I. Project Context
   Country Context
Armenia experienced remarkable growth in the 2000s which was followed by a severe downturn during the global financial crisis. Real growth averaged 12 percent per year during 2000–2008 and was driven primarily by foreign exchange inflows, mostly in the form of remittances. These inflows boosted domestic investment, primarily in the mining and construction sectors. Growth in per capita incomes (from US$620 to US$3,700) and job creation over the observed period together with improved social safety nets contributed to a significant decline in poverty. Although social policies contributed to lowering poverty during the 2000s, the main channel was the improvements in both labor (wages) and non-labor (remittances) income. The poverty rate decreased from over 50 percent of the population in 1999 to about 28 percent in 2008. Armenia has been a consistent reformer and its achievements have translated into improved living conditions, but only in the period before the global financial crisis. Armenia made notable progress toward the Millennium Development Goals between 2000 and 2008. The poverty incidence increased during the financial crisis - to 36 percent in 2010 (vs. 28 percent in 2008) - and moderated at 35 percent in 2011. The share of the very poor in 2011 amounted to 20 percent, compared to 12.6 percent recorded in 2008. Poverty also became deeper and more severe, with a poverty gap of 8.1 percent in 2010 (vs. 5.1 percent in 2008) and
poverty severity of 2.5 percent (vs. 1.4 percent in 2008). Inequality, measured by the Gini coefficient, increased on the basis of both consumption (from 0.24 to 0.26) and income aggregates (from 0.34 to 0.36). In addition, labor force participation decreased and unemployment rates increased to almost 20 percent following the crisis. Improvements in living conditions and the country’s overall recovery have been slow in the post-2008 period. Armenia's overreliance on commodities and remittances, excessive growth in construction and other non-tradables, and structural bottlenecks in the economy contributed to this slow recovery. The global financial crisis reversed some of the achievements and revealed existing vulnerabilities of the country’s economy. Armenia experienced a sharp contraction of the output in 2009. To counter the effects of the crisis, the government focused mainly on increased spending on infrastructure, social protection, and emergency financing for enterprises. The government’s crisis response policies substantially expanded the fiscal deficit from 0.4 percent of GDP in 2008 to 7.6 percent of GDP in 2009. As a result, in just 2 years, the public-debt-to-GDP ratio more than tripled and peaked at about 42 percent in 2011 (up from 13.6 percent at end-2008). While the fiscal expansion helped protect the poor and maintain jobs, the pace of recovery was slow with only 2.1 percent growth in 2010, but picking up to 4.6 percent in 2011 and 6.2 percent in 2012. To restore a sustainable fiscal path, the Government has embarked on a significant consolidation of its fiscal accounts, which helped reduce the overall fiscal deficit to 1.5 percent of GDP in 2012.

Sectoral and institutional Context

Armenia’s social protection system consists of both contributory and non-contributory programs (Table 1 attached in portal). The main contributory program is the pensions program. It covers the greatest number of beneficiaries and absorbs the most significant share of expenditures (4 percent of GDP). The Family Benefit Program (FBP) is the second largest social protection program and the most important social assistance (means-means tested) program targeting the poor population. The ILCS (Integrated Living Conditions Survey) data suggest that these two programs play a significant role in mitigating poverty and inequalities. The simulated impact of the two programs, covering the post crisis period, suggests that poverty would have been much higher in the absence of these programs. Without both pensions and FBP, the poverty incidence would have been 43 percent, as opposed to the actual 27.6 percent in 2008. In 2010, poverty would have grown from the actual 35.8 percent to approximately 54.2 percent. Overall and compared with other countries in the ECA (Europe and Central Asia) region, Armenia spends a relatively low share of its GDP on social protection (less than 6 percent in 2012). Like many countries in the region, Armenia reacted to the global financial crisis with an increase in social protection spending, but the main drivers of spending growth were social insurance and to a lesser extent social assistance. The expenditures increase in social insurance was caused by a real increase in benefit levels and, to a lesser extent, in coverage. Disability pensions steadily increased both in coverage and spending since 2007, while old age pensions spending hiked in 2009 despite fewer beneficiaries. Increased spending on labor market programs was also launched as a stabilizer against unemployment in the crisis but it was actually the unemployment benefit program that drove labor market spending. The budget for active labor market policies (ALMPs) has been declining since 2006 driven by a shrinking envelope for wage subsidies and public works. In 2012, Armenia spent only 0.08 percent of GDP on active labor market programs, which is significantly lower than the ECA average of 0.5 percent. The FBP is Armenia’s flagship social assistance program and it constitutes a meager 0.8 percent of GDP. Interestingly, in the post crisis period the number of families in the FBP beneficiaries has declined from 121,000 (yearly average) in 2008 to 86,000 in 2011. It, however, reversed to around 100,000 in 2013. According to survey data the program reaches around 12 percent of the population and is
well targeted - 76 percent of its resources goes to the poor. The coverage of the program is rather low since only one quarter of the poor receives the transfer. In order to improve efficiency, the government has instituted measures to detect errors and fraud by aligning the FBP database with a number of other relevant public databases. While this has increased the accuracy of targeting the program to the poor, it has also resulted in many errors of exclusion and a sharp decline in the number of families who receive the family benefit. There is no overarching social protection or social welfare strategy in Armenia but various sector strategies and national programs do exist. They cover areas such as labor market and employment, pensions, social assistance, family and child protection, and disability. Moreover, overall social protection of the population is set as one of the priorities in the Armenian Development Strategy 2025 (ADS) that was approved in 2013. The government renewed its focus on the FBP prompted by the financial crisis and rising poverty which further intensified social vulnerability. Poor and vulnerable households continue to rely heavily on public transfers, which in the case of pensions or FBP account for 60 percent of the income of the extreme poor. The FBP is more cost-effective than any other social protection program. For instance, FBP costs 1.14 drams to reduce the poverty gap by 1 dram (ILCS). However, in order to increase efficiency and effectiveness of the program, continued efforts are needed to improve the benefit formula, increase the coverage, and strengthen the management and monitoring of the FBP. Moreover, given the rise in poverty levels since 2008, the government needs to ensure sufficient resources for the possible expansion in the FBP coverage and support of beneficiaries’ integration in the labor market. Low-productivity and unemployment remain the two main labor market issues in Armenia. Nearly 40 percent of workers are employed in low-productivity agricultural activities. Many jobs do not pay enough to lift people out of poverty. In addition, the slow pace of job creation has been unable to absorb increases in the labor force. The results were a significant reduction in labor market participation rates, two-digit unemployment rates, and large emigration rates. The national unemployment rate has remained stubbornly high between 2009 and 2012 (17.4 percent in 2012). Regional disparities deepened as most investments and employment creation focused in Yerevan, leaving behind other marzes. The majority of the unemployed are new labor market entrants, or persons without previous work experience, mostly youth. Young women (15-34) are most affected by unemployment; Generally, women more often involve in part time jobs. New labor market entrants represent over one-half of the unemployed, while job losers are only slightly more than one-quarter, the rest are people who voluntarily quit their jobs. Hence, the key to reducing unemployment in Armenia is facilitating labor market entry, particularly by easing the school-to-work transition. Sustained reduction of poverty can be ensured by providing productive jobs. Therefore, Armenia needs to support the creation of new, productive jobs in the economy’s modern sectors to encourage active participation in labor market and search for self-reliant, income-generating opportunities. It is also important to ensure that workers have skills needed in the newly created modern jobs. These goals are in line with the national Employment Strategy for 2013-2018. The public pension system is undergoing major reform and institutional rationalization, but significant challenges remain with regard to the implementation of new laws. Starting from 2014, the Armenian pension system - mandatory, defined benefit pay-as-you-go (PAYGO) system, financed by payroll contribution – will be transforming into a multi-pillar pension system with mandatory fully funded individual account-based pension pillar, which will be added to the current pay-as-you-go pillar. The pension reform was enacted in 2010 through a set of laws focusing on state pensions (pay-as-you-go pillar), fully funded pensions (commonly called second pillar), unified income taxes, personified record-keeping, and investment funds. Further support would be needed for the development of the funded pension infrastructure, including by-laws and regulations, funded pensions supervision, development of capital markets, attracting reputable asset managers, and disclosure. The government is also aiming to strengthen analytical
capacity for assessments of various policy options with a view of improving fiscal sustainability while, at the same time, implementing the already approved pension reform. The pension area requiring specific support is the design of risk-based fraud and error supervision functions. With the 2010 pension reform, the State Social Security Service (SSSS) transformed from an independent PAYG (pay-as-you-go) pension agency with its own contribution collection, individual record-keeping, and pension payment capacity to a department of the Ministry of Labor and Social Issues (MLSI). It remained responsible for PAYG pension payment, qualitative supervision of the insured individuals' status, and servicing the insured individuals. With social insurance contributions amalgamated into the personal income tax, revenue collection transferred to the State Revenue Committee, and personified monthly tax report introduced and administered by the State Revenue Committee, the SSSS will, in future, redirect capacity to strengthening its core business processes and clients relations. Finally, with introduction of an integrated social services delivery model involving pensions, social assistance, employment and disability certification, Armenia has made substantial changes into how the social protection system functions. In 2012, the government approved the Decree on the Approval of the Operational-Structural Model of Comprehensive System of Integrated Social Service Provision. The Decree sets out a clear concept of the model of integrated social service provision and an outline of the implementation plan, with a clear division on the piloting and roll-out phases. The government has chosen a model of functional integration of four existing agencies (responsible for pensions, social assistance, employment and disability certification) that will be placed under one roof in 56 locations across the country. The model includes the introduction of joint reception area and case management procedures. The piloting of integrated service delivery within the integrated social service delivery centers has first been initiated in four sites (Masis, Ararat, Vedi in Ararat marz, and Avan community in Yerevan), financed under the Social Protection Administration Project, and implemented by the MLSI. Subsequently, 15 other sites were added and became operational. The management information system within these centers is currently undergoing adjustments in order to establish linkages to 18 internal (MLSI) and external databases and this work is to be completed by September 2013. The pilot activities under integrated social protection service delivery are planned to be completed and evaluated by November 2013. Following a thorough evaluation of the piloted integrated social service provision, the government will refine the model and enable its country-wide roll-out covering 37 remaining Integrated Social Protection Centers (ISPCs).

II. Proposed Development Objectives
The proposed Project Development Objectives (PDOs) are to (i) improve social protection service delivery and (ii) strengthen analytical and monitoring and evaluation functions of the agencies delivering social protection benefits and services.

III. Project Description
Component Name
Roll-Out of Integrated Social Protection Service Delivery
Comments (optional)
The component would support rolling-out of integrated social protection service delivery that was initiated and piloted under the Social Protection Administrative project.

Component Name
Support the Implementation of the New Employment Strategy by the Government
Comments (optional)
This component will support the implementation of the new employment strategy by the Government through measures that build on existing initiatives and infrastructure.

**Component Name**
Modernization of the Pension System

**Comments (optional)**
The pension component would support the SSSS (State Social Security Service) in improving its core business processes and upgrading them in line with ISPC requirements.

**Component Name**
Strengthen MLSI Analytical Capacity and Monitoring and Evaluation Systems

**Comments (optional)**
This component is aimed at strengthening the capacity of the monitoring and evaluation unit within the MLSI and developing an integrated system of M&E of SP benefits and services.

**Component Name**
Project Management

**Comments (optional)**
This component would finance the standard operation of the Project Coordination Unit (PCU) at MLSI for the duration of the project, trainings, project audit, and incremental operating costs.

**Component Name**
unallocated

**Comments (optional)**

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**IV. Financing (in USD Million)**

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**V. Implementation**
The proposed SPAP II project would be the second World Bank project implemented by the Ministry of Labor and Social Issues (MLSI) as an implementing agency. The institutional arrangement for the implementation of the proposed project would rely on the institutional arrangement successfully carried out under the SPAP, whereby the MLSI would be the agency responsible for the implementation of the proposed project with the technical aspects would be the responsibility of the PCU (Project Coordination Unit) team at the MLSI. The PCU would be responsible for general coordination, preparation, implementation and monitoring and evaluation of the project activities. The Foreign Financing Project Coordination Center under the Ministry of Finance (FFPMC) would carry out fiduciary aspects (including the financial management function) of the project.

**VI. Safeguard Policies (including public consultation)**
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Comments (optional)

VII. Contact point

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