I. Introduction and Context

Country Context
1. Armenia has sustained economic reforms leading to significant improvements in its income levels over the past years. Growth advanced 12 percent on average between 2001 and mid-2008, driven by an increased inflow of remittances and foreign investments, high commodity prices, the transition rebound and strong reform efforts. However, the global financial crisis hit Armenia severely despite a swift Government response. The economy contracted by 14.2 percent in 2009, while poverty rose by nearly 5 percent to 34 percent. The fiscal deficit increased to about 8 percent of GDP deteriorating the debt profile to 34 percent of GDP. The economic contraction was mostly due to a fall in remittances (by about 35 percent), decline in exports (by about 33 percent) and the collapse in commodity prices. Construction activity, which is a key engine of growth of the past several years, fell significantly (by 54 percent), leading to significant job losses. The Government responded with a significant stimulus package focusing on safeguarding key social programs, increasing public investments with a view to short-term job creation, and providing credit and guarantee facilities for private enterprises.

2. In 2010, the economy moved to recovery path, and recorded 2.6 percent growth of real GDP. The Government is aware of the need to advance a comprehensive structural agenda, which includes consolidating the fiscal position and securing new sources of growth. The recovery is expected to take place at a moderate pace with the official growth forecast for 2011 at only between 3 and 4 percent, increasing to 5-6 percent over the medium term. Investing in infrastructure, including water sector, will continue to be within the Government fiscal stimulus package.

Sectoral and Institutional Context
3. For many years after the collapse of the Soviet Union, most of the water supply and sanitation systems in Armenia were in serious state of disrepair. Despite an abundance of water in the country, water was available for only a few hours a day in most cities and villages and at low pressure. Over the past decade, GoA has succeeded in improving access, reliability and quality of the drinking water with increased use of public-private partnership (PPP), which has brought about higher efficiency and improvements in quality and service to customers.

4. Through two IDA credits in the total amount of $43 million, the World Bank assisted the Armenia Water and Sewerage Company (AWSC) under a Management Contract with the private operator, SAUR, to achieve the following results during the period of 2004-2011 for the benefit of 264,000 households (0.62 million persons):

   - The weighted average daily supply of drinking water service increased significantly, from 6 hours/day to 16 hours/day.
   - Cities with minimal daily hours of water supply increased from 68 percent to 90 percent.
   - Revenue collection increased significantly from 47.9 percent to 95 percent.
   - Billing on the basis of metered consumption increased from 40 percent to 77 percent.
   - Bacteriological safety compliance increased from 93 percent to 98 percent.

5. However, a recently completed Water Sector Note by the World Bank in 2011 (ESW) revealed that a significant amount of investments is still needed to a) reduce excessive percentage of non-revenue water (NRW) at 85% due to commercial and technical losses; b) implement rehabilitation works of poor quality water and wastewater infrastructure in selected cities and villages; and c) continue implementation of institutional development measures at the AWSC to ensure sustainability. Estimates indicate that short-to-medium term investment requirements during the period 2012-2016 in the AWSC service area amount to
$100 million. With the World Bank support and leading donor coordination efforts under the ESW framework, the Government managed to leverage an $85 million program from active IFIs in the sector (WB for this Project, EBRD and ADB) to continue the reform agenda and address the above-mentioned challenge. With a strong Government commitment to the sector, a supplemented $15 million counterpart contribution was allocated from the state budget to make up for the required $100 million.

Relationship to CAS

6. This proposed repeater Project supports the Strategic Objective II of the Country Partnership Strategy for Armenia-Strengthening Competitiveness for Post-Crisis Growth. The Project is referenced in the Country Partnership Strategy Progress Report presented to the Board in June 2011. The Project also addresses the recommendations of the Armenia Water Sector Note (ESW), which was jointly produced by the World Bank and the State Committee of Water Systems in 2011.

II. Proposed Development Objective(s)

Proposed Development Objective(s)

A. Proposed PDO

7. The Project Development Objective is to support improvement of the quality and duration of water supply services in selected areas of the Armenia Water and Sewerage Company's (AWSC) Service Area.

Key Results

8. The implementation of activities to be supported by this repeater project will achieve the following results:

- Increase the weighted average daily supply of drinking water service in three cities from 12.3 hours/day to 16.6 hours/day.
- Reighted average non-revenue water in three cities from 83.5% to 70%.
- Increase the ratio of billing and collection by AWSC from 93.5% to 98%.
- Improve capital investment and asset management planning practice of AWSC.

III. Preliminary Description

Concept Description

10. Similar to the successful design and implementation modality of the MWWP, the proposed Project will have the same three components:

Component 1: Investments in Water Supply Systems (WB: $8.6m; Borrower: $1.72m): This component will finance: design, implementation and supervision of the rehabilitation of water systems in the cities of Masis, Echmiadzin and Ashtarak, including their neighboring settlements. The rehabilitating works will include rehabilitation of networks linked to operation efficiency and reduction of non-revenue water. The main goal of the investments under this Component is to finance physical infrastructure that is technically sound, cost effective, reliable and reduce technical losses.

Component 2: AWSC Investments (WB: $1.8m; Borrower: $0.36): This component will finance: (i) water meters replacement and installation of meter chambers in several cities and villages throughout the AWSC Service Area to reduce commercial losses; (ii) automation of pumping stations and reservoirs; and (iii) procurement of equipment and machinery for improved O&M system of AWSC.

Component 3: AWSC Management Strengthening (WB: $4.6m; Borrower: $0.92): This component will finance: (i) a two years fee of the enhanced management contract to improve AWSC administration, operations, maintenance, and to ensure optimal implementation of the program investment funds; (ii) technical studies, project management and monitoring, including independent technical audits and financial audits.

11. Lessons Learned from previous operations and incorporated in the design of this project:

- PPP Contract alone cannot resolve all sectoral challenges. The state of the infrastructure and assets is still very poor, with a need for major investments to bring it up to a reasonable condition as well as for expansion of service.

- The need to manage a system with high levels of NRW (with technical losses estimated as much as 40-45% out of total losses of 85%) diverts scarce resources from system improvement. The high level of water loss also has operational and financial costs.

- While Armenia may not suffer water resource constraints in the short-term, given the forces of climate change, the current level of water losses will jeopardize long-term effectiveness and sustainability in a do nothing scenario.

- Tariff policy must ensure sector long-term sustainability. Tariffs should aim at O&M cost recovery, with mechanisms for adjustment for varying economic conditions. Tariff levels in Armenia, at around AMD 200/m3 (US$0.55/m3) appear low in relation to regional or international norms (where typical examples are around AMD 400/m3). Based on the ESW analysis, the Government intends to increase tariffs in 2013.
12. Innovation under the Project: The Management Contract is now called Enhanced Management Contract, which includes additional tasks building on the ESW recommendations. These include Development of a Total Management Plan (business plan for AWSC, capital investment plan and asset management plan) to ensure the long-term sustainability of the water or wastewater utility. This will help SCWS and AWSC make better decisions on when it is most appropriate to repair, replace, or rehabilitate assets and developing a long-term funding strategy. Furthermore, additional performance indicators are now added to the enhanced MC, namely, financial performance and reduction in losses (none-revenue water). Finally, the operator is now better accountable for the performance indicators with a more vigorous system of calculating incentives and penalties.

IV. Safeguard Policies that might apply

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VI. Contact point

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