ACHIEVING INCLUSIVE AND RESILIENT GROWTH IN ARMENIA: CHALLENGES AND OPPORTUNITIES

ARMENIA SYSTEMATIC COUNTRY DIAGNOSTIC CONCEPT STAGE
What is a Systematic Country Diagnostic?

Identify key challenges and opportunities for country to accelerate progress in poverty reduction and shared prosperity (the World Bank Group Twin goals) in a sustainable way.

- Conducted upstream of country partnership framework (CPF) to inform strategic discussions with client countries and not limited to areas of engagement for WBG in the country.

- Diagnostic is NOT about what projects or programs the WBG could or will support in the future. That will come later in when the CPF is prepared.
ARMENIA SYSTEMATIC COUNTRY DIAGNOSTIC CONCEPT STAGE
1. Context and progress towards the twin goals
2. Looking Ahead: SCD Objectives and Key Questions
3. Reigniting sustained and inclusive growth: What are the key hypotheses the SCD will examine?
4. Approach
5. Timeline
1. Context and progress towards the twin goals

• Until 2008, Armenia featured as one of the “pre-eminent reformer among the former Soviet Republics”.

• Since 2008, radically different and challenging circumstances, with a low growth-low investment environment and stalled poverty reduction.
• Small and landlocked within a troubled neighborhood

• Closed borders with Azerbaijan and Turkey, Georgia is the only regional and international trade route (Iran’s opening)

• Demographic challenges - shrinking and aging population

• Social challenges - opportunity and equity gaps between women and men, girls and boys

• Environmental/natural disaster risks

• Lagging implementation of some critical reforms

• Country is multi-connected via trade, financial flows, ICT, migration, and diaspora

• Armenia could graduate to UPPER middle income category in about 5 years
Progress towards poverty reduction and shared prosperity

- Poverty reduction gains by and large before 2009, stagnation since.
- Spatial differences – capital city, secondary cities, rural areas.
- Shared prosperity gains by and large before 2009; consumption of the poorest 40 percent barely grew since 2009.

Spatial Differences in Poverty Rates in Armenia (% poor): Secondary Cities have the highest poverty rate

Shared prosperity in Armenia (consumption growth)
What have been the drivers of poverty reduction?

- Employment rate, labor and agriculture income, pensions are key drivers of poverty reduction. Remittances are driver of poverty reduction outside Yerevan.
- Drivers have changed in importance after the 2009 crisis
  - for secondary cities: waning impact of labor income and growing importance of pensions and remittances
  - for rural areas: greater importance of labor income, agriculture income and employment; remittances impact declined
- for Yerevan: labor income, employment and pension have become more important


Note: Based on micro-decomposition of poverty change, negative numbers indicate that the factor helped to reduce poverty, positive numbers indicate the opposite effect (World Bank staff calculations).
2. Looking Ahead: 
SCD Objectives and Key Questions

SCD Objective: to formulate forward looking options for fostering inclusive and sustainable growth in Armenia to support poverty reduction and shared prosperity
- With a focus on ensuring greater equality of opportunity for women and men, girls and boys

➢ Can Armenia continue to rely on the past development model to achieve sustainable growth with poverty reduction and shared prosperity?
  ✓ Global external environment has changed drastically (low commodity prices, low investment/liquidities)
  ✓ Past drivers of growth have run their course (transition gains from structural opening/catching up and first generation reforms)

➢ What could be the key enabling conditions to reignite economic growth that is both inclusive and resilient?
  ➢ Inclusive growth as a growth process where equal opportunities are provided to economic participants and benefit all.
    - Special focus women opportunity to find good jobs
  ➢ Resilient growth means building macroeconomic buffers over time, protecting the most vulnerable segments of the population with safety nets and managing natural and environmental assets sustainably.
3. FOUR HYPOTHESES
1. Armenia needs a new growth model and drivers of growth to adapt to its new circumstances

2. Supporting firms’ productivity and a vibrant private sector crucial for economic growth

3. Investing in productive individuals will be key for inclusive growth

4. Building national resilience to vulnerabilities will bring sustainable growth
Hypothesis 1: A new growth model and new drivers of growth

- Prior to 2009, Armenia experienced a “double Dutch Disease” (currency appreciation with high financial inflows (FDI, ODA, remittances, exports).
- After 2009 and an abrupt stop of financial inflows, sluggish growth.
Lack of trade integration

- less open than its peers (exports of goods and services 30% of GDP),
- “more” landlocked with two closed borders,
- ranked 141 among 160 economies worldwide in 2016 Logistic Performance Index,
- only half of the road network (excluding urban) is in good or fair condition,
- low high-speed broadband penetration, high prices.

Exports of goods and services (% of GDP)

Logistics Performance Index
(Scale 1-5, 5=best)

Source: Logistics Performance Index (World Bank)
What will it take for new growth drivers to emerge and be sustained?

• What are the existing positive drivers? What can we learn from them? How can they be accelerated and applied elsewhere in the economy?
  → Dynamism and resilience in the agriculture sector.
  → Success story of small but fast-growing IT industry
  → Recent growth rebalancing from consumption to exports and increasing diversification of export destinations
  → Active and entrepreneurial diaspora
  → Prospects of Armenian mining and metals?
  → Possible re-integration of Iran and transit corridor between Iran and Russia/Europe.

• How can Armenia rebalance its growth model from domestic drivers (consumption, non-tradable) to exports and tradable?
  → Growth analysis and scenarios

• How much is Armenia connected to the rest of the World? What policies/regulations are hindering the development of exports commensurate with Armenia’s particular endowments? What can be done to support a multi-connectivity agenda for Armenia to tap into regional and global markets?
  → Trade, Trade and Transport facilitation analyses with regional and global value chains
  → Trade in services
  → Multi-connectivity angle (ICT, diaspora)
  → Trade integration agreements (EEU)
Firm-level productivity characteristics*:

- **Heterogeneity**: A large number of relatively efficient firms coexist alongside significantly less efficient competitors.

- The **policy environment in Armenia** has a larger impact on firm-level productivity than in other countries in the region.

- Among policy factors the overall **quality of governance** and the availability of **skilled labor** have the largest impact on firm-level productivity.

- **Export propensity** is positively correlated with access to finance, higher rates of ICT use, increased importing activity, access to infrastructure and productivity.

- **Foreign-owned firms** employ more highly skilled labor and are more productive.

Investment climate

- Armenia investment climate lags behind
- Powerful business groups with interests cutting across sectors influence policymaking and prevent new market entrants.
- Lack of market contestability in sectors providing important production inputs (utilities, internet connectivity) hinder the emergence of a dynamic export-oriented private sector.

World Competitiveness Index 2016

Doing Business 2016

<table>
<thead>
<tr>
<th>Region</th>
<th>Europe &amp; Central Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Category</td>
<td>Lower middle income</td>
</tr>
<tr>
<td>Population</td>
<td>3,017,712</td>
</tr>
<tr>
<td>GNI Per Capita (USD)</td>
<td>3,880</td>
</tr>
<tr>
<td>City covered</td>
<td>Yerevan</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Topics</th>
<th>Armenia -4.1</th>
<th>Georgia - 4.3</th>
<th>Estonia - 4.8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a Business</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dealing with Construction Permits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Getting Electricity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registering Property</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Getting Credit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Protecting Minority Investors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paying Taxes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trading across Borders</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Resolving Insolvency</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
What will it take for Armenia’s private sector to strive and export to the world?

- What are the top constraints to firm productivity? How can firm productivity be enhanced?
  - Measurement and comparison of Armenia firm-level productivity
  - Determinants of firm productivity, firm and product survival, entry, exit
  - Main constraint to firm productivity growth

- To what extent does the current investment climate support firms to access global markets? What are the key constraints to be removed?
  - Regulations and implementation of rules, formulation and effectiveness of policies
  - State footprint (interaction between the private and public sector, e.g. tax administration)
  - Role of financial markets and their intermediation role against the background of low domestic savings
  - Property rights, constraint to entry and exit
  - Access to infrastructure including road, water, electricity, internet, finance
  - Access to skills
  - Enabling environment for innovation and knowledge

- How adequately do the incentives of the governance environment support firm productivity?
  - Role of the public sector as producer and employer
  - Competition and market contestability
  - Less traditional investment climate barriers such as corporate governance and conflict of interest between the public and private sectors
Hypothesis 3: Invest in people’s productivity

Labor productivity growth slowed down significantly
Structural shift from agriculture towards better jobs but low productivity

Change in value added and employment between 2010 and 2015
Weak employment outcomes despite high education

- **Weak employment outcomes**
  - 44% women, 60% men employed (low participation)
  - 19.5% women, 17.6% men unemployed
- About half of the jobs in Armenia are informal, of which 72 percent in agriculture, 30 percent outside.
- One in four jobs is considered low-paying.
- More than half of the youth pursue high tertiary education, general education is close to universal.
- **Skills matter as much as education.** The labor market rewards education (credentials) combined with skills (job and socio-emotional). an additional year of education would increase hourly earnings by around 2.4 percentage points.
- Employers report difficulties in finding workers with the needed skills.
- More than a third of households have migrants who work abroad.
Spatial differences in activity patterns reflect variations in labor market opportunities

Activity status of household heads in Yerevan, Secondary cities and Rural areas

<table>
<thead>
<tr>
<th></th>
<th>Nonpoor</th>
<th>Poor</th>
<th>Nonpoor</th>
<th>Poor</th>
<th>Nonpoor</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yerevan</td>
<td>44%</td>
<td>38%</td>
<td>41%</td>
<td>34%</td>
<td>28%</td>
<td>16%</td>
</tr>
<tr>
<td>Secondary cities</td>
<td>25%</td>
<td>24%</td>
<td>21%</td>
<td>20%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Rural</td>
<td>10%</td>
<td>6%</td>
<td>14%</td>
<td>29%</td>
<td>55%</td>
<td>54%</td>
</tr>
</tbody>
</table>

Employee | Self employed | Unemployed | Retired | Student | Out of labor force

Source: World Bank staff calculations using ILCS 2015. Household heads aged 15 to 75
What will it take for all individuals to meaningfully contribute to Armenia’s development?

• What are the key constraints to enhancing individuals’ productivity? How can all segments of the work-able population contribute to the economy, especially women?

• To what extent is education delivering and producing individuals with needed skills?

• What are the root causes of spatial disparities and their underlying dynamics?

• What are the implications of a shrinking and aging population for the labor supply and existing skills?

• What is the impact of migration on reservation wage, labor productivity, stock of educated individuals, and incentives to work? What are the implications?
Hypothesis 4: Build resilience to vulnerabilities

Significant macroeconomic vulnerabilities

• Limited available fiscal space exhausted, leaving country vulnerable to shocks
• Challenging financial sector conditions: under-sized, bank-dominated, with rising vulnerabilities

Bank nonperforming loans to total gross loans (%), 2016

- Upper middle income: 3.8
- Lower middle income: 6.0
- Europe & Central Asia (excluding high income): 9.2
- Georgia: 3.7
- Armenia: 9.3
**Household and environmental vulnerabilities**

**Individual level:** Increasing share of the vulnerable and moderate poor; high share of out of pocket spending on essentials (health, energy).

**Natural and environmental:** vulnerable to earthquakes, landslides; environmental risks (health risks of air pollution), degradation of natural resources (water, erosion of rangelands)
What will it take to build resilience?

- **Macroeconomic** sustainability, including fiscal, external, financial:
  - How to rebuild a fiscal buffer?
  - How to anticipate and respond to the macroeconomic impact of a declining and aging population on long-term growth and macroeconomic sustainability? How to respond to the macroeconomic impact of migration and remittances?

- **Protecting households** from vulnerabilities
  - What are the key vulnerabilities at the individual-level?
  - How can vulnerabilities be mitigated and by which instruments or mix of instruments? (social protection, health spending, dependence on natural assets, vulnerability to environment)

- **Environmental** sustainability:
  - How to respond to threats to the environment, climate change?
  - How to manage vulnerability to natural disasters? Here strengthened disaster risk management frameworks and role of citizen engagement would be important.
4. APPROACH
Approach


• **Benchmark** or evaluate performance using comparator countries:
  - Include select countries from group of lower middle income countries, upper middle income countries, Eurasian Union, Eastern Partnership countries, EU member and candidate countries (including Western Balkan countries)
  - Countries that could be considered “aspirational” for Armenia such as Singapore
  - When relevant the SCD will also compare Armenia’s experience and policies to remittance receiving countries, landlocked countries, and countries experiencing similar demographic patterns.

• Use **data** from NSS and international databases.

• **Knowledge** sources
  - building on existing knowledge
  - gaps in knowledge to be identified (e.g. urbanization, job diagnostic, trade and transport facilitation)
Criteria for priorities?

Using the analyses, the SCD will prioritize the constraints and opportunities most important for inclusive and resilient growth, based the following criteria:

Criterion 1: Large and lasting impact on inclusive growth and resilience and hence on poverty reduction and shared prosperity

Criterion 2: Macroeconomic context

Criterion 3: Sequencing, complementarity and feasibility of reforms

Criterion 4: Feedback from country experts (sounding board)

The SCD will consider what the reform priorities would imply for spatial disparities as well as and for strengthening the economic potential of both women and men.
5. Next Steps
Timeline

- Regional Operation Committee Concept Review (February 15)
  → Chaired by the World Bank Regional Vice President
- Consultations on SCD concept (March 2017)
- Consultations on reform priorities (June 2017)
- WB Management decision meeting (June 2017)
  → Chaired by the World Bank Regional Director
- Report publication (July 2017)
THANK YOU

armenia_scd_team@worldbankgroup.org