2005). As Mukherjee (2007) describes, many farmers are badly in need of long-term loans at low-interest rates for their agricultural operations, due to the high (at 20%) interest rate loans that are provided for a period of one-year. However, in the financial sector it is important to assess the significant role of Agricultural Cooperative Bank of Armenia (ACBA). Most of the agricultural and agribusiness loans are made by the ACBA, which provides lending to meet the needs of commercial farmers and Small and Medium Enterprises (SME) agribusinesses at long-term sustainable market rates.

Irrigation. The irrigated area has declined sharply since the collapse of the Soviet Union. Armenia inherited from Soviet Union a rather costly and inefficient irrigation system – heavily depending on electricity for pumping. The lack of recurrent expenditure on operations, maintenance and systems repair over the last decade has resulted in a serious deterioration in the condition of the network. According to WB and International Fund for Agricultural Development (IFAD) estimates, the infrastructure on over 52% of previously irrigated land is in a poor state or entirely non-operational. Around 30% of the total arable

area is presently being irrigated, down from the 54% registered in Soviet times, reflecting not only the deterioration in the infrastructure, but also the deterioration due to the fragmentation of public agencies and the lack of effectiveness in using funds for carrying out operation and maintenance of the irrigation system (World Bank 2005).

According to Mukherjee (2007) the lack of irrigation is a major issue in almost all the regions. The land productivity is low due to irrigation problems such as absence of irrigation facility, damaged pumping station and erratic supply of irrigation water. In absence of irrigation, most part of lands is not cultivated, in many villages, being left for haymaking. Some villages have irrigation facilities though local residents complain about high cost of irrigation water and its erratic supply. Cattle breeding are also negatively affected by irrigation problems. Lack of irrigation also makes land cultivation unattractive and unprofitable. In some villages there is no irrigation facility while in other villages such existing facility needs to be renovated and extended. Water consumers are required to pay their water bills irrespective of how and the quality of the service that are provided, whether in timely fashion and in necessary quantities or not.

Irrigation water costs vary by region but farmers are billed for only at around 46 percent of total operation and maintenance costs (and pay only 80 percent of amounts billed), with transfers from the state budget partly covering the gap. Because of the previous lack of clarity in the allocation of responsibilities for the management of the irrigation system and lack of efficiency of the Water Supply Agency, the irrigation sector is characterized by wasteful practices and a high rate of water losses at the level of conveyance infrastructure. Division of management responsibilities for irrigation and drainage has led to coordination problems. Management of existing irrigation infrastructure has been separated from responsibility for the primary and secondary drains. Responsibilities for irrigation development, OM&R resides with the State Committee for Water Management that has a regulatory function and oversees,

plans and programs new investment and maintenance activity, as well as construction and contracts implemented by the Water Supply Agency. Responsibility for drainage works, on the other hand, resided with the Ministry of Agriculture, but has been merged with the SCWM starting January 2005. Coordination has been less than satisfactory in the past with the result that drainage works are under-funded and under-invested. The SCWM has now been subordinated to the Ministry of Territorial Administration (World Bank 2005).

Expensive medicaments. Though there are vet services in the villages for vaccination, which are carried out periodically free of charge, the medicaments for livestock are rather expensive and many farmers cannot afford to buy them. The vaccination of cattle and sheep is inexpensive. However, for pigs both vaccination and feed are expensive. The villages have veterinary service though farming and cattle breeding advice is not easily accessible. There is a lack of information on the quality of medication or pesticide and the villagers buy whatever is available, which is usually not very efficient. There is also lack of support institutions to provide technical advice (also called agricultural extension) and technical knowledge to farmers (Mukherjee 2007).

In 2006, participatory assessment of agriculture-related issues and services was undertaken in 9 regions of Armenia - Shirak Marz, Aragatsoin Marz, Lori Marz, Gegharqunik Marz, Ararat Marz, Tavush Marz, Syunik Marz, Armavir Marz and Vayots Dzor. The villagers from 58 villages of Armenia (across 9 regions) listed 10 key issues in agriculture, which were considered to be crucial:

1. Common occurrence of drought and hailstorm and lack of related services
2. Lack of irrigation facilities and network
3. Lack of ability to purchase seeds and chemical fertilizers, pesticides, diesel, fuel
4. Lack of agricultural machinery
5. Lack of access to bank credit

6. Lack of good roads
7. Low selling prices and limited local markets
8. Lack of agro-processing facility
9. Livestock-related issues and high cost of veterinary medicines
10. Lack of access to technical information and technology

(Mukherjee 2007)

Chapter 3. The Major IFIs Financing Rural Development in Armenia: Their Strategies

Though the GoA considers rural development as one of its policy priorities, financing for rural development to larger extent still comes from foreign aid and international loans provided to Armenia, because of the budget constraints. In this respect, it is important to assess the role of International Financial Institutions in rural development in Armenia.

IFIs are considered to have crucial role in helping developing countries around the world to promote economic development and stability. However, in the 1980s, the IFIs began attaching rigid conditions to their loans, which had dramatic negative effects in some countries. These conditions often required the implementation of Structural Adjustment Programs, which has eventually caused IFIs' failure in several countries like Argentina, Latin America, and the Caribbean (Challenging the IFIs 2005). However, it is also important to assess the positive impacts that IFIs have had on economies of different countries all over the world, particularly on the developing countries.

In Armenia budgetary resources allocated to the agricultural sector comprise limited part of total state expenditure: from 1994 to 2000, for example, it represented less than 5% of total state expenditures, in 2005 it comprised 3.2%, in 2006 - 3.8%, in 2007 - 4.3% of state expenses (MoF Report 2008). The same picture we face in the infrastructure sector (see Table 6). Consequently, financing public goods and service delivery to the rural sector from

domestic resources is fundamentally unsustainable and budget needs to be greatly supplemented by donor funds.

Table 6: State Allocations to Public Infrastructure Sectors (million USD)

	2004	2005	2006	2007
Drinking Water	2.45	-	-	-
Irrigation	6.00	2.77	2.41	-
Roads	7.38	20.78	21.26	21.26
Total	15.83	23.55	23.67	21.26

Source: Statistical Yearbook of Armenia (2008)

Table 6 shows that the budgetary allocations for infrastructure are inadequate even for the maintenance of the infrastructure. Moreover, Medium Term Expenditure Framework does not specify how these amounts will be shared between urban and rural public infrastructures.

Therefore, we should assess the impact of IFIs' contribution on the country's economy. This study identifies the major donors that have been making investments in Armenia for rural development (*WB, MCC, ADB*), describes their strategies and compares those strategies with the development needs of the country.

World Bank

The WB is the largest multilateral donor in Armenia (natural resource management and poverty reduction, foreign investment and export promotion, information technologies, infrastructure, education, health, social sector, agricultural reform, municipal development, transport, and judicial reform). The WB's commitments in Armenia to-date have totaled USD1.2 billion, divided among 51 projects, of which USD 947 million has been disbursed. The Bank is in the process of negotiating a new Country Partnership Strategy, in which International Bank for Reconstruction and Development (IBRD) funding will largely

supplant International Development Agency (IDA), and which will include support for SMEs (Strategy for Armenia, 2009).

Armenia joined the WB Group in September 1992. Since joining the Bank, Armenia has been the recipient of substantial Bank assistance, both financial and in the form of Analytical and Advisory Services. In early 1993, its first loan was on IBRD terms. Later in 1993, with per capita income estimated at USD380, it was declared eligible for IDA funding and all subsequent lending has been on IDA terms. In the early years, the Bank operated without a formal strategy; however, the Bank's initial activities benefited substantially from the diagnosis developed in a 1993 CEM (formal economic report, which laid the basis for the Bank's knowledge of the country and provided a roadmap for reform, as well as analytical work). From 1993 to 2002 the Bank supported 29 operations in Armenia, peaking in FY1998–2000 with an annual average of USD86.7 million during those three years. During 1993-2000, net official development assistance to Armenia averaged annually about 11 percent of GDP. The Bank committed a total of USD700 million during FY93-02 for 29 projects. The focus of the lending program was selective and addressed key development priorities. Seventy-five percent of the commitments were directed toward economic policy reform, agriculture and rural development, and infrastructure rehabilitation (transport and energy) (World Bank 2004a).

The WB has also played a key role in mobilizing resources for Armenia. Following the 1994 ceasefire, the Bank played an important role and its participation was an important signal to other donors. During this time, the Bank chaired annual meetings of a Consultative Group of donors to Armenia. An innovative approach that the Bank utilized was the mobilization of the skills and financial resources of the Armenian Diaspora. A series of teleconferences was held that permitted workers in high-tech industries in Armenia to tap into

the knowledge and experience of those living in the US, Europe, and Russia (World Bank 2004a).

The first country strategy embedded in a credit document reflected the turbulent situation from which the country was emerging. The strategy emphasized: (a) economic stabilization and institution building, (b) poverty alleviation and support for better targeting of social protection, (c) infrastructure rehabilitation, and (d) structural reforms to complete the transition to a market economy and promote private sector development and growth. Later strategies recognized the need for additional measures such as accelerating the restructuring of large firms, improving the business environment, and strengthening investment promotion. By the time of the country strategy in the late 1990's the macroeconomic situation had improved significantly. Bank strategy remained roughly as before: (a) consolidation of macroeconomic stability; (b) fostering rapid private sector development through further structural reforms; strengthening the financial system and the legal and judicial framework; and alleviation of key bottlenecks in energy, transport, and water; and (c) support for the social sustainability of reform and poverty alleviation by strengthening the social safety net and reforming the health and education systems (World Bank 2004a).

Asian Development Bank

Armenia became a member of the ADB in September 2005 and was classified as a Group B1 country, making it eligible for resources from the Asian Development Fund, as well as ADB's Ordinary Capital Resources. The ADB Board of Directors also endorsed ADB's Economic Report and Interim Operational Strategy for Armenia, prepared in consultation with the Government, key development partners, and other major stakeholders. In line with the Government's current priorities, promoting rural development, encouraging the private

sector, and deriving benefits from enhanced regional cooperation have been identified as potentially suitable broad-based goals for ADB's operational strategy. ADB's interim operational strategy is guided by three principles: (i) establishing operations to respond to Armenia's development challenges; (ii) being selective in determining initial operational areas and focusing on delivering swift results; and (iii) partnering with other development agencies to exploit the existing institutional infrastructure.

In designing its operational strategy for Armenia, ADB has held discussions with key development partners, including the WB, the International Monetary Fund, the European Bank for Reconstruction and Development, the United Nations Development Program, the International Fund for Agricultural Development, the International Finance Corporation, the United States Agency for International Development, the MCC, and the German development bank, Kreditanstalt für Wiederaufbau. The strategy complements the assistance provided by other development partners and envisages close partnerships with the leading funding agencies in the country. ADB cooperates with CSOs in Armenia to strengthen the effectiveness, quality, and sustainability of the services it provides (ADB 2009).

ADB seeks to provide assistance to Armenia for comprehensive and integrated development of the rural areas, focusing on water supply, sanitation, waste management, rehabilitation of rural roads, and security of energy supplies. ADB Strategy in the rural sector is the following: improve the irrigation infrastructure as a key to enhancing agricultural productivity and rural incomes, promote growth of rural entrepreneurship, agro-processing, and rural SME development, improve rural energy supplies to promote a better standard of living, expand trade opportunities by improving regional roads and railways and extending ADB's Trade Finance Facilitation Program to local banks, improve regional connections for road and rail transport and trade facilitation, improve rural roads to improve the livelihoods

of the rural population, rehabilitate water supply systems to improve living standards of villages and small towns, upgrade and build regional energy transmission networks.

The overall advantages of the ADB's activities in the rural sector are estimated to have the following outcomes: Rehabilitation of water and municipal services and irrigation infrastructure will improve the living standards of the villages and secondary towns, expand the irrigated area, and increase agricultural production. Rehabilitation of rural roads will create livelihood opportunities for the rural poor and access to markets for farmers and rural entrepreneurs to sell their produce for higher returns. Better road infrastructure will also facilitate access to clinics and schools, contributing to improved health and education indicators in the long run. Integrated markets will reduce imbalances in regional development, contributing to reduction in regional inequality. Developing energy alternatives will help diversify energy sources and prevent deterioration of living standards caused by disruption of imported energy supplies (Economic Report and Interim Operational Strategy, 2006).

Millennium Challenge Corporation

The GoA entered into the Millennium Challenge Compact with the United States of America, acting through the MCC on March 27, 2006, providing for a 5-year grant of up to USD 235,650,000 to advance economic growth and reduce poverty in Armenia. The objectives of the MCA-Armenia Compact can be summarized as follows: reduce rural poverty through the sustainable increase in the economic performance of the agricultural sector, rural roads rehabilitation, better access to economic and social infrastructure, reduce transportation cost, increase vehicular activity, sustain maintenance of roads network, increase agricultural productivity, improve quality of irrigation, increase irrigated land,

maintenance of irrigation system, reduce energy cost, improve water-to-market activity, access to credit to improve agricultural activities (Armenia Monitoring & Evaluation Plan, 2009).

It is also important to emphasize, that countries who receive assistance from MCC, should remain committed to the key principles which establish their eligibility for MCA assistance. These are the policies that deepen the democratic process, strengthen the judiciary, encourage economic freedom, the reduction of poverty through economic growth, willingness to have progress towards fair election processes, and citizen participation monitored by independent observers (MFA's American Department Report on U.S. Assistance to Armenia 2006).

Chapter 4. The Objectives Achieved in the Rural Sector in Armenia through IFIs in the Last Five Years

The donor community has provided assistance to the GoA in numerous different ways to address many aspects of rural development in the country and support the Government strategy. This study explores whether the development programs in the last five years have achieved their objectives and had a substantial impact on rural development during this period. To assess it, it is necessary to go beyond individual projects of the WB, MCC, and ADB, examine the country's overall progress in key areas through donor contribution.

World Bank's Projects

Since joining the WB in 1992 and IDA (the World Bank's fund for the world's poorest countries) in 1993, Armenia has received about USD1.2 billion to support 51 projects.

Armenia consistently ranks among the top performing countries in IDA's portfolio, measured by the IDA Performance-Based Allocation system. In 2008, Armenia also became eligible to begin borrowing from the WB's market-rate lending window (IBRD), and in March 2009 arranged an initial loan from IBRD to support SMEs facing credit constraints due to the global financial crisis. IBRD eligibility is a sign of Armenia's development success (World Bank 2009).

IDA has funded 40 investment projects focused on rural and community development; renewable energy and heating; health and education; water supply and sewerage; transport; and judicial and public sector modernization. The latest IDA policy credit in 2009 has a special focus on protecting vulnerable populations from impacts of the current global economic crisis. Several IDA projects have helped convert a badly deteriorated, state-run agricultural system into a more competitive sector capable of supporting growth and reducing rural poverty. In irrigation, IDA helped to rehabilitate over 4,000 irrigation canals, increasing productivity of some 140,000 hectares of land, and to introduce local management of tertiary canals by water users' associations. IDA rural development projects have strengthened agricultural research; extended rural finance to over 17,500 under-served rural enterprises and farms; helped community groups implement proposals aimed at improving competitiveness; strengthened veterinary services; and piloted provision of extension services by private providers. IDA and the ADB coordinate their transport, water and policy-based lending (World Bank 2009).

The WB's recent projects focus on energy, infrastructure rehabilitation, agriculture, social sector, business environment, and the financial sector, with an increasing recent focus on poverty alleviation. Areas identified for WB support during 2005–2008 include (i) further strengthening of bank regulations and supervision; (ii) development of financial infrastructure, including the payments system and credit information bureau; and (iii)

establishment of an anti-money laundering regime. The WB is currently implementing Rural Enterprise and Small Scale Commercial Agriculture Development Project which addresses the priorities of community development and capacity building as well as strengthening the Government's decentralized agricultural extension system. This Project (\$20.0 million) aims to provide long-term finance and capacity building for small scale rural businesses, help targeted farmers and rural entrepreneurs have a better link with markets, increase their income from rural activities, and increase employment opportunities in rural areas. The Rural Enterprise and Small Scale Commercial Agriculture Project broadened the mandate from agricultural development to rural development with four main objectives:

- Increase efficiency of the agricultural sector
- Increase employment in the rural economy
- Increase agricultural productivity
- Reduce the incidence of rural poverty

The Performance indicators for this project include: 1) number of communities benefiting from project interventions; 2) number of participating beneficiaries accessing services; 3) number of additional jobs created; 4) number of labor days created; and 5) value of additional labor wages generated (World Bank 2009).

Irrigation Development Project (\$24.9 million) aims to enhance the profitability and sustainability of irrigated agriculture, providing the basis for stabilizing irrigated agriculture as a predominant source of productive employment. Natural Resource Management Project (\$8.3 million) aims to adopt sustainable natural resource management practices and alleviate rural poverty in mountainous areas where environmental degradation is now reaching a critical point. The project will help avert further deterioration of natural resources (soil, water, forest, fishery, and biodiversity) and stabilize incomes in the local communities. Irrigation Dam Safety Projects (I and II) (\$26.6 million and \$6.8 million) aim to protect the

population and the socioeconomic infrastructure downstream of the dams facing the highest risk of failure. Electricity Transmission and Distribution Project (\$21.0 million) aims to (i) improve the measurement and accountability of electricity and revenue flows between generation, transmission, and distribution companies; (ii) reduce technical losses in electricity transmission and distribution systems, and improve system reliability; and (iii) improve the commercial performance and financial condition of Armenergo (national dispatch company) and the High Voltage Electric Network Company (transmission company). Social Investment Fund II Project (\$20.0 million) aims to assist the Government in its continuing endeavor to improve the living standards of lower-income groups and strengthen institutions at the local level. Foreign Investment and Export Facilitation Learning and Innovation Lending (\$1.0 million) aims to improve the encouragement of prospective investment and exports through the establishment of a lead agency which will streamline transaction processing and implement a promotion strategy. Through the Armenian Development Agency, the project will help develop skills, operational systems, and procedures to facilitate private business needs. Municipal Water & Wastewater Project (\$23.0 million) aims to improve the quality of water and wastewater services in the Armenia Water and Sanitation Company service area by providing efficient and sustainable water and wastewater services and strengthening the capacity and sustainability of the Armenia Water and Sanitation Company. The project will support a key country assistance strategy objective—financial and technical rehabilitation of Armenia's water and wastewater systems—by improving utility financial discipline with better cash generation and expenditure management, improving water & wastewater services, and rehabilitation of sector infrastructure. The WB's Board of Executive Directors on August 27, 2009 approved a credit of USD 36.6 million equivalent of additional financing for the Lifeline Road Improvement Project for Armenia. This project will assist the GoA in its ongoing efforts to drastically improve accessibility of the country's main road network for the

rural population and to create employment. It will also help Armenia mitigate the impacts of the global economic crisis on the country's economy and the well-being of its population. The LRIP-AF has two main components. First, it will support *rehabilitation of approximately 140 km of the lifeline roads*, located in seven regions. In addition, a *technical assistance* component will help the Armenian Government to modernize and increase the efficiency of how they design their roads, and to support a road safety audit manual as well as a “safe village” pilot that could be scaled up to improve safety standards in other areas (Economic Report and Interim Operational Strategy, 2006).

Considered overall, the country's performance in managing macroeconomic policy and in implementing many structural reforms was strong with the WB's significant contribution throughout the decade. The Bank's contribution to institutional development was substantial. In transport and agriculture the Bank's assistance made important contributions—rehabilitation of the road network and of the irrigation system. Lending instruments were well formulated, and adjustment and investment operations were coordinated and mutually supporting. The sequence of an initial institution building loan, followed by an infrastructure credit, an adjustment credit, and then investment in energy and irrigation was successful.

The strategies pursued during the decade are considered to be relevant to the country's development needs. The emphasis placed on infrastructure renewal and the dismantling of the remnants of a centrally planned economy was highly appropriate for the country—especially during the first half of the decade (World Bank 2004a). From the ratings of individual projects it can be concluded that project objectives have been relevant to the country's development needs and have their huge contribution to the country's progress in key rural areas.

Table 7: World Bank's Active Projects in the Rural Sector in Armenia

World Bank's active projects in the rural sector	Approval date
Lifeline Road Improvement Project - Additional Financing	27-AUG-2009
Irrigation Rehabilitation Emergency Project	28-JUL-2009
Access to Finance for Small and Medium Enterprises	24-FEB-2009
Rural Enterprise & Small-Scale Commercial Agriculture Development Additional Financing	24-FEB-2009
Lifeline Roads Improvement Project	24-FEB-2009
Additional Financing for the Municipal Water and Wastewater Project	30-OCT-2008
Second Foreign Investment & Export Facilitation Project	16-NOV-2007
Renewable Energy Project	29-MAR-2006
Rural Enterprise & Small-Scale Commercial Agriculture Development Project	07-JUL-2005
Irrigation Dam Safety 2 Project	10-JUN-2004
Municipal Water and Wastewater Project	04-MAY-2004

Millennium Challenge Corporation's Projects

In 2006 the GoA has received a grant (\$235.65 million) from the Government of the United States of America through the MCC to support a five-year program aimed at increasing agricultural productivity in poor rural areas of the country. Armenia has planned to achieve this goal through strategic investments in rural roads, irrigation infrastructure and technical and financial assistance to improve the supply of water and to support farmers and agribusinesses. The Program (started in September 2006) was intended to impact approximately 750,000 people, or 75% of the rural population, and is expected to reduce the rural poverty rate and boost annual incomes. The five-year Compact was initially planned to fund:

1. Rural Road Rehabilitation Project (\$67 million) that includes the rehabilitation of up to 943 km of rural roads, more than one third of Armenia's Lifeline roads network (total length of which is 3019 km), improvements of up to 19 bridges, drainage facilities and road safety feature. When complete, the Lifeline road network will ensure that every rural community

has road access to markets, services, and the main road network. Under the Compact, the GoA will be required to commit additional resources for maintenance of the road network.

2. *Irrigated Agriculture Project* is a \$146 million project to increase the productivity of approximately 250,000 farm households through improved water supply, higher yields, higher-value crops, and a more competitive agricultural sector. This project consists of two activities: *An infrastructure* activity that aims to increase the amount of land under irrigation by 40% and will improve efficiency by converting from pump to gravity-feed irrigation, reducing water losses and improving drainage. Within the Irrigation Infrastructure activity construction of seven reservoirs and eighteen gravity schemes, as well as rehabilitation of 68 pumping stations, 198 kilometers of main canals and 588 kilometers of tertiary canals was envisioned; and *A water-to-market* activity that will improve the efficiency of water delivery to farmers and boost farm productivity and profitability through a combination of training, technical assistance, access to credit and essential equipment for farmers in the irrigation zones rehabilitated under the Program. Administrative and monitoring and evaluation costs of the Program are budgeted at approximately \$23 million. Training and demonstrations are expected to be provided for 60,000 farmers, of whom approximately 38,000 will be expected to adopt water saving and productivity innovations that will increase the net benefit to their farming operations. By the end of the Compact, it is expected that approximately 7,800 hectares will be converted into higher-value agricultural cultivation as a result of increased access to water combined with an effective training program. One of the Water-to-Market Activity's aims is to introduce and expand post-harvest operations, processing and marketing. This will help to best preserve the quality of agriculture products and add value to production. When combined with reliable information on market conditions and opportunities, this will contribute to the better positioning of fresh and processed food products in the domestic, regional and international markets. Food safety and quality assurance considerations such as

Hazard Analysis and Critical Control Point and International Standards Organization certification will also be addressed through this sub-activity. It is expected that by the end of the compact these activities will impact 300 agribusiness associations and SMEs directly and 15,000 producers indirectly.

However there have been changes during the compact implementation. As a result of the June 2009 meeting MCC's Board of Directors, MCC suspended funding for any further road construction and rehabilitation under the compact. The hold on funding of RRRP was announced to be the result of actions by the GoA that were inconsistent with MCC principles promoting democratic governance. The RRRP of MCA-Armenia is still on hold. This implies that the remaining road links planned under the MCA-Armenia RRRP will not have been rehabilitated by the end of the Compact (MCC 2009).

Table 8: Achievements through MCC investment in Armenia

	<i>Projected results (2006)</i>	<i>Achievements (as of September, 2009)</i>
Rural Roads Rehabilitation Project	<ul style="list-style-type: none"> ✓ 943 km roads ✓ improvements of up to 19 bridges 	<ul style="list-style-type: none"> ➤ 24.5 km of rural roads constructed ➤ Feasibility studies and designs of 3 road packages (575 km) completed
Irrigation Infrastructure Activity	<ul style="list-style-type: none"> ✓ construction of 7 reservoirs ✓ 18 gravity schemes ✓ rehabilitation of 68 pumping stations, ✓ rehabilitation of 198 kilometers of main canals ✓ rehabilitation of 588 km of tertiary canals 	<ul style="list-style-type: none"> • feasibility studies of 7 reservoirs and 68 pumping stations completed, environmental and hydrological studies of drainage systems completed • Designs completed for 39,6 km main canals and 262 hydro technical structures , 18 gravity schemes, 78,5 tertiary canals, 466 km drainage systems • 26 Environmental Management Plans (MIP) developed • 6,5 Tertiary canals rehabilitated in 4 communities • 29 irrigation structures installed in the main canals included in the program • 1,3 km of canal section in Arzni-Shamiram main canal rehabilitated • Water Management Structure installed

		in Artashat main canal • Launch of 4 gravity scheme construction and pumping station rehabilitation works
Water to Market Activity	<ul style="list-style-type: none"> ✓ 60,000 farmers trained ✓ 7,800 hectares converted into higher-value agricultural cultivation ✓ 300 agribusiness associations and SMEs assisted ✓ 15,000 producers affected 	<ul style="list-style-type: none"> • 30,159 farmers trained • \$4.2 million credit lent to farmers • 193 demonstration sites established • 106 enterprises assisted • 3, 577,000 USD in agricultural loans provided to 326 end-borrowers • Management Improvement Plans (MIP) developed for 44 WUAs

Source: MCA-Armenia Fact Sheet, September 30, 2009

Asian Development Bank's Projects

In November 2007, the operational business plan was endorsed for Armenia, covering 2008–2010. The program includes projects for which funding has been proposed from both country-level and regional ADF resources, as well as ADB's Ordinary Capital Resources. The nonlending program will support the Government's pro-poor initiatives, with advisory technical assistance focused on capacity building, training and studies, and project preparatory technical assistance to prepare for forthcoming lending operations. Two projects (approved in 2007) funded from ADF resources were - Water Supply and Sanitation Sector Project for \$36 million and the Rural Roads Sector Project for \$30.6 million. In 2008, the Supplementary Rural Roads Sector Project (17,320,000) was approved. In 2007, technical assistance for the preparation of municipal services and rural roads rehabilitation projects were approved. The technical assistances totaled \$0.9 million in grants (ADB 2009).

The main outputs of the Rural Roads Sector Project were envisaged about 220 km of improved rural roads and the establishment of an efficient road sector management system. The outcome will be increased mobility and improved accessibility to basic social service delivery institutions, employment opportunities, and domestic and international markets for

communities and enterprises in rural and urban areas of the four regions (Ararat, Armavir, Kotayk, and Gegharkunik regions). The feeder roads improved under the Project will lead to (i) higher and more frequent quality transport services available for road users; (ii) increased business opportunities for private sector in general, particularly agriculture (including agro-processing), industrial, and service sectors; and (iii) more synergetic benefits from close partnerships in the road and other sectors relevant to the project.

The projected outcome of the Water Supply and Sanitation Sector Project is improved access to safe, reliable and sustainable water supply and sanitation services in about 16 project towns and up to 125 project villages managed on commercial principles and environmentally sound practices. Project loan was approved on 31 October 2007, signed on 18 December 2008, and the loan was declared effective on 28 May 2008.

Table 9: ADB’s Major Projects in the Rural Sector

Projects	Amount	Date Approved
Supplementary Rural Road Sector Project	\$ 17,320,000	7 Nov 2008
Water Supply and Sanitation Sector Project (Water and Other Municipal Infrastructure and Services)	\$ 36,000,000	31 Oct 2007
Rural Road Sector Project	\$ 30,600,000	28 Sep 2007

According to Hovhannisyán, in the last 5 years the major achievements in the agricultural sector are the following: successful implementation of Forest Conservation program (5 billion AMD), prevention of diseases through vaccination (4 billion AMD), preservation of plants (800 million AMD), flood control (through cleaning river-bed, and so on) (3,5 billion AMD), tangible achievements in the area of bee breeding, the implementation of Assistance to Farmers program in the last 2 years (3.2 billion AMD), in Shirak and Gegharkuniq regions subsidization of agricultural loans by the GoA, provision of advisory

services and financial resources, implementation of Cattle-breeding development program, etc. (Interview with the chief of the Financial - Economic Accounting Board in the Ministry of Agriculture).

Conclusion and Recommendations

This study focused on Armenia's key issues in rural development by studying rural sector performance, agricultural services and infrastructure support, rural employment and poverty, financial markets and public sector and identified the main factors that hold back rural development.

Both the GoA and the various local and international organizations actively implement a number of projects aimed at solving the most urgent problems in the rural sector. As it was mentioned before, rural development is an important part of the economic policy of the RoA. The National Policy for Rural and Agricultural Development is manifested in the laws adopted by the Parliament of Armenia, in Government decrees, as well as in other secondary legislation promoting the process of programs implementation. Financial resources are allocated for rural and agricultural development, project implementation and state regulation in accordance with the Law on State Budget approved by the Parliament annually. Furthermore, it becomes evident that the rural development and agrarian policy is an important part of the economic policy of the RoA directed to social and economic development of the country, since the economic growth of the rural communities has the capacity to alleviate poverty and increase the national income in Armenia.

However, budgetary resources allocated for rural development are insufficient. Furthermore, there is no single formal authority to plan, implement, and manage rural infrastructure development, neither there is a lead agency in charge of rural development nor

an interministerial body coordinating rural development (Economic Report and Interim Operational Strategy, 2006).

It becomes clear, that co-mingling of the budget appropriations with the donor funds is crucial in the rural sector. Further, the strategies and activities that the WB, ADB, and MCC implement in the rural sector are closely correlated to the policy priorities and strategy of the GoA, moreover, the programs implemented by the WB, MCC, and ADB are relevant to Armenia's rural development needs and have major contribution to the progress in the rural sector.

Nevertheless, according to the Government Program 2008, the GoA considers important provision of state budget expenditures with internal resources and diminishing financial dependence on external resources. Furthermore, the Government's policy of accomplishing efficient implementation of state expenditure (envisaged to be based on the principles of fair budget expenses and efficient allocation of state resources corresponding policy priorities) will facilitate this intention. However, as the Government Program 2008 implies, for 2008-2012 period the Government does not envision any specific strategy in order to substitute the IFI's funding with more sustainable mechanisms.

To sum up, from a legal perspective, the government strategy to sustain rural development is through funding it both from its own budget sources and international loans and grants.

Some recommendations are made below mainly directed to the GoA, which can be feasible and helpful for Armenia:

- ✚ Armenia should continue making investments in rural development using IFI financial resources, since its own budgetary funds are insufficient.

- ✚ When implementing rural development related programs and activities, it is important to take into consideration the priorities defined by the villagers, therefore bottom-up participatory decision-making is recommended.
- ✚ SMEs have the potential to generate employment and additional income. Hence, the government should direct investments toward SMEs development, as an alternative to agricultural production and potential source for job creation in rural areas.
- ✚ The GoA should be a crucial drive for expanding export of agricultural products and provide subsidies for local producers; emphasis should be on ensuring safety and quality in the agricultural products to meet international standards, since failure to meet these standards is a noticeable barrier for exports.
- ✚ The GoA should insure the farmers' produce in unfavorable geographical regions.
- ✚ In the agriculture sector the emphasis should be on implementing innovative production technologies; providing access to low-interest credits; providing seed and pedigree stock; improving access to information and markets.
- ✚ Continue investments in rural roads infrastructure to facilitate trade and economic development, as well as in water supply and irrigation facilities and networks.

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Appendix 1. Questionnaire

1. What is the Armenia's progress in key areas of the rural sector in the last 5 years (agriculture, development of social and physical infrastructures, promotion of micro- and small enterprises, agro-processing, development of financial markets (financial services, access to bank credit)?
2. What is the Government's strategy and goals related to rural development?
3. What were the budgetary allocations for rural development during the last 5 years?
4. How do you estimate the IFIs' contribution to the progress in key areas in the rural sector in the last 5 years?
5. How do you assess the effectiveness of major donor programs (implemented by MCA, WB, and ADB) in meeting their goals in the rural sector in Armenia?
6. What should be the future strategy of the Government of Armenia to substitute IFI's funding with more sustainable mechanisms?
7. Please, identify significant differences between expected results and actual achievements.