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REPUBLIC OF ARMENIA

COUNTRY STRATEGIC OPPORTUNITIES PAPER

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CURRENCY EQUIVALENTS

Currency Unit	=	Armenian Dram (AMD)
USD 1.00	=	AMD 586
AMD 100	=	USD 0.17

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m ²)	=	10.76 square feet (ft ²)
1 acre (ac)	=	0.405 ha
1 hectare (ha)	=	2.47 acres

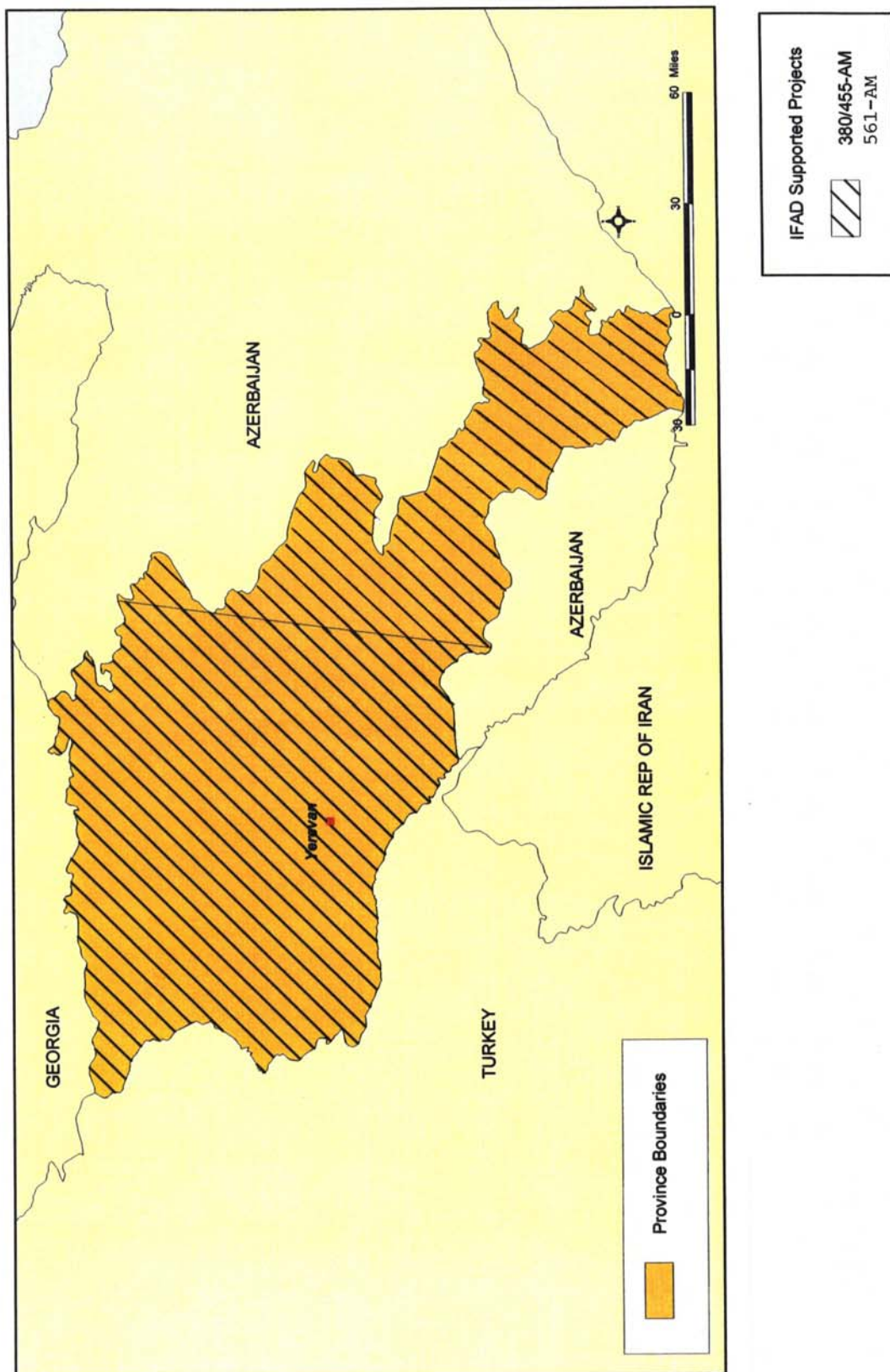
ABBREVIATIONS AND ACRONYMS

ACBA	Agricultural Cooperative Bank of Armenia
ASP	Agricultural Services Project
CEN	Central and Eastern Europe and the Newly Independent States
COSOP	Country Strategic Opportunities Paper
EU	European Union
IRP	Irrigation Rehabilitation Project
NGO	Non-Governmental Organization
NWASP	North-West Agricultural Services Project
PCE	Project Completion Evaluation
PCU	Project Coordination Unit
PIM	Participatory Irrigation Management
PRSP	Poverty Reduction Strategy Paper
SME	Small and Medium Enterprises
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
VICSA	Vertical Integrated Commodity Systems Approach
WUCC	Water Users' Consumer Cooperative
WUA	Water Users' Association

GOVERNMENT OF THE REPUBLIC OF ARMENIA
Fiscal Year

1 January – 31 December

COUNTRY MAP



Source: IFAD
The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

IFAD PORTFOLIO OVERVIEW

PROJECT NAME: AGRICULTURAL SERVICES PROJECT	
INITIATING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	United Nations Office for Project Services
LENDING TERMS:	Highly Concessional
EXECUTIVE BOARD APPROVAL:	26 April 2001
LOAN EFFECTIVENESS:	26 September 2001
CURRENT CLOSING DATE:	31 March 2006
LOAN ACRONYM:	561-AM
DENOMINATED CURRENCY:	Special Drawing Rights (SDR)
APPROVED LOAN AMOUNT:	SDR 12.35 million
LOAN DISBURSEMENTS:	SDR 6 839 962.29 (55.38%)

PROJECT NAME: NORTH-WEST AGRICULTURAL SERVICES PROJECT	
INITIATING INSTITUTION:	IFAD
SUPERVISING INSTITUTION:	IFAD
LENDING TERMS:	Highly Concessional
EXECUTIVE BOARD APPROVAL:	4 December 1997
LOAN EFFECTIVENESS:	14 April 1998
CLOSING DATE:	31 December 2002
LOAN ACRONYM:	455-AM
DENOMINATED CURRENCY:	SDR
APPROVED LOAN AMOUNT:	SDR 9.55 million
LOAN DISBURSEMENTS:	SDR 9 548 832.82 (100 %)

PROJECT NAME: IRRIGATION REHABILITATION PROJECT	
INITIATING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	International Development Association
LENDING TERMS:	Highly Concessional
EXECUTIVE BOARD APPROVAL:	12 April 1995
LOAN EFFECTIVENESS:	6 October 1995
CLOSING DATE:	30 June 2000
LOAN ACRONYM:	380-AM
DENOMINATED CURRENCY:	SDR
APPROVED LOAN AMOUNT:	SDR 5.4 million
LOAN DISBURSEMENTS:	SDR 5 400 000.00 (100%)

EXECUTIVE SUMMARY

1. Armenia was reportedly the wealthiest republic in the former Soviet Union prior to 1998, but its receipt of three highly concessional loans from the Fund clearly reflects the extent of the country's economic collapse. Following the earthquake of 1988, the break-up of the Soviet Union in 1989-91, the war with Azerbaijan over Nagorno Karabach, the Azerbaijani-Turkish blockade and the economic and political collapse of neighbouring Georgia, the Armenian economy contracted in real terms by 42% in 1992, and dropped by a further 8.8% in 1993. A comprehensive programme of macroeconomic stabilization and structural reform led to inflation falling from 5 273% in 1994 to 18.5% in 1996 and to it now being maintained at an average of 3.1%. Between 1994 and 1998, an average annual gross domestic product (GDP) growth of 6% was recorded, notwithstanding the Russian financial crisis at the end of the same period. This rose to 7.7% for 1998-2002 – the fastest rate of real GDP growth among the Commonwealth of Independent States. However, comparison of percentage changes in 1990-2000 output levels by sector shows that industrial output in 2000 was -69.2% compared to 1990, construction -32.3% and services -12.1%, with only agriculture showing a modest increase of 13.7%. At the same time the benefits of growth have been very unevenly distributed and even if the average annual real GDP growth is maintained at 7.7%, it will still take another 10-12 years to return to pre-transition economic levels and standards of living. This reflects the extraordinary severity of the shock inflicted upon the Armenian people and the degree of poverty they continue to suffer, despite their impressive recovery to date.

2. In the four or five years following Armenia's economic collapse, the agricultural sector provided an important safety net in terms of food security and at least partial employment for people who had lost their livelihoods in other sectors. Armenia's agricultural land resources were privatized in 1991-1992 when 70% of all land was transferred to private ownership, and there are now more than 335 000 family-owned farms, which produce about 98% of the total agricultural output. The average farm size is 1.37 ha, usually comprising three parcels: one irrigated and two non-irrigated. Irrigation is crucial to production and productivity. Some 60% of all farmers have access to irrigation and, on average, 0.7 ha per farm is irrigated. It is estimated that 88% of farms are of less than 2 ha and account for 77% of the total suitable land area. The other 12% are larger than 2 ha.

3. The rural sector in Armenia is characterized by the classic constraints on production and profitability of impoverished, subsistence-oriented smallholder agriculture, aggravated by the legacy of an abrupt transition from a command economy. First, a very large number of 'farmers' have little or no technical knowledge and skills, having entered the sector via land privatization as a survival strategy to cope with the collapse of other sectors of the economy. This is manifested in poor crop and animal husbandry and management, including excess seeding rates, little use of fertilizer and plant protection measures, and inadequate feeding, health and sanitary practices. Secondly, the small farm sizes and priority accorded to food self-sufficiency can and do lead to poor returns, soil and pasture degradation, and to production patterns that are unsuitable and unsustainable for local agro-ecological conditions. Thirdly, technology and infrastructure, for example, farm machinery and irrigation inherited from the pre-transition period, is often inappropriate in terms of scale, cost and service requirements. Fourthly, even after 12 years of adjustment, there is still a seriously disabling absence of the information, instruments and institutions needed to efficiently operate a market-oriented rural economy, particularly in terms of input supply, technical and mechanical services, marketing, rural finance and agri-business. This inhibits access to affordable improvements to production and productivity, and prevents rationalization through diversification. Fifthly, the Government has tended to be weak and inconsistent with respect to the maintenance and development of coherent and supportive policy, regulatory and coordination environments. Consequences include the deterioration of genetic resources; difficulties in controlling endemic disease; unavailability or inadequate use of improved varieties and certified seed; lack of appropriate applied research; poor quality control at the farm and processing levels; and farmers being discouraged from becoming proactive entrepreneurs.

4. Poverty is geographically widespread, deep-rooted and severe. There is a great deal of inequality within the country, with most poor people living well below the poverty line. About 50% of all rural households subsist on less than 75% of the minimum consumption basket. Regional rural poverty correlates to altitude, where harsh conditions severely restrict agricultural productivity. However, rural poverty is not a matter of human poverty but of income. People are almost universally literate, infant mortality is low and life expectancy is high.

5. IFAD's strategy for development in this context, realized through its financing of the Irrigation Rehabilitation Project, the North-West Agricultural Services Project (NWASP) and the Agricultural Services Project (ASP) in 1995, 1997 and 2001, respectively, has involved: (i) broad poverty reduction through agricultural growth; (ii) focus on the poorest rural areas of the country; (iii) institution-building both by involving grass-roots groups in implementation and management and by increasing their responsibilities; and (iv) targeted poverty reduction measures for poor groups that have not benefited from agricultural growth. The rationale for the strategy was that providing essential elements for productive activities in agriculture was a relatively quick way of reducing Armenia's severe rural poverty. This approach appears to have been more than justified given the very positive findings of the 2001 NWASP Project Completion Evaluation and the 2002 External Review of the Results and Impact of IFAD Operations. Moreover, the orientation and achievements of the portfolio to date are consistent with IFAD's strategic framework and its sub-regional strategy for Central and Eastern Europe and the Newly Independent States, in terms of:

- strengthening the capacity of the rural poor and their organizations (water users' associations (WUAs), village credit associations, and social infrastructure maintenance groups);
- ensuring more equitable access to productive natural resources and technology, notably irrigation water; and
- increasing the access of the poor to financial services and, to some extent, markets, (although much remains to be done).

6. As far as the future is concerned, Armenia's agro-ecology is such that agriculture's role as an engine of the economy must, of necessity, be a minor one. In recent years, other sectors, notably services, construction and industry, have begun to pick up and it is reasonable to expect that labour will return to them from the agricultural and rural areas. Meanwhile, the current situation within the country means that any development strategy must centre on reaping the benefits of resource-allocation efficiency provided by transition to a market orientation without imperilling the safety net functions of such benefits for a population that is still mostly very poor. This perspective is based on: (i) the work of an IFAD Country Strategic Opportunities Paper (COSOP) mission to Armenia on 14 April-4 May 2003; (ii) a consultative COSOP workshop held near the capital city of Yerevan on 25-26 April 2003 and attended by 51 representatives of government, the private sector, national non-governmental organizations, beneficiary organizations, and international donor institutions, followed by a validation workshop in September 2003; and (iii) the Government's approved Poverty Reduction Strategy Paper, which identifies the following four priorities: (a) pro-poor economic growth; (b) public administration reform and anti-corruption measures; (c) social-sector reform; (d) human development; and (iv) the objectives of the current draft Strategy for Sustainable Agricultural Development, which are to: achieve real growth in farmers' income through increased agricultural productivity; provide opportunities for real growth in the income of off-farm rural poor; and improve the food security of Armenia's urban population, especially the poorest segments.

7. In view of the emerging market orientation of many farmers and revival of other sectors of the economy, it is proposed to shift the focus of IFAD's thrust in Armenia from its present emphasis on food security only to market-oriented agricultural production **and** food security.

8. By virtue of its mandate, the Fund's investments in Armenia will continue to target very poor subsistence-oriented farm families, mostly located in the mountainous areas. However, such

investments will also be targeted at poor farm families that produce some surplus over and above their own consumption needs and thereby generate additional income from the sale of it. Support will be provided also to small- and medium- scale rural service providers such as traders, processors and input suppliers. The traders and processors are of interest not so much because of their poverty, but because they provide both upstream and downstream links to subsistence and market-oriented farmers and better employment and income-earning opportunities for them. For families forced to remain in a subsistence mode of production, the mix of productive and social infrastructure and small agricultural production loans, as provided for under ASP, will continue. For market-oriented small farmers, for those who might move into that segment, and for rural service providers, a vertical integrated commodity systems approach (VICSA) will be applied. The basic principle of the VICSA is to make a thorough analysis of specific commodities, examining the whole chain from the market to the producer, and subsequently address weak links in the chain. Depending on the commodity involved, weak links may relate to organization of farmers, finance and availability of appropriate technology at the **primary producer** level; finance, technology and business planning skills at the **processing** level; and inappropriate tax regimes, export regulations or quality control at the **wholesale** level. Thanks to the improved implementation capacity in Armenia, the use of the VICSA is now possible.

9. In terms of project opportunities, a number of considerations are proposed. First, there is a need to consolidate and capitalize on investments already made by IFAD in Armenia, most notably in the area of institutional support for participatory irrigation management (PIM) and rural financial services. Although significant progress has been made thus far, substantial support is still required for strengthening the PIM concept to enable WUAs to become viable technical and financial entities throughout the country. For rural financial services there is a need for further outreach, diversification of service providers, and products. Secondly, since coherent private-sector development, especially for poverty reduction, cannot be effectively and efficiently achieved without an adequate institutional framework, support is required for the Ministry of Agriculture to finalize and follow up implementation of the national agricultural strategy. Thirdly, the area-specific interventions that may be supported by IFAD will continue to focus on the most disadvantaged, mountainous part of the country where severe rural poverty is most persistent. Fourthly, the limited capacity of existing projects to identify and address gender-related issues should be rectified in any future operations supported by the Fund.

10. It is proposed that IFAD's next intervention in Armenia should provide a flexible response to the rapidly changing environment within the agricultural sector. As noted, IFAD investments will initially focus on consolidating support for PIM and rural financial services. By using the VICSA approach in parallel, other possible entry points for future investments will be the development of extension and marketing linkages. However, Armenia has neither the human nor the financial resources to sustain public-sector support in these areas, and in any event it is questionable whether this would be appropriate in the long term. Promotion of horticultural products will represent a particular niche for a future intervention. Such initiatives could also enhance incomes without jeopardizing food security, which is still a pertinent issue in Armenia. Support to selected infrastructure development in the poorest communities, including feeder roads for market linkages, will likewise be considered. Should the establishment of farmer organizations be identified as a bottleneck within the VICSA concept, support may be provided to speed up the process – such organizations being of critical importance for overcoming diseconomies of scale in the smallholder sector.

11. It is proposed to formulate an agricultural services-cum-market linkage project, supported by a loan of USD 12-15 million, for presentation to the Executive Board in December 2004 or April 2005. Following Board approval of the project, no new project initiatives are expected to be developed during the period covered by the present COSOP (2003-2008).

12. IFAD-financed interventions have an established niche and track record in Armenia. The fact that the resource envelope for the future is limited provides a solid foundation for discussions with the

Government on further enforcement of pro-poor policies and institutions. Project implementation performance to date reflects both the Government's strong commitment to reducing poverty and IFAD's relatively high per capita lending programme for the country. The main findings and recommendations of the present COSOP have been discussed with and endorsed by the Government and other stakeholders.

REPUBLIC OF ARMENIA

COUNTRY STRATEGIC OPPORTUNITIES PAPER

I. INTRODUCTION

1. The Republic of Armenia joined IFAD as a member of Category III in January 1993, after which a General Identification Mission identified three projects for financing. Between 1995 and 2001, IFAD cofinanced the Irrigation Rehabilitation Project (IRP), supporting the rehabilitation of tertiary canals and water management through the establishment of water users' associations (WUAs). The second project, the North-West Agricultural Services Project (NWASP), which started up in 1998, achieved 97% disbursement by June 2001 – 18 months ahead of schedule. NWASP extended the achievements of IRP in three *marzes* (provinces) with respect to irrigation development and water management on poor smallholder farms, and supported the provision of improved seed varieties, animal health and rural financial services, and the rehabilitation of social infrastructure in the poorest beneficiary communities. The third project, the Agricultural Services Project (ASP), got under way in 2001 and, although its activities have been almost exclusively concentrated on Armenia's poor mountainous areas, it is replicating the NWASP approach, content and achievements on a national scale.

2. An important element in the formulation of the present Country Strategic Opportunities Paper (COSOP) were the findings of a consultative COSOP workshop held near the capital city of Yerevan on 25-26 April 2003. Some 51 persons, representing the Government, national non-governmental organizations (NGOs), the private sector, beneficiary organizations and international donor institutions participated in the workshop. On the basis of lessons learned from previous and ongoing IFAD-financed operations in Armenia, participants put forward suggestions for future support by the Fund. Representatives of the same group of stakeholders participated in a validation workshop in Yerevan in September 2003, when the main findings and conclusions of the COSOP were endorsed.

II. ECONOMIC, SECTORAL, AND RURAL POVERTY CONTEXT

A. Country Economic Background

3. Armenia is a small, landlocked country with few natural resources. It covers a total area of 29 800 km² with a population of about 3.8 million, and is bordered by Azerbaijan, Georgia, Iran and Turkey. Following the 1988 earthquake, the break-up of the Soviet Union in 1989-91, the war with Azerbaijan over the Armenian enclave of Nagorno Karabach, the Azerbaijani-Turkish blockade and the economic and political collapse of neighbouring Georgia, the Armenian economy contracted in real terms by 42% in 1992 and dropped by a further 8.8% in 1993. It is estimated that the gross national product per capita fell by about 75% during the first four years of independence.

4. At the end of 1994, the Government launched a comprehensive programme of macroeconomic stabilization and structural reform. This led to the elimination of hyperinflation (inflation fell from 5 273% in 1994 to 18.5% in 1996 and it is now being maintained at its present average of 3.1%), and an average annual growth in the gross domestic product (GDP) of 6% between 1994 and 1998 notwithstanding the financial crisis in Russia at the end of the same period. This rose to 7.7% for 1998-2002. The sectoral composition of GDP has shown a marked shift from 1990 to the present time. In 1990, the shares of agriculture, industry, construction and services were 12.6%, 44.5%, 18.0% and 24.9%, respectively. The share of agriculture rose to 46.3% in 1993 and thereafter began to fall again to its present estimated 30%.¹ Correspondingly, construction fell sharply to a low of 4.1% in 1993, services to a low of 17.4% in 1994 and industry to a low of 19.9% in 1998, and their

¹ Economist Intelligence Unit: Armenia Country Profile 2002 and Country Report, February 2003.

present estimated shares are 12%, 35% and 23%, respectively. These shifts may perhaps be put into perspective by comparing percentage changes in the levels of sector output between 1990 and 2000. Thus, compared to that of 1990, industrial output in 2000 was -69.2%, construction -32.3% and services -12.1%, with only agricultural showing a modest increase of 13.7%.² At the same time, the benefits of GDP growth have been very unevenly distributed (see below), partially contributing to the persistence of poverty. Moreover, even if average annual real GDP growth is maintained at 7.7%, it will still take some 10-12 years to return to pre-transition economic levels and standards of living. This indicates the extraordinary severity of the shock inflicted upon the Armenian people and the degree of poverty they continue to suffer despite the impressive progress in recovery to date.

5. As far as the financial services sector is concerned, the collapse of several banks in 1994 precipitated a process of reform and consolidation that led to the number of banks being reduced from 58 to 31 by the end of 2000. At 17% of GDP, capitalization of the sector remains low. High lending rates and limited access to credit constrain the financial intermediation capacity of banks. The non-bank financial sector is still underdeveloped although a significant number of activities have been initiated during the last two years, especially by the United States Agency for International Development (USAID).

6. Armenia has been forced to reorient its liberal trade regime owing to the continuing blockade by Azerbaijan and Turkey and financial and economic problems in Russia. While Russia remains the country's main bilateral trading partner, accounting for 20% of imports and 18% of exports, the Commonwealth of Independent States' share of Armenian exports declined from 73% in 1994 to 24% in 2000. Countries of the European Union (EU) now account for 36% of exports and 34% of imports, compared with 16% and 9%, respectively, in 1994. Principal exports are precious stones, metals and jewellery, while the main imports are food, tobacco, beverages and mineral fuels. Indeed, imported products account for more than 55% of total food consumption in Armenia. In 2002, the export revenue of USD 507 million was more than twice as high as in any year in the mid-to-late-1990s; the trade deficit was cut to USD 483 million and the current account deficit reduced to 9.2% of GDP. The Armenian diaspora is an important source of foreign exchange, estimated at USD 170-200 million for 2002-2003. Remittances from abroad are essential to many families but there is reason to believe that direct foreign investment from these and other sources will be much greater once the regulatory framework for private-sector development has been further improved and enforced.

B. Agricultural Sector³

7. In recent years, the share of agriculture and the food industry to GDP has been around 30%, with more than three quarters originating from agriculture. Agricultural 'employment' steadily increased from 18% of the labour force in 1990 to 43% in 1999, but this reflects the contraction of other sectors rather than any inherent strength in agriculture. About 60% of the country is suitable for agriculture. This comprises 1 391 000 ha: 494 300 ha of arable land (35.5%), 63 800 ha of perennial plantations (4.6%), 138 900 ha of grasslands (10.0%) and 694 000 ha of pastures (49.9%). Agriculture depends to a great extent on irrigation, and half of both the total arable land and of the perennial plantations are now irrigated.

8. The country is affected by serious ecological degradation, including lack of drainage, high salinity in many valleys, and degradation of pastures in the high mountains with consequent increases in soil erosion in foothill and mountain areas. Small-scale farmers (see below) have, of necessity, largely disregarded the need for soil conservation measures in their cropping patterns, and numerous trees (including fruit trees) were felled during the first few years after independence to satisfy the need for firewood.

² Drawn from *Growth, Inequality and Poverty in Armenia*, Keith Griffin et al., Yerevan, August 2002.

³ Drawn from *A Strategy for Sustainable Agricultural Development*, Yerevan, November 2002.

9. Armenia's agricultural land resources were privatized in 1991-1992, when 70% of all land was transferred to private ownership. However, 25% of each category of land in every community was kept in 'state reserve' so as to provide for future growth and for the needs of new landless families. Pastures were also excluded from privatization and were transferred to local communities. From a situation whereby all primary production was controlled by about 400 public state farms, there are now more than 335 000 family-owned farms which produce about 98% of all agricultural produce. The average farm size is 1.37 ha, usually made up of three parcels: one irrigated and two non-irrigated. Some 60% of all farmers have access to irrigation and, on average, 0.7 ha is irrigated per farm. It is estimated that 88% of the farms are of less than 2 ha, and cover 77% of the total suitable land area. The remaining 12% are larger than 2 ha.

10. Since privatization, the contributions of the livestock and crops sub-sectors to agricultural GDP have changed markedly. At the end of the 1980s, the livestock sub-sector accounted for 55% and crops for 45%, but by the second half of the 1990s the livestock sub-sector had shrunk to about 40% and that of crops had increased to 55-60%. A major shift has taken place in the cultivation of basic food crops for self-consumption (cereals, potato) at the expense of fodder crops, fruit trees, vineyards and industrial crops. Around 20% of farms cultivate only crops, and a mere 2% specialize in livestock. Both crop and livestock production yields are low owing to the very limited use of agricultural inputs, which are anyway of poor quality, and inadequate farming practices.

11. The reliance on wheat for home consumption is understandable in view of the present level of food insecurity in the country, but is only marginally profitable as imported grains are significantly cheaper. Yields of the major crops are believed to be only 50-60% of potential yields. For example, compared to 1990, the area put down to cereals has increased by 30% while the gross harvest has increased by only 11%. By contrast, potatoes are a vitally important food and cash crop, and have good export potential. Potato areas have increased over the last decade – from 22 400 ha in 1990 to an average of 32 700 ha in 1995-2000, about 10-15% of which is under early potatoes. Similarly, fruit production has excellent potential and indeed was previously the most profitable element of the crop sub-sector. In the dire food and fuel crisis of the early 1990s, the area covered by fruit gardens was reduced from 50 158 ha to 21 604 ha – a decrease of 56.9%⁴. The variety of altitudes within the country and of soil-climatic conditions are suitable for the production of apricot, peach, plum, cherry, apple, pear, quince, walnut, peanut, fig and pomegranate. About 70% of the country's fruit gardens are situated at 400-1 000 m above sea level, 4-5% at 1 500-2 000 m, and 2.5% at above 2 000 m. Fruit is produced in 482 settlements in all *marzes* in the country's nine agricultural zones. Finally, vegetable cultivation is widespread, with the 18 000-22 000 ha under cultivation in the 1980s increasing to 27 000 ha by the late 1990s. Overall yields of vegetables seem to be quite satisfactory.

12. Virtually all livestock is privately owned. Around 186 000 farms and households have cattle: 38 500 raise pigs, 83 500 keep sheep and 119 000 have ten or more domestic fowls. Many holdings raise different species, and more than 84% keep at least two types of animals. Privatization of land, property and animals has mainly resulted in small herd sizes and fragmented herd structures: the average number of cattle per cattle farm is 2.32 head, including 1.3 cows. Dairy cattle production is the most important branch of animal production. More than two thirds of the meat and milk marketed by the sector originates from farms with one-to-three cows. The goat population has increased threefold since farm privatization and, in some areas, goats are likely to replace dairy cattle, especially on smallholder farms. There is no comparative advantage in pig production given the need to rely on imported feed for improving performance. Overall, the production potential of the existing animal breeds is under-utilized by an estimated 30-50% due to inadequate feeding⁵, weak farm management and poor health conditions.

⁴ The trees were cut down for firewood and to release land for subsistence crops.

⁵ During the 1990s, feed sources shrank dramatically. Imports of fodder grain and other feedstuffs were stopped and the production of concentrated feed decreased significantly. Silage, beetroot and other vegetables are practically not used for feeding animals and the majority of farmers feed their cattle and sheep exclusively with hay and straw in the winter period.

C. Rural Poverty⁶

13. Most of the available data on poverty in Armenia as a whole and the rural areas in particular come from a series of nationally representative household income and expenditure surveys carried out by the Government with the assistance of the World Bank in 1996, 1997/98 and 2001.⁷ The results of these surveys show that poverty in Armenia is geographically widespread, deep-rooted and severe. Preliminary estimates from the 2001 survey show the incidence of poverty to be 51.3% in towns and cities and 50.1% in rural areas, and the respective incidence of extreme poverty as 18.2% and 11.2%, respectively. There is a great deal of inequality within the country, with most poor people living well below the poverty line. About 50% of all poor rural households subsist on less than 75% of the minimum consumption basket.

14. Regional rural poverty correlates with: altitude, where harsh conditions severely restrict agricultural productivity; small farms, where household labour is underemployed on relatively small plots; lack of irrigation, which drastically reduces the profitability of all crops; large family sizes; and high dependency ratios. Shirak, Lori and Kotayk are the poorest *marzes*.⁸

15. The disparities between rural and urban areas are attributable to household income structures. Rural households are relatively less represented in the 'extremely' poor category because they can mostly satisfy their food consumption needs from their own production. The fact that they have parity representation with urban households in the 'poor' category indicates the extent to which they are cash-starved for other essential consumption items, notwithstanding increased production. This in turn reflects the structural issues that constrain them to a subsistence orientation and prevent their entry into an efficient market economy.

16. This situation is further reflected by the very few opportunities for wage labour or self-employment. Unemployment rates are very high⁹ and only about 60% of the adult population is active in the labour force. Most of the rural labour force has to rely on the agricultural economy, and, with so many workers having been absorbed into the sector, productivity – as opposed to production – has declined sharply. In rural areas the opportunities for off-farm self-employment are very limited, especially for the poor. Self-employment provides only 5% of total household income in Armenia and the majority of this has been captured by wealthy urban households. The poorest quintiles generate less than 2% of their income from their own entrepreneurial activities. The rural landless are, consequently, particularly vulnerable.

⁶ Drawn from Griffin, op cit.

⁷ In order to assess the level of income poverty, three standard measures of poverty have been estimated, based on the household survey data. The incidence of poverty is measured by the proportion of the poor in the total population, i.e. the head count measure. The depth of poverty is measured by the poverty gap, which measures the average amount of income by which the poor fall short of the poverty line. The severity of poverty is measured by the Foster-Greer-Thorbecke Index, which gives some sense of the inequality among the poor by simply giving a larger weight to households that are far below the poverty line. The poverty lines for each of the survey years were based on the actual consumption patterns of Armenian households. The food consumption patterns of these households were used to determine the cost of a 2 100 calorie diet, i.e. the minimum food basket. The value of this minimum food basket is used as the extreme poverty line. Households whose consumption falls short of the value of the minimum food basket are considered to be extremely poor. To determine the value of the complete poverty line, an allowance for essential non-food consumption items was added to the minimum food basket. This amount varied over the survey years because it was based on actual consumption patterns, but accounted on average for about 30% of the total value of the poverty line. Households whose consumption did not meet this poverty line were considered to be poor. The 1996 poverty lines were AMD 6 612 (USD 15.2) and AMD 10 527 (USD 24.2) per month of per capita expenditure for extreme poverty and poverty, respectively. In average 1998/99 prices, these poverty lines would be AMD 7 194 and AMD 11 735. *Social Snapshot and Poverty in the Republic of Armenia*, The National Statistical Service, Yerevan 2001.

⁸ Some care has been taken in interpreting the figures because urbanization is also a strong correlate of poverty, reflecting the catastrophic collapse of the industrial, manufacturing and service sectors.

⁹ Estimated by the 1998/99 household surveys to be 25% and by the International Labour Organization to be as high as 34%. Cited in the United Nations Development Programme (UNDP) 'National Human Development Report: Ten Years of Independence and Transition', Yerevan 2001.

17. Rural poverty in Armenia is not a matter of human poverty but of income. People are almost universally literate, infant mortality is low and life expectancy is high.¹⁰ However, there is also a gender dimension to poverty. The transition period has seen a negative impact on women's economic and political status. Overall, the number of employed women has risen to 52.4% of the work force, while their average monthly wages are only about 75% of men's earnings.¹¹ Since the establishment of the *marzes* in 1996, no woman has been appointed governor or deputy governor or as head of a municipality. Women are chairpersons in only 2% of the country's 859 village councils.¹²

18. In conclusion, the principal causes of poverty are to be found in the collapse of real income and a sharp increase in inequality, which combined to push down consumption in the early years of transition. The persistence of poverty, despite recent years of growth, is attributable to continuing low income and high inequality; the growth pattern; and the aftermath of the Russian financial crisis. Armenian output is still only about 65% of its 1990 level. The current estimated Gini coefficient for income distribution is 0.60. Current output is predominantly from low-productivity informal activities in agriculture, commerce and urban services, which do not provide sufficient earnings to lift households out of poverty. Although agricultural output has been growing, producer incomes remain depressed by low farmgate prices.

D. Constraints on and Opportunities for Rural Poverty Reduction

19. The rural sector in Armenia is characterized by the classic constraints on production and profitability of impoverished, subsistence-oriented smallholder agriculture, aggravated by the legacy of an abrupt transition from a command economy. First, a very large number of 'farmers' have little or no technical knowledge and skills, having entered the sector via land privatization as a survival strategy to cope with the collapse of other sectors of the economy. This is manifested in poor crop and animal husbandry and management, including excessive seeding rates, little use of fertilizer and plant protection measures and inadequate animal feeding, health and sanitary practices. Secondly, the small farm sizes and priority accorded to food self-sufficiency can and do lead to poor returns, soil and pasture degradation, and to production patterns that are unsuitable and unsustainable for local agro-ecological conditions. Thirdly, technology and infrastructure, for example, farm machinery and irrigation inherited from the pre-transition period, is often inappropriate in terms of scale, cost and service requirements. Fourthly, even after 12 years of adjustment, there is still a seriously disabling absence of the information, instruments and institutions needed to efficiently operate a market-oriented rural economy, particularly in terms of input supply, technical and mechanical services, marketing, rural finance and agri-business. This inhibits access to affordable improvements to production and productivity, and prevents rationalization through diversification. Fifthly, the Government has tended to be weak and inconsistent with respect to the maintenance and development of coherent and supportive policy, regulatory and coordination environments. Consequences include deterioration of genetic resources; difficulties in controlling endemic disease; unavailability or inadequate use of improved varieties and certified seed; lack of appropriate applied research; poor quality control at the farm and processing levels; and farmers being discouraged from becoming proactive entrepreneurs.

¹⁰ UNDP, op. cit.

¹¹ Current average wages in Armenia are USD 46 per month.

¹² UNDP's Gender Empowerment Measure shows the percentages of women in the following categories, seats in Parliament, administrators and managers, professional and technical workers as 31, 34.5 and 64.9, respectively, for 2002. Comparable figures for 1997 are 6.3, 29.4 and 68.5. United Nations Development Programme, National Human Development Report, 2002.

E. National Strategy for Rural Poverty Eradication¹³

20. The two key national strategy documents on rural poverty eradication are the Poverty Reduction Strategy Paper (PRSP) and the draft Strategy for Sustainable Agricultural Development. The lead ministries involved in their production are the Ministry of Finance and the Ministry of Agriculture, respectively. Local experts were hired to draft the PRSP, and the Food and Agriculture Organization of the United Nations (FAO) assisted in the preparation of the agriculture strategy paper within the framework of a technical cooperation programme. The PRSP was endorsed by the Government in August 2003. The agricultural strategy is currently being redrafted with EU help.

21. The PRSP identifies the following priorities: pro-poor economic growth; public administration reform and anti-corruption measures; social-sector reform; and human development. Overall, the PRSP stresses the importance of targeting programmes at the most vulnerable populations.

22. As it now stands, the objectives of the agricultural strategy are to: achieve real income growth for farmers through increased agricultural productivity; provide opportunities for real income growth for off-farm rural poor; and improve the food security of Armenia's urban population, especially the poorest segments. These objectives are to be achieved by: strengthening the efficiency of the agriculture and food sectors vis-à-vis the domestic market; developing import substitution in the sub-sectors where Armenia has a comparative and competitive advantage; and developing exports in the sub-sectors where Armenia has, or can build up, a comparative and competitive advantage. It identifies the following action areas: economic and agricultural policies; efficiency and profitability of agricultural production; land-use and natural resource management; agricultural support services to farmers, including rural finance; agricultural marketing and processing; and food security.

23. Given the country's present agricultural structures and its goal to fight poverty in rural areas, the agricultural strategy targets both small-scale surplus-producing and subsistence production farms. It also accords importance to new technologies, particularly to increase the range of reliable seed varieties, to irrigation and marketing, and to the development of agro-processing and agri-business, and appropriate rural financial services. In recognizing the need to establish appropriate local-level organizations to mediate many of the actions it recommends, the strategy calls for measures to promote farmers and other rural producer and entrepreneurial groups. These measures include: improving the legal framework for such groups; establishing regular policy dialogue with them; reviewing the incentive framework and tax policies for them; and strong support of the donor community in promoting groups in agricultural and rural development projects.

24. While both the PRSP and the agricultural strategy are being further elaborated by the various stakeholders, the emerging policy framework is sufficiently conducive to any future operations supported by the Fund.

III. LESSONS FROM IFAD EXPERIENCE IN ARMENIA

25. Experience under the IRP, NWASP and ASP shows that setting up and providing essential elements for productive activities in agriculture has rapidly contributed to reducing poverty. This is partly thanks to other key elements being in place, notably the high level of education among the beneficiaries. What is still needed for sustainable growth is a longer-term strategy of moving beyond the current focus on increased production (although this will remain important) to improved input supply, essential infrastructure and financing. Future interventions will need to take more account of

¹³ Drawn from USAID, *Strategy for 2004-2008*, May 2003 and *A Strategy for Sustainable Agricultural Development*, op cit.

demand characteristics, i.e. marketing and processing constraints, and to further strengthen the country's policy and institutional frameworks.

26. Design of the above-mentioned projects has gone through a logical evolution in accordance with both the expressed needs and requirements of target groups and the implementation capacity prevailing at any particular point in time. The IRP focused solely on irrigation development to alleviate immediate food security constraints; ASP is gradually addressing issues in relation to financial services and, to some extent, market linkages. All three projects (including NWASP) have focused on institutional development appropriate to transition to a market economy, particularly at the beneficiary level. Future programmes will need to: capitalize on achievements to date in institutional development; further strengthen and transfer responsibilities to grass-roots institutions in order to help them achieve self-reliance and sustainability; continue to use projects and implementation experience as entry points for policy dialogue with government institutions; and attempt to reach target groups who, while eligible, have not yet benefited from any support.

27. The implementation approach of NWASP and ASP, whereby a project coordination unit (PCU) contracts out project activities to implementing agencies in the public, private and NGO sectors, has proved effective. This approach also provides for continuity and efficiency despite frequent rearrangements of government ministries, departments and agencies (MDAs) as a result of rapid political, social and economic changes in Armenia as a 'transition' country. The implication for future programmes is that implementation benefits are most likely to be retained and improved by supporting an approach that combines the PCU system with an MDA role directed to policy, regulation and coordination.

28. A Project Completion Evaluation (PCE) of NWASP was undertaken by IFAD's Office of Evaluation in December 2001. Armenia was one of the ten countries covered by the July 2002 External Review of the Results and Impact of IFAD Operations (External Review).

29. The PCE noted that "a typical beneficiary household output in cereals and potatoes increased by more than 66%." With regard to rural finance under NWASP, it concluded that "the Agricultural Cooperative Bank of Armenia (ACBA) has developed the capability and a clear commercial banking philosophy for lending to rural communities." And, with regard to community development, it stated that Shen, the Armenian NGO with implementation responsibility, "has effectively implemented the community development component using a combination of community sensitization, motivation and provision of resources to allow communities to meet their objectives. The field evaluation indicated that activities had generally assisted a cross-section of the village community. Priority projects were addressed in target villages."

30. With regard to IRP and NWASP impact, the External Review found that:

- **Physical and financial assets:** "beneficiaries have been able to increase their assets as a result of increased production and loans."
- **Changes in access to basic resources (land/water):** "a tendency among poorer people to give up land from the redistribution process was halted as a result of IFAD assistance, which made their farming more viable. Access to irrigation water has dramatically increased and there has been some increase in access to drinking water under the NWASP community development component."
- **Human assets – social capital and people's empowerment:**
 - **Gender relations:** "There was a notable absence of focus upon women's development in both IRP and NWASP, although women have benefited under NWASP from community development infrastructure."

- **Grass-roots organizations:** “The portfolio has led to major original grass-roots institutional development in the form of WUAs/water users’ consumer cooperatives (WUCCs) and village associations, which are the medium for group guarantees of loans through the ACBA under the credit components.”
- **Control of input supply/marketing:** “The portfolio has led to increased control of input supply in the sense that increased beneficiary incomes allow increased purchasing of inputs. An important dimension of control over input supply relates to irrigation water delivery. While marketing is in the hands of beneficiaries, there is recognition by all stakeholders that it is severely constrained by the collapse of the agro-processing, packaging and distribution sub-sector.”
- **Food security (production, income and consumption):** “There is little doubt that the portfolio has contributed significantly to food security, surplus sales and income therefrom.”
- **Technology change/improvement:** “Some beneficiary farmers under NWASP used their loans to buy new agricultural vehicles and tools appropriate in scale to the size of their holdings following land privatization and distribution.”
- **Environment and common resource base:** “Water entering the main [irrigation] systems is down from 2.5 billion m³ in 1994 to 1.5 billion m³ in 2000 and water drawn from Lake Sevan has been reduced from 270 million m³ to 170 million m³ in the same period” and “properly strengthened and organized WUCCs significantly reduced the loss of water at on-farm level thanks to the investments on the tertiary level financed by IFAD within the project.”
- **Institutions, policies and regulatory framework and capacity-building:** “In these regards the IFAD portfolio has had a substantial impact in three main areas:
 - (i) the national establishment of WUAs/WUCCs and corresponding changes in state water policy and regulation;
 - (ii) the establishment of a centre for assistance to WUAs in the Ministry of Agriculture; and
 - (iii) increasing ACBA’s capacity and the scope and regulation of the provision of rural financial services to a large poor section of the population previously thought to be ‘unbankable’.”

IV. STRATEGIC FRAMEWORK FOR IFAD

A. IFAD's Strategic Niche and Proposed Thrusts in the Country

31. Over the past three years, IFAD operations in Armenia have been guided by a COSOP produced in 2000 that built upon the rationale and lessons of the pre-2000 IRP and NWASP. The key elements of IFAD’s strategy have been: broad-based poverty reduction through agricultural growth; a focus on the poorest rural areas in the country; institution-building by involving grass-roots groups in implementation and management and increasing their responsibilities; and poverty reduction activities targeted at poor groups that had not benefited from agricultural growth. The rationale was that providing essential elements for productive activities in agriculture, and thereby increasing household food security and income, was a relatively quick way of impacting favourably upon the severe rural poverty engendered by the economic collapse of the former Soviet Union.

32. Given the findings of the PCE on NWASP and the External Review, this strategic approach, which was shaped by IFAD's overall strategy for the period, appears to have been more than justified. The orientation and achievements of the portfolio to date are also consistent with the strategic framework for IFAD and the sub-regional strategy for Central and Eastern Europe and the Newly Independent States (CEN) in terms of:

- strengthening the capacity of the rural poor and their organizations (village credit and WUAs, social infrastructure maintenance groups);
- ensuring more equitable access to productive natural resources and technology, notably irrigation water; and
- increasing the access of the poor to financial services and, to some extent, markets (although much remains to be done).

33. The foregoing review shows that, in the four or five years following the country's economic collapse, the agriculture sector provided an important safety net in terms of food security and at least partial employment for people who had lost their livelihoods in other sectors. However, the absolute limits of Armenia's agro-ecology are such that agriculture's role as an engine of future overall growth of the economy must, of necessity, be a minor one. In recent years, other sectors, notably services, construction and industry, have begun to pick up and it is reasonable to expect that labour will return to them from the agricultural and rural areas. Meanwhile the current situation within the country means that any development strategy must centre on reaping the benefits of resource-allocation efficiency provided by transition to a market orientation, without imperiling the safety-net functions of such benefits for a population that is still mostly very poor. At the current time, this will involve increasing production and productivity where the returns are highest, and diversification of the non-farm rural economy on the basis of small and medium enterprises (SMEs) to promote greater accrual of value-added to poor rural people while assuring relative equity. In view of the emerging market orientation by a significant number of farmers and the revival of other sectors of the economy, it is proposed to shift the focus of IFAD's thrust in Armenia from its present emphasis on food security only to market-oriented agricultural production **and** food security.

34. By virtue of its mandate, IFAD's investments in Armenia will continue to target very poor subsistence-oriented farm families mostly located in the mountainous areas. However, such investments will also aim at poor farm families that can produce some surplus over and above their own consumption needs and generate additional income from the sale of it. Support will also be provided to small- and medium-scale rural service providers such as traders, processors and input suppliers. The traders and processors are of interest not so much because of their poverty but because they provide upstream and downstream linkages to subsistence and market-oriented farmers and better employment and income opportunities.

35. For families currently forced to remain in a subsistence mode of production, the mix of productive and social infrastructure and small agricultural production loans, as provided under ASP, should be maintained. For market-oriented small farmers, for those who might move into that segment and for rural service providers, a vertical integrated commodity systems approach (VICSA) will be applied. The basic principle of the VICSA is to make a thorough analysis of specific commodities, examining the whole chain from the market to the producer, and subsequently address weak links in the chain. Depending on the commodity involved, weak links may relate to organization of farmers, finance and availability of appropriate technology at the **primary producer level**; finance, technology and business planning skills at the **processing level**; and inappropriate tax regimes, export regulations, quality control or lack of information concerning final consumer preferences at the **wholesale or retail level**. Thanks to the improved implementation capacity in Armenia, the use of the VICSA is now possible.

B. Main Opportunities for Innovations and Project Interventions

36. The ongoing ASP is due for closure at the end of March 2006.¹⁴ Assuming that the volume of IFAD support to Armenia is maintained at the same level, only one new project is likely to be financed during the period covered by the present COSOP. In terms of future project opportunities, account should be taken of the following considerations. Firstly, there is a need to consolidate and capitalize on IFAD's investments in Armenia to date, most notably in the areas of institutional support for participatory irrigation management (PIM) and rural financial services. Despite the significant progress made, substantial support is still required for strengthening the PIM concept, thereby enabling WUAs to become technically and financially viable entities throughout the country. Further assistance will be required for the refinement and application of the legal and institutional framework already approved and established by the Government. For rural financial services, there is a need for further outreach, diversification of service providers, and products. Support may entail the establishment of a refinancing facility that may be assessed by several providers on a competitive basis. Areas in particular need of attention at the production level include loan and crop insurance schemes,¹⁵ and machinery leasing arrangements. Secondly, since coherent private agriculture-sector development cannot be effectively and efficiently achieved without an adequate institutional framework, support is required for the Ministry of Agriculture to finalize the national agricultural strategy and set up a competent unit for policy, regulation and coordination. This will ensure both consistency of policy formulation for poverty-reducing agricultural and rural development, and quality control of inputs and outputs. Thirdly, any area-specific interventions supported by IFAD will continue to focus on the most disadvantaged, mountainous parts of the country where severe rural poverty is most persistent. Fourthly, the limited capacity of existing projects to identify and address gender-related issues should be rectified in any future operations supported by IFAD.

37. In view of the above considerations, as well as the strategic niche outlined for the Fund and the limitations of the resource envelope, it would not seem appropriate to suggest a classical three-option scenario for future IFAD investments in Armenia. The next intervention, on the other hand, should provide a flexible response to the rapidly changing environment within the agricultural sector. In addition to the consolidation of existing interventions and support for policy formulation, other possible entry points for future investments using the VICSA approach will be the development of extension and marketing linkages. However, the Armenian State has neither the human nor the financial resources to sustain public-sector support in these areas and, in any event, it is questionable whether this would be appropriate in the long term. The links between private-sector sources of demand and producers, e.g. contract farming, should be strengthened. Technical advice and physical inputs may be part of such contracts. As noted, the promotion of horticultural products will represent a particular niche for any future intervention as such products are suited to almost all agro-ecologies across Armenia and there are a number of very promising domestic and export markets for them. Such initiatives could also enhance income without jeopardizing food security, which is still a pertinent issue in Armenia. Support to selective infrastructure development in the poorest communities, including feeder roads for market linkage, will likewise need to be considered.

38. Should the establishment of farmers' organizations be identified as a bottleneck within the VICSA concept, support may be provided to speed up the process. Such organizations are of critical importance with regard to overcoming diseconomies of scale in the smallholder sector as they provide a basis for input supply and marketing and for enhancing beneficiary representation and leverage with respect to relevant policy and legal environments. If so required, assistance should be provided to rationalize the organizational structure by turning it into a national farmers' union, as understood in the context of a liberal market economy.

¹⁴ The current rate of implementation indicates a likely completion by October-December 2004.

¹⁵ The current portfolio has reached about 20 000 poor farm households with production credit which, although significant, still leaves a large potential beneficiary population given that there are some 335 000 small farms in total. The financial services are provided through ACBA, which maintains a recovery rate of more than 98%.

39. With regard to the organization and management of a future investment, it is proposed to retain the PCU/implementation agency arrangement in view of its demonstrated success under previous IFAD-financed interventions. An important element of the proposed unit would be a small team devoted to setting up technical and marketing links between beneficiary organizations and other actors within the private sector. An intermediate measure could be to establish a small support unit similar to the Centre for Assistance to Water Users' Organizations (CAWUO) that was established following the start-up of IRP and NWASP.¹⁶

C. Outreach and Partnership Possibilities with NGOs and the Private Sector

40. The rural finance and machine-leasing aspects of IFAD's next intervention could be realized through continued and wider cooperation with the ACBA. As noted earlier, the support already provided to ACBA under the current portfolio has met with significant success. With regard to rural finance for production, innovations to be explored with ACBA would include savings mobilization, the use of remittances, crop insurance and linkages between ACBA and existing microfinance institutions with a view to increasing their outreach. In April 2003, a new joint stock company, **ACBA Leasing**, was established with the International Finance Corporation as one of the four main shareholders. During formulation of the new intervention, IFAD should explore opportunities for using such leasing facilities for the benefit of the above-mentioned target groups.

41. With regard to innovative mechanisms for increasing the outreach of rural finance to overcome poverty, opportunities exist for links with well-established SMEs and microenterprise service providers. Aniv, a local foundation, already receives support from IFAD under ASP for developing small rural enterprises and thereby increasing employment opportunities for the rural poor. Continued support of this type under the proposed initiative would be desirable in principle but subject to Aniv carrying out a long-term strategic planning exercise acceptable to IFAD.

42. Finally, links would be forged with the State Water Committee with regard to irrigation, water policy and WUAs.

D. Opportunities for Strategic Linkages with Other Bilateral and Multilateral Donors

43. Significant opportunities exist for strategic cooperation and linkage with USAID and the United States Department of Agriculture (USDA) in the areas of rural finance, agribusiness and marketing. USAID has been closely involved in developing the microfinance sub-sector, in leading moves to create a national microfinance network, and in promoting SMEs in the rural sector. Indeed, the first strategic objective of USAID's Armenia Strategy for 2002-2008 is to increase employment in a competitive private sector, to be achieved through support to micro, small- and medium-sized enterprises and an improved business environment. USDA has long been involved in programmes for agricultural marketing, rural finance, extension, and capacity-building of farmers' associations. Consideration should also be given to setting up donor-assisted fund accessible to financial service providers on a competitive basis, possibly under the responsibility of the Ministry of Finance and Economy.

44. Linkage is also expected to be made with the World Bank with regard to irrigation, agribusiness and the regulatory framework for agriculture, based on past experience. Complementarity is anticipated between the proposed new IFAD initiative and the activities of IRP with regard to the relationship of large and small delivery systems, water policy, WUAs and fiscal arrangements to agricultural development. Similarly, the proposed new initiative is likely to develop

¹⁶ CAWUO is continuing to reinforce the development of beneficiary organizations related to irrigation until such time that they are strong enough in terms of management skills and financial sustainability to graduate to full autonomy.

common interests with the agro-processing and agri-business development centre elements of the World Bank's ongoing Agricultural Reform Support Project.¹⁷

45. The proposed intervention is also expected to link up and cooperate with UNDP¹⁸ with regard to strengthening the Ministry of Agriculture's capacity with respect to policy, regulation and coordination.

E. Areas for Policy Dialogue

46. The main objective of IFAD's future policy dialogue in Armenia should be to assure focus on opportunities for pro-poor growth and development in rural areas. The Fund's operational approach to achieving this objective will be to continue to lead by example through the projects it supports, as it has done over the last nine years.

47. Based on the foregoing analysis, it is clear that any further substantial reduction of poverty through agricultural growth will call for serious attention being paid to implementing an appropriate policy and legal framework. This framework should be strengthened by introducing consistent, transparent, accountable and less complex regulations for input supply, including irrigation water; domestic and international agricultural trade terms; growth-oriented agricultural subsidy, taxation and pricing; and the establishment and governance of farmers' organizations.

48. Other important policy areas that will need to be addressed include problems of fragmentation through appropriate institution-building; services for informational and technical inputs; rural finance; marketing; and mitigation of weather-based risks.

49. Policy areas significant for off-farm rural employment and income generation include reorientation and training of the labour force; links between primary producers and processors; rural finance; marketing; and facilitation for the establishment of rural SMEs. Most of these policy issues are expected to be addressed within the framework of the national agricultural strategy. Along with other donors, IFAD will maintain close dialogue with the Government for the finalization of the strategy document.

F. Action Areas for Improving Portfolio Management

50. The implementation of the portfolio is fully satisfactory, thanks to direct supervision by IFAD. However, close follow-up should be maintained in view of the rapid institutional changes that continue to characterize transitional development in Armenia. The implementation performance of projects reflects both the strong commitment of the Government to poverty reduction and the relatively high per capita lending programme for the country.

G. Tentative Lending Framework and Rolling Programme of Work

51. Subject to the approval of an Inception Memorandum, it is proposed to formulate an agricultural services-cum-market linkage project, supported by a loan of about USD 12-15 million, for presentation to the Executive Board in December 2004 or April 2005. Following approval of the project, no development of new project initiatives is expected for the period covered by the COSOP

¹⁷ The World Bank reports that it has no further agricultural-sector projects in the pipeline, pending finalization of the national agriculture strategy by Government. It is intended that the Fund will maintain contact and dialogue with the Bank as the proposed IFAD initiative is developed and explore options for further links between it and any subsequent interventions emerging from the Bank during the period 2003-2008.

¹⁸ A new Common Country Assessment and United Nations Development Assistance Framework are about to be formulated. Further consultation between UNDP and IFAD's country portfolio manager for Armenia is expected with a view to identifying further scope for potential complementarity and partnership arising from the formulation.

(2003-2008). Instead, IFAD will continue to focus on sound project implementation and impact assessment.

52. Armenia will continue to benefit from an IFAD technical assistance grant (TAG) for action-research in PIM. In addition, it is recommended that a well-established service provider should receive a grant under the IFAD/NGO Extended Cooperation Programme to finance a pilot initiative for the provision of rural financial services and improving access to markets. It is also foreseen that Armenia will benefit from a regional TAG aimed at developing methodologies for research-extension linkages in transitional economies. Finally, it is expected that the TAG for gender mainstreaming in CEN, recently approved and now under implementation, will generate approaches to more effectively address gender-related issues.

53. The main findings and recommendations of the COSOP have been endorsed by the Government and other stakeholders. As noted above, following the approval of this COSOP, the agricultural services-cum-marketing linkage project will be designed and processed in 2004.

APPENDIX I

COUNTRY DATA
ARMENIA

Land area (km² thousand) 2001 1/	28	GNI per capita (USD) 2001 1/	570
Total population (million) 2001 1/	3.81	GDP per capita growth (annual %) 2000 1/	9.4
Population density (people per km²) 2001 1/	135	Inflation, consumer prices (annual %) 2001 1/	3.1
Local currency	Armenian Dram (AMD)	Exchange rate: USD 1 =	AMD 586
Social Indicators		Economic Indicators	
Population (average annual population growth rate) 1995-2001 1/	-1	GDP (USD million) 2001 1/	2 118
Crude birth rate (per thousand people) 2001 1/	11	Average annual rate of growth of GDP 1/ 1981-1991	n.a.
Crude death rate (per thousand people) 2001 1/	7	1991-2001	1.6
Infant mortality rate (per thousand live births) 2001 1/	31	Sectoral distribution of GDP 2001 1/	
Life expectancy at birth (years) 2000 1/	74	% agriculture	28
Number of rural poor (million) (approximate) 1/	n/a	% industry	34
Poor as % of total rural population 1/	n/a	% manufacturing	22
Total labour force (million) 2001 1/	1.93	% services	38
Female labour force as % of total 2001 1/	49	Consumption 2001 1/	
Education		General government final consumption expenditure (as % of GDP)	11
School enrolment, primary (% gross) 2001 1/	78 a/	Household final consumption expenditure, etc. (as % of GDP)	91
Adult illiteracy rate (% age 15 and above) 2001 1/	2	Gross domestic savings (as % of GDP)	-2
Nutrition		Balance of Payments (USD million)	
Daily calorie supply per capita, 1997 3/	2 371	Merchandise exports 2001 1/	340
Malnutrition prevalence, height for age (% of children under 5) 2001 1/	13 a/	Merchandise imports 2001 1/	870
Malnutrition prevalence, weight for age (% of children under 5) 2001 1/	3 a/	Balance of merchandise trade	-530
Health		Current account balances (USD million)	
Health expenditure, total (as % of GDP) 2001 1/	8 a/	before official transfers 2001 1/	-402
Physicians (per thousand people) 2001 1/	n/a	after official transfers 2001 1/	-201
Population using improved water sources (%) 2000 4/	n/a	Foreign direct investment, net 2001 1/	221 a/
Population with access to essential drugs (%) 1999 4/	0-49	Government Finance	
Population using adequate sanitation facilities (%) 2000 4/	n/a	Overall budget deficit (including grants) (as % of GDP) 2001 1/	n/a
Agriculture and Food		Total expenditure (% of GDP) 2001 1/	n/a
Food imports (% of merchandise imports) 2000 1/	25	Total external debt (USD million) 2000 1/	1 001
Fertilizer consumption (hundreds of grams per ha of arable land) 2000 1/	141	Present value of debt (as % of GNI) 2000 1/	30
Food production index (1989-91=100) 2001 1/	71	Total debt service (% of exports of goods and services) 2000 1/	8
Cereal yield (kg per ha) 2001 1/	1 859	Lending interest rate (%) 2001 1/	27
Land Use		Deposit interest rate (%) 2001 1/	15
Arable land as % of land area 2000 1/	18		
Forest area as % of total land area 2000 1/	12		
Irrigated land as % of cropland 2000 1/	51		

a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Indicators* CD ROM 2003

2/ UNDP, *Human Development Report*, 2000

3/ UNDP, *Human Development Report*, 2002

LOGICAL FRAMEWORK

Narrative Summary	Verifiable Indicators	Means of Verification	Assumptions/Risks
<p>Goal: Improve living conditions of the poor rural population, most notably in the mountainous areas of Armenia</p>	<ul style="list-style-type: none"> • Rate of outmigration decreased • Number of very poor rural households decreased • Reduction in rural unemployment rate 	<ul style="list-style-type: none"> • Baseline and repeater surveys • Evaluation studies • National poverty profile studies • National and <i>marz</i> statistical reports 	<ul style="list-style-type: none"> • Political stability and Government commitment to pro-poor macroeconomic and marketing support in the rural economy • Adoption of PRSP and ASP strategies by Government and donors
<p>Objective</p> <ul style="list-style-type: none"> • Incomes increased and food security improved for the targeted poor households through provision of basic services, application of the VICSA approach and support for strengthening the legal and institutional framework for agricultural production 	<ul style="list-style-type: none"> • Financial parameters: increase in income, numbers/types loans, repayment rates • Technical changes: increase in production and productivity, volume and proportion marketed, number of market outlets • Numbers of organizations and membership (disaggregated by gender and socio-economic status women), legal status, financial status 	<ul style="list-style-type: none"> • Baseline survey, annual updates • Evaluation studies • Participatory impact assessments • National and <i>marz</i> statistical reports • Ministry of Agriculture reports. • Bank reports • PCU and beneficiary records 	<ul style="list-style-type: none"> • No abrupt changes in the macroeconomic policy environment. • Establishment of appropriate policy, legal, regulatory and institutional environments • Increased income used to reduce effects of poverty at the household level. • Output prices remain sufficiently attractive
<p>Outputs</p>			
<p>1. Quality, locally produced seed made available to farmers</p>	<ul style="list-style-type: none"> • Locally produced certified seed as percentage of total seed purchases 	<p>Producer records Beneficiary monitoring PCU reports</p>	<p>No abnormal meteorological occurrences. Government commitment to facilitating production environment</p>
<p>2. Small-scale schemes constructed or rehabilitated to modern and efficient standards and managed and maintained by WUAs or Village Councils.</p>	<ul style="list-style-type: none"> • Percentage of operation and maintenance costs met by WUAs or village councils • Payment of water delivery charges • Amount, proportion of requirement, and timeliness of water delivery to plots • Crop yields/ha improved • Water conservation/efficiency 	<p>WUCC records FWUCC records Beneficiary monitoring PCU reports</p>	<p>Availability of appropriate technology Reorganization of OME completed. No government interference in the collection or use of water charges. Legal status of WUCCs/FWUCCs clarified.</p>

Narrative Summary	Verifiable Indicators	Means of Verification	Assumptions/Risks
Outputs			
3. Use of appropriate machinery under leasing arrangements leading to increased production/productivity	<ul style="list-style-type: none"> • Crop yields improved • Soil conservation • Volume, type, costs of leasing 	Lessor and lessee records Beneficiary monitoring PCU reports	Capacity and willingness of ACBA leasing to provide appropriate affordable equipment Emergence of alternative, competitive lessors
4. Producer credit made available to farmers, entrepreneurs through ACBA village associations, Aniv Foundation, and other service providers in all <i>marzes</i>	<ul style="list-style-type: none"> • Number and value of loans made, disaggregated by gender • Arrears remain under 5% 	ACBA, service provider records PCU reports	Linkage with Armenian Microfinance Network Connection of finance provision and marketing
5. Social infrastructure, including feeder roads in poor villages, upgraded and maintained by the communities.	<ul style="list-style-type: none"> • Types, costs of upgrade and maintenance record 	Service provider records Beneficiary monitoring	
6. Linkage of beneficiaries to sources of technical and marketing information	<ul style="list-style-type: none"> • Contracts between beneficiary producers and purchasers/information service providers 	Purchaser/information service provider records Beneficiary monitoring PCU (extension/marketing sub-unit) records	Sufficient domestic/export demand Supportive business environment for purchasing individuals/companies
7. Effective agricultural policy formulation, regulation and coordination of support in Ministry of Agriculture	<ul style="list-style-type: none"> • Staffing, roles and responsibilities • Policy statements • Regulations and their enforcement • Partnerships 	Ministry Unit records Development agency records PCU records Beneficiary monitoring, especially quality of inputs and terms of leasing and marketing contracts	Government commitment
8. Project interventions effectively managed by PCU.	<ul style="list-style-type: none"> • Activities completed compared to annual programme of work and budget (APW&B) • Disbursement rate in line with appraisal targets • Timely progress reporting 	Beneficiary interviews Contracts APW&B, progress reports, IFAD	Government does not micro-manage PCU activities.

STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS (SWOT) ANALYSIS

Strengths	Weaknesses	Opportunities	Threats
<p>Overall</p> <ul style="list-style-type: none"> Well-educated agricultural and rural labour force Extensive experience in, and advantageous agro-ecology for, horticulture Deteriorated but compared to many countries still viable basic agricultural and rural infrastructure and communication <p>NGOs</p> <ul style="list-style-type: none"> Wide range of experienced national and international NGOs High level of competence among most NGO staff Often good NGO connections/experience with practical field conditions 	<p>Overall</p> <ul style="list-style-type: none"> Underdeveloped legal, regulatory and policy framework for effective transition to a profitable market economy Fragmentation of the agricultural base through the land reform/privatization process into many sub-economic holdings High inequality of distribution of benefits from the emerging economic recovery Lack of commercially viable technical, financial, managerial and informational support services appropriate to sustainable market-oriented rural/agricultural sector growth, evidenced particularly subsistence orientation, lack of working capital and low productivity Absence of an rural MSME sector <p>NGOs</p> <ul style="list-style-type: none"> Indifferent cooperation among NGOs Limited coverage of any given NGO in terms of activities and physical location Legal issues over financing and operation of NGOs that do not register locally 	<p>Overall</p> <ul style="list-style-type: none"> Economic rationalization of landholdings through diversification of the rural economy Modernization of competitive, good-quality seed and seedling supply Irrigation (especially small-scale) Off-farm SME development, especially agro-processing and services Information and education/training networks in support of agricultural and rural development, reflected in development of producer/purchaser links in support of agricultural/rural sector growth Development of internal and external markets for primary and secondary agricultural products Improved banking and financial systems with respect to market-oriented agricultural and rural development <p>NGOs</p> <ul style="list-style-type: none"> Further development of linkages with operations supported by NGOs 	<p>Overall</p> <ul style="list-style-type: none"> Risks of inadequate regulation discouraging private investment Loss of qualified people through emigration Limited agricultural resource base subject to often extreme and variable weather conditions <p>NGOs</p> <p>NGOs supported by other external partners may not be perceived by Government as eligible for loan resources</p>

Strengths	Weaknesses	Opportunities	Threats
<p>Ministry of Food and Agriculture</p> <ul style="list-style-type: none"> Some knowledge about the rural situation and the technical potential of different agricultural zones <p>Extension</p> <ul style="list-style-type: none"> Emerging trends of producer-processor linkages for extension activities 	<p>Ministry of Food and Agriculture</p> <ul style="list-style-type: none"> Subject to frequent reorganization, reflecting political manoeuvring Internally incoherent with many technical departments, which are underfunded, inadequately staffed and ill-equipped, e.g. very limited communications, information technology capability Separated in responsibility from key agricultural functions, e.g. irrigation Rural development does not have a lead ministry Dependent upon supplementary donor-funded assistance to maintain even a minimum capacity for policy, regulation and coordination of agricultural development <p>Extension</p> <ul style="list-style-type: none"> Institutionally complicated, technically weak and under-resourced extension capability Lack of knowledge about local agro-ecologies Patchy farmer technical knowledge 	<p>Ministry of Food and Agriculture</p> <ul style="list-style-type: none"> Stripping out of ineffective technical departments and strengthening of policy, regulatory and coordination capability, i.e. relinquishing implementing functions and reorientation to advisory and supervisory/monitoring role <p>Extension</p> <ul style="list-style-type: none"> Packaging of technical support to farmers with private sector processing/marketing buyers 	<p>Ministry of Food and Agriculture</p> <ul style="list-style-type: none"> The next greater leap forward in agricultural productivity may be hampered by the absence of MOA and the enforcement of an appropriate legal and institutional framework <p>Extension</p> <ul style="list-style-type: none"> Absence of a clear strategic framework for extension services

Strengths	Weaknesses	Opportunities	Threats
<p>Rural Finance</p> <ul style="list-style-type: none"> Well-established track record by ACBA for agricultural production credit through IFAD financing <p>Farmer Organizations</p> <ul style="list-style-type: none"> Successful experience of establishing farmer organisations under IFAD-financed projects in Armenia 	<p>Rural Finance</p> <ul style="list-style-type: none"> Commercial banking sector small (capitalized at about USD380 million dollars in total) Commercial banks reluctant to lend to agricultural/rural enterprises Problems with policy and legal environment for non-banking financial institutions, e.g. Government apparently seeking to levy value-added tax on their operations Fragmentation of microfinance initiatives <p>Farmers Organizations</p> <ul style="list-style-type: none"> Underdeveloped: limited geographic coverage and functional scope; unfamiliarity of farmers and office-bearers with their efficient and effective operation; problems of financial sustainability; and fragmentation in the approach to their development 	<p>Rural Finance</p> <ul style="list-style-type: none"> Build upon longstanding partnerships with existing organizations Some reputable microfinance NGOs Establish donor-assisted loan fund open to competitive bidding by commercial financial institutions for onlending Possible partnership with USAID in development of an Armenian Microfinance Network <p>Farmers Organizations</p> <ul style="list-style-type: none"> Promotion of a policy and legal environment for the coherent development of effective/efficient farmers' organizations Establishment of technical/organizational support Encouragement of financial sustainability Promote movement to a national farmers' union appropriate to operation in a market economy 	<p>Farmer Organizations</p> <ul style="list-style-type: none"> Political interference in the organizational process

IFAD'S CORPORATE THRUSTS AS RELATED TO THE PROPOSED COUNTRY PROGRAMME

1. As documented throughout the text of the main report the thrusts of the COSOP are inline with IFAD's Strategic Framework objectives of enhancing the capacity of the poor and their organizations (WUAs, village credit associations, infrastructure maintenance groups) increasing the access of the poor to productive natural resources and technology (irrigation water and improved on-farm water management, processor-extension linkages), and improving the access of the poor to financial services and markets (VICSA concept). It is also in line with IFAD's regional strategy for CEE/NIS as it calls for supporting activities that are firmly associated with the five main thrusts of the regional strategy, namely, institutional development to empower the rural poor; enhancing farm productivity; increasing opportunities for income-diversification; enhancing market linkages; and improving natural resource management.

2. In line with the Fund's mandate, the COSOP proposes to target communities situated in the most disadvantaged, mountainous parts of the country with the highest concentration of the rural poor. The document acknowledges that gender-related issues and the empowerment of women need further and more focused attention in future interventions. By emphasizing a long-term and consistent approach and using projects as examples and entry points, the COSOP advocates policy dialogue with relevant stakeholders concerning the development of a legal and institutional framework for the sub-sectors where the Fund is investing.

3. Finally the COSOP pays tribute to an efficient implementation record in terms of a suggested resource allocation and further emphasis of management for impact.

ACTIVITIES OF OTHER PARTNERS IN DEVELOPMENT – ONGOING AND PLANNED

Donor/agency	Nature of project/programme	Project/programme coverage	Status	Complementarity/synergy potential
USAID	Armenia's Strategy for 2002-2008 states as its first strategic objective 'Increased Employment in a Competitive Private Sector.' This is to be achieved through a programme of support during the period to micro, small and medium-sized enterprises and to an 'improved business environment'.	National	Ongoing	<ul style="list-style-type: none"> • Development of the microfinance sub-sector and leading moves to create a national microfinance network. • Donor-assisted national fund for agricultural production credit. • Programme of support during the period to micro, small and medium-sized enterprises and to an 'improved business environment'. • Policy and regulatory environment for rural finance and agri-business.
USDA	Longstanding and continuing programmes for - agricultural marketing - rural finance and - capacity-building of extension and farmers' associations.	TAP, MAP, IPM National	Ongoing	<ul style="list-style-type: none"> • Research support (grants, TA) to agricultural marketing. • Capacity-building (grants, TA) of extension. • Policy and regulatory environment for agri-business, including Marketing.
World Bank	<ul style="list-style-type: none"> • Rehabilitation of critical irrigation structures, water management organizations • Food processing, improved producer prices for export products 	Irrigation Development Project (IDP) - national Agricultural Reform Support Project (ARSP)	2001-2007 Ongoing	<ul style="list-style-type: none"> • Irrigation, water management and water policy. • Agribusiness development (Agribusiness Development Centres and investment in agro-processing). • Regulatory framework for agriculture.
UNDP/FAO	Strengthening capacity of Ministry of Agriculture	'Support to Strengthening Coordination Capacities of the Ministry of Agriculture, ARM/02/010.'	Ongoing	<ul style="list-style-type: none"> • Improving the Ministry of Agriculture's capability with respect to policy, regulatory functions and coordination, necessary for medium-long-term coherence, confidence and partnership in agricultural and rural development.
ACBA and ACBA Leasing	Rural financial services, village credit associations and machinery leasing	National	Ongoing	<ul style="list-style-type: none"> • Building on past association with ACBA to extend poverty outreach of production credit, savings mobilization, use of remittances, crop insurance and related village credit associations, and to develop new leasing arrangements for appropriate agricultural machinery for horticulture.
ANIV Foundation	Agro-processing	Five <i>marzes</i>	2001-2005	<ul style="list-style-type: none"> • Viable and financially sound small enterprises providing new rural employment opportunities in poorer villages.
Armenian Social Investment Fund	Community infrastructure	National	2001-2005	<ul style="list-style-type: none"> • Rehabilitation/installation of social infrastructure in the poorest communities, community management organizations.

