

Easing Armenia's Transition to a Market Economy



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CHALLENGE

With independence in 1991, Armenia suffered a severe economic contraction. Between 1990 and 1993, GDP dropped by more than 50 percent. This led to hyperinflation, a budget deficit that reached a high of 55 percent, factory closures, little electricity supply, and large-scale emigration. About 80 percent of the population survived on humanitarian assistance and more than half the population lived below the poverty line.

APPROACH

A series of 10 projects—spanning a dozen years—supported Armenia's economic reform program to restore and maintain macroeconomic stability, create conditions for economic growth, and improve living conditions. These broad areas would form the foundation for the transformation of the economy from a centralized model to a market-based one. The program included a rehabilitation credit for 1995-1996, five structural adjustment credits between 1996 and 2004, two structural adjustment technical assistance credits between 1996 and 2002, and two poverty reduction support credits beginning in 2004 and ongoing. The technical assistance projects supported the implementation of the eight adjustment operations by providing the necessary expertise for strengthening institutions.

RESULTS

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

Highlights:

Financial Discipline and Public Sector Management

- Economic stabilization: inflation fell to 0.6 percent in 2005 from 176 percent prior to the adjustment program; the budget deficit fell from 9 percent to 1.9 percent; growth has averaged about 10 percent per year.
- Improving budget management through the adoption of a rigorous medium-term expenditure framework to manage the scaling-up of sector reforms.
- Improving customs and tax administration and broadening the tax base.
- Improved payment discipline in energy: collections increased from 30 percent to 85 percent.

Private Sector Development

- Removal of nearly all price controls and trade barriers.
- Adoption of key financial legislation early in the program: a real property code, bank insolvency law, bankruptcy law, collateral law.
- Reduction in bureaucracy: Armenia ranked 34 in the World Bank Group's *Doing Business 2007* report.
- Privatization of nearly all state-owned enterprises.

Social Development

- Adoption of a poverty reduction strategy that provides a powerful tool for policy formulation.
- Significant increase in budget allocations for health and education, doubling from 2002 to 2006.
- Family poverty benefit and pensions increased by more than 50 percent during 2002-04.

IDA CONTRIBUTION

- The 10 projects totaled US\$410 million of which US\$382 million came from IDA financing and US\$28 million from other sources-principally the Netherlands, as well as Argentina.
- Operations were in rapid succession, providing sustained financial and technical support to the government and generating a critical mass of reforms that helped to raise living standards.
- More than just providing critical deficit financing, the projects also provided a genuine opportunity for the government to benefit from external expertise. Technical assistance came from IDA and bilateral donors, with significant support from the Japanese Policy and Human Resources Development fund.
- Parallel investment operations in water, health, education and power were mutually reinforcing. For example, improved energy regulation and ownership policies supported by policy-based credits were matched by investment lending in energy.
- These policy operations were closely linked to IMF stabilization and poverty reduction programs.

NEXT STEPS

- IDA is providing two more Poverty Reduction Support Credits that focus on supporting the government to strengthen corporate and public governance, including tax and customs, and competition policy and human development. These policy-based projects are closely linked with on-going sector-specific projects.
- The completion of the credit series will coincide with the parliamentary and presidential elections of 2007 and 2008, respectively. Future policy-based lending will depend upon budgetary needs and the government's commitment to pursuing a reform agenda.

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Policy-based Lending in Armenia

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