Board Meeting of August 26, 1997
Statement by Pieter Stek

ARMENIA
Country Assistance Strategy,
Second Structural Adjustment Credit,
Second Structural Adjustment Technical Assistance Credit

My Armenian authorities wish to express their strong appreciation for the Bank staff’s work in preparing this Country Assistance Strategy. The analysis is very much to the point and the proposed strategy is fully in keeping with the Government’s priorities and a sensible division of labour between the IFIs and bilateral and private donors. I can confirm that the Armenian authorities agree that continuity of the Bank staff has contributed materially to the consistency of the programme and mutual trust (par. 41). If there is something my authorities regret, it is that the availability of IDA funds rather than the absorption capacity of the country is the limiting factor for the size of the programme.1)

This being said, the Armenian government firmly intends to pursue the policies required to be eligible for the amount of World Bank funding envisaged in the high base case scenario.

The Reform Programme and the Government’s Priorities

The Government’s priorities are well set out in the CAS. For useful specifics, I draw attention to the Letter of Development Policy (LDP) of the Armenian Government (Annex 2 of the SAC document). The following additional comments may be made:

a. The Government is in full agreement with the need to raise the savings ratio of the public and the private sector. The impression may have been created in the CAS that ultimately a level

1) Personally, I would add that the mention of the budget as another limiting factor (p.i) surprises me: Armenia is a case of a country with “an exceptional track record on reform” (p. 2; see also p. 13 paragraph 30) and with a combination of good growth prospects but a very real poverty problem too. Economizing on the Bank Group’s efforts at first glance would not seem to be in accordance with sensible precepts for selectivity.

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of the budget deficit of 3-4% is regarded as appropriate (par. 14). This, however, is a target to be achieved by 2000; table 2 (p. 9) indicates a significant further decline by 2005 in the strong-reform scenario and such a further decline is in line with the Government’s thinking. The Government is undertaking a strenuous effort to raise tax revenue (1996: 12.9% GDP; 2000: 17.1%). As a result of administrative and legislative improvements, the tax revenues of the state budget of the 2nd quarter increased significantly compared to the 1st quarter of 1997. The evolution of tax and custom revenues, therefore, is showing measurable improvement. This is essential because external grants will presumably decline. The effort is coupled with progressive moves towards realistic tariffs for energy, water, etc. and the termination in general of lossmaking business activities in the public sector.

On the expenditure side it is noteworthy that Armenia, since 1995, has conducted a stringent policy of non-accumulation of arrears in the budget.

The IMF programme provides for equality of the targets for the accruals and the cash basis budget which prevents new arrears from creeping in. The Government, moreover, is now devoting attention to the reduction of arrears accumulated in the energy sector, particularly in internal payments for electricity supply. The Government adopted on July 30, 1997, a Financial Rehabilitation Strategy for the power sector and a detailed implementation plan will be approved by October 1997. The strategy aims at recovering receivables and at developing financial restructuring plans for sector enterprises to enable their privatization, starting in early 1998.

b. As for private sector savings, in addition to their anticipated recovery as growth continues, the authorities realize that savings will be stimulated by the development of an efficient financial sector. They hope that IFC will be an active partner in this and shed the seeming reticence of the language in par. 62. In my own view, Armenia offers precisely the kind of opportunities for which IFC should be watching. It would also be most welcome if IFC’s outreach programme could be expanded to include Armenia (and others). The Government agrees with the other points made under heading B on p. 6, including the importance of judicial reform. The government is fully aware of the importance of well functioning markets within a sound legal and regulatory framework, including a competent judiciary, for attracting foreign investment (LDP par. 30-34 and par. 29). It is moving ahead fast, particularly in completing the regulatory framework, and with adequate technical assistance, it will be possible to implement the framework created all the sooner and all the better. The Government is currently working on a comprehensive strategy for Capital Markets Development which will focus on specific actions and resources required to establish the essential market institutions and the related legal and regulatory framework.

c. The challenges to social and environmental sustainability are being met head on. The reform of the health system, with all the complications inherent to this sector, is proceeding apace. It is strongly focused on meeting essential needs of all through the new Basic Benefit Package (LDP par. 50). More in general, the stress of policy on disease prevention and primary health care will be strong. Great care is being devoted to creating sustainable financing mechanisms at a higher level of public spending than the current inordinately low level. The Government will also allocate more money as a matter of priority to education and focus the
funds where they are most needed in order to preserve the traditional high standards which are now under threat (LDP par. 40-46). The rate of repair of the damage sustained will, of course, be partly dependent on the recovery of income levels and of fiscal revenue.

A major step on the path to sustainability has been taken by the drawing up of a National Environmental Action Plan, which is still on track for finalization this year. Discussions with Bank staff have been intensive over 1 1/2 years and have been crucial to heightened awareness and ownership.

At the core of the Government's policy to sustain reform and of this CAS lies the envisaged systematic approach to poverty alleviation. The Government faces a difficult problem of targeting support for the poor, as is clear from the CAS document (par. 43 Box 4 and SAC par. 69-71). Together with the Bank staff, it is firmly resolved to deal with this problem and to establish a means-tested single poverty benefit.

The Government realizes that part and parcel of successful reform is the maintenance of public support for its programme including commitments to IFIs. For this purpose it is intent on improving public information and will publish the LDP. The CAS itself has been widely discussed not only with donors but also with NGOs and academia.

In conclusion, Armenia already has provided convincing evidence of being willing and able to use external assistance to good purpose. It does not shrink from the challenges before it. The fact that reform itself is not at issue between the major parties and that Armenia, as is correctly noted in the CAS, is a cohesive society augurs well for continued growth, containment of and emergence from poverty, and sustained reform.