June 2005
IMF Country Report No. 05/178

Republic of Armenia: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; and Press Release on the Executive Board Discussion

In the context of the request for a three-year arrangement under the Poverty Reduction and Growth Facility with the Republic of Armenia, the following documents have been released and are included in this package:

- the staff report for the request for a three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on March 17, 2005, with the officials of the Republic of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 10, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of May 25, 2005 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its May 25, 2005 discussion of the staff report that completed the request.

The documents listed below have been or will be separately released.

Joint Staff Advisory Note on the Poverty Reduction and Strategy Paper Progress Report
Letter of Intent sent to the IMF by the authorities of the Republic of Armenia*
Memorandum of Economic and Financial Policies by the authorities of the Republic of Armenia*
Poverty Reduction Strategy Paper Progress Report
Technical Memorandum of Understanding*
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Julian Berengaut and Martin Fetherston

May 10, 2005

- Program discussions were held in Yerevan during March 3–17, 2005. The mission team comprised Mr. Al-Atrash (head), Ms. George, Messrs. Takizawa, Ding (all MCD), Hauner (FAD), and Kelmanson (PDR). Messrs. Berengaut and Gelbard (both MCD) joined the mission for a few days, and Mr. McHugh, resident representative, assisted the mission. Mr. Stepanyan and Ms. Minasyan (economists in the local office) also assisted the mission. The mission briefly overlapped with a joint World Bank-IMF FSAP update team.

- The mission met with President Kocharian, Prime Minister Margaryan, Mr. Khachatryan (Minister of Finance and Economy), Mr. Sargsyan (Chairman of the Central Bank of Armenia), other senior officials, and representatives of the donor community and civil society.

- The attached Letter of Intent (Attachment I), and the Memorandum of Economic and Financial Policies (Attachment II) set out the authorities' economic program for 2005–08, for which they are seeking financial support under a Poverty Reduction and Growth Facility (PRGF) arrangement of SDR 23 million (25 percent of quota), to be disbursed in semi-annual installments over three years.

- The Poverty Reduction Strategy Paper Progress Report (IMF Country Report No. 05/175) and the Joint Staff Advisory Note (IMF Country Report No. 05/176) were circulated to the Board in April 2005. The 2004 Article IV consultation and sixth review under the previous PRGF arrangement (IMF Country Report No. 04/410) and the ex post assessment of Armenia's long-term program engagement (IMF Country Report No. 05/2) were discussed by the Executive Board on December 1, 2005.

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Attachments

Appendices

ACRONYMS

CBA	Central Bank of Armenia
CPI	Consumer Price Index
DSA	Debt Sustainability Analysis
FSSA	Financial Sector Stability Assessment
GDP	Gross Domestic Product
MCA	Millennium Challenge Account
MEFP	Memorandum of Economic and Financial Policies
MFE	Ministry of Finance and Economy
MTEF	Medium-Term Expenditure Framework
NCO	Noncommercial Organization
PIP	Public Investment Plan
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
REER	Real Effective Exchange Rate
SCC	State Customs Committee
STS	State Tax Service
VAT	Value-Added Tax

EXECUTIVE SUMMARY

Under the previous PRGF-supported program, Armenia accomplished macroeconomic stability, rapid growth, and a significant reduction in poverty. Indeed, the strong growth of recent years has brought real output back to the 1989 level and contributed to a reduction in the overall poverty rate from 56 percent in 1999 to an estimated 32 percent in 2003.

To consolidate these gains, there is a need to address the remaining structural weaknesses and implementation gaps as identified in the ex post assessment of Armenia's long-term Fund engagement. In particular, there is a need to consolidate macroeconomic stability, mobilize domestic revenue resources, enhance the business climate, and support PRSP implementation.

The new program for which the authorities are requesting Fund support focuses primarily on achieving three objectives:

- maintaining macroeconomic stability through prudent monetary and fiscal policies;
- generating additional domestic resources to finance poverty-reducing and growth-enhancing expenditures in particular by strengthening tax and customs administration; and
- boosting private sector activities by fostering financial sector development and improving governance including in the corporate sector.

The 2005 reform agenda is ambitious. It focuses on fiscal and financial sector reforms. On the former, the focus is mainly on addressing three critical areas of weakness: (i) the VAT chain, (ii) tax audits, and (iii) the management of tax arrears and VAT refund arrears. On the latter, the focus is on improving banking supervision, strengthening corporate governance, and developing the nonbank financial sector.

Armenia's economic outlook is favorable, although not without risks. On the macroeconomic policy front, possible overheating associated with large capital inflows needs to be monitored closely, with both fiscal and monetary policies standing ready to respond. The recent surge in remittances and capital inflows has already made the policy environment more difficult for the central bank. On the structural front, a lack of commitment to address vigorously the problems in tax and customs administration could hurt growth prospects, and hence, impede further reductions in poverty. Recent statements at the highest political level in support of improving tax and customs operations suggest an encouraging environment for the new program.

I. Introduction

1. Under the previous PRGF-supported program, Armenia accomplished macroeconomic stability, rapid growth, and a significant reduction in poverty. To consolidate these gains, there is a need to address the remaining structural weaknesses and implementation gaps as identified in the ex post assessment of Armenia's long-term Fund engagement. The new program, for which the authorities are requesting Fund support, focuses on improving tax and customs administration and strengthening the financial sector.

II. Recent Political and Economic Developments[1]

2. The three-party government coalition remains intact, despite internal divisions among coalition leaders. The opposition parties continue to maintain their parliamentary boycott and reject the results of the 2003 presidential elections. After an extended hiatus, Armenia and Azerbaijan have renewed contacts over the future status of the disputed enclave of Nagorno-Karabakh. However, sporadic fighting on the ceasefire line has heightened the urgency for a political solution. Parliamentary elections are scheduled for 2007, followed by presidential elections a year later.

3. **Macroeconomic performance continued to be strong in 2004 and early 2005**. Real GDP grew by 10.1 percent in 2004, mainly driven by a boom in agriculture and continued private construction activities, despite a marked drop in the diamond processing industry (Table 1). Twelve-month consumer price inflation fell from 8.6 percent in 2003 to 2 percent in December 2004, aided by tight monetary policy and the continued nominal appreciation of the dram. In the first two months of 2005, real GDP grew by 7 percent (year-on-year), led by construction, while 12-month inflation rose to 3.5 percent in March, mainly due to a higher-than-expected increase in food prices earlier this year. While the labor market showed signs of recovery in 2004, with the official unemployment rate falling to 9.4 percent from 10.1 percent a year earlier, job creation remains sluggish, in particular when contrasted with rapid output growth. Poverty and inequality indicators fell notably in recent years owing mainly to higher salaries, private transfers from abroad, and state social assistance (Table 2 and Box 1).

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[1] For a review of performance under the previous PRGF arrangement, see the ex post assessment of Armenia's long-term program engagement (IMF Country Report No. 05/2) and Section II of the attached Memorandum of Economic and financial Policies (MEFP).

Armenia: Main Economic Indicators, 2001–2004

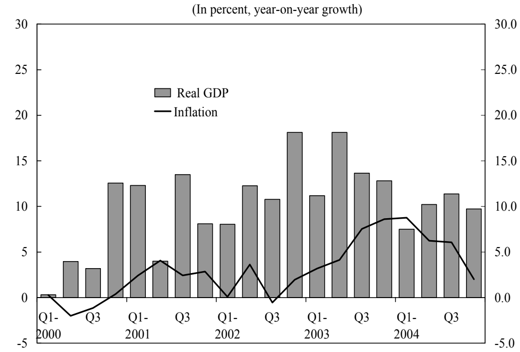
(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004 Est.
Real GDP growth (in percent)	9.6	13.2	13.9	10.1
Investment	19.8	21.7	24.7	23.9
Inflation (average, in percent)	3.1	1.1	4.7	7.0
Inflation (end-of-period, in percent)	2.9	2.0	8.6	2.0
General government balance (commitment basis)	-3.8	-0.4	-1.1	-1.7
External current account	-9.5	-6.2	-6.8	-4.7
Debt-to-exports ratio	132	131	87	74
Poverty rate 1/	47	49	32	...

Sources: Armenian authorities; and Fund staff estimates.
1/ Percent of population. Based on household surveys.

Economic Activity and Inflation

(In percent, year-on-year growth)



Box 1. Poverty in Armenia

After remaining flat during earlier years of growth, the most recent household survey from 2003 showed that overall poverty rates began to fall significantly, as did inequality indicators. The overall poverty rate fell from 56 percent in 1999 to an estimated 32 percent in 2003, while the Gini coefficient of income fell from 0.59 to 0.44 in the same period. Poverty reduction in cities other than Yerevan as well as in rural areas, however, has lagged, reflecting the lower participation outside of Yerevan in the rapid development of the economy.

Armenia: Poverty and Inequality, 1999–2003

(Percent of population, unless otherwise noted)

	1999	2001	2003
Real GDP growth (in percent)	3.3	9.6	13.9
Overall poverty rate	56	47	32
Urban areas	63	48	31
Yerevan	59	45	22
Other towns	67	51	40
Rural areas	48	46	34
Extreme poverty	26	16	6
Gini coefficient (current income) 1/	0.59	0.54	0.44
Gini coefficient (consumption) 1/	...	0.34	0.27

Source: Armenian authorites; based on data from household surveys.
1/ Ranges from 0 (perfect equality) to 1 (total inequality).

Looking forward, the authorities can achieve their goals of poverty reduction, as set out in their Poverty Reduction Strategy Paper (PRSP), by focusing on two main areas. First, ***improving rural infrastructure***, especially rural roads and water supply, will be important for these areas to participate in the economic growth process experienced in Yerevan. At the same time, targeting an efficient delivery of social services such as health and education will be essential for the poor. Second, ***creating conditions for employment growth*** will have a significant impact on poverty reduction. A pick-up of small- and medium-sized enterprise activity is key to increasing employment. In this regard, efforts to improve the business environment have to be stepped up, with an emphasis on tackling corruption at all levels of the economy, and ensuring well-functioning financial and judicial systems. Consistent with the PRSP, these themes are strongly emphasized in the proposed PRGF-supported program, reinforcing the World Bank's PRSC. Assuming the implementation of these policies, Armenia should be on track to achieve the Millennium Development Goals by 2015.

4. **Fiscal policy remained sound in 2004** (Table 3). The central government deficit of 1.7 percent of GDP was somewhat higher than programmed (1.3 percent of GDP), mainly due to the deferment of a major grant to 2005.[2] While the tax-to-GDP ratio improved by 0.1 percentage points relative to 2003, it remained short of PRSP and Medium-Term Expenditure Framework (MTEF) objectives.[3] Expenditures were in line with program targets. The deficit was fully financed through external financing. In the first quarter of 2005, tax revenues were on track to meet the end-year target of AMD 310 billion. Despite the improvement in 2004, expenditure execution, particularly in capital spending, was substantially lower than envisaged in the budget. As in past years, this relates mainly to the procurement process, with large underexecution early in the year tending to be only partly offset in the remaining months.

Armenia: Selected Fiscal Indicators, 2002–05
(Central Government, in percent of GDP)

	2002	2003	2004 Est.	2005 Prog.
Total revenue and grants	18.8	17.8	15.6	15.8
of which : tax revenue	14.6	14.0	14.1	14.7
grants	3.5	3.2	0.6	0.6
Total expenditure	19.3	18.9	17.3	18.7
Current expenditure	13.9	12.8	13.4	14.0
Capital expenditure and net lending	5.4	6.1	3.9	4.7
Overall balance (commitment basis)	-0.4	-1.1	-1.7	-2.9
Overall balance (cash basis)	-2.6	-1.5	-1.7	-2.9
Memorandum item:				
Social expenditure	4.9	5.0	5.4	6.5

Sources: Ministry of Finance; and Fund staff estimates.

5. **Following higher-than-expected inflation in early 2004, the central bank tightened monetary policy during the second half of the year.** As a result, inflation decelerated to 2 percent (end of period), helped by the nominal appreciation of the dram by 12 percent over the year as a whole. Broad money grew by 22 percent over the same period, which reflected a higher demand for money from strong income growth and improved confidence in the banking system (Table 4). In the first quarter of 2005, reserve money grew by 19.5 percent (year-on-year) with the Central Bank of Armenia (CBA) intervening in the foreign exchange market against the backdrop of strong appreciation pressures on the dram. Financial intermediation is expanding, with bank credit to the private sector growing by 28 percent in February 2005. Spreads of average lending and deposit rates, however, remained high at over 1000 basis points, in part due to high lending risk. Despite the rapid credit growth, the banking system remains sound, well-capitalized, and liquid, as noted in the FSSA (Table 5).

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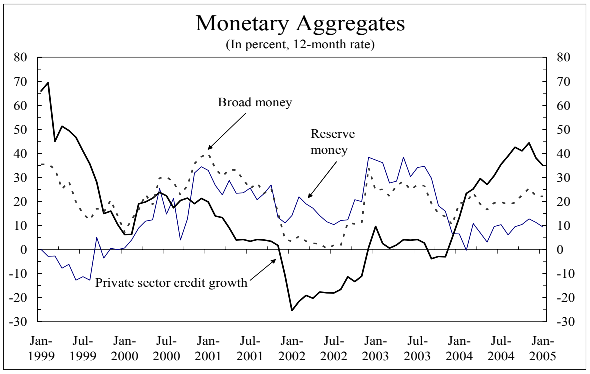
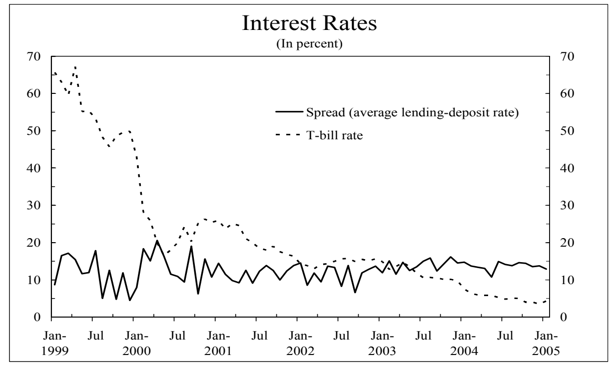
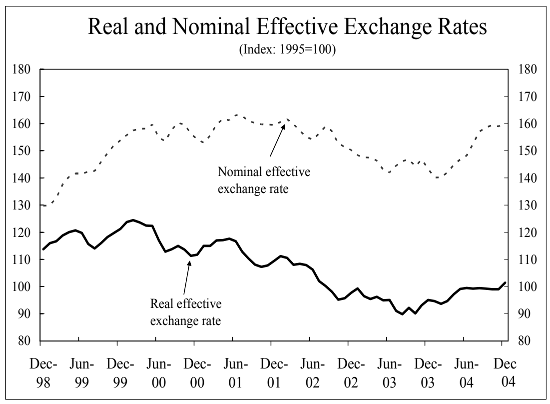
[2] The 2004 budget deficit was much lower than in the original program (2.6 percent of GDP), mainly due to GDP overperformance and expenditure underexecution.

[3] As in past years, the revenue target was met in nominal terms, but lagged in percent of GDP terms, suggesting low tax buoyancy. Armenia's comparatively low tax to GDP ratio has been the result of weak tax and customs administration, low tax rates, and growth in tax-exempt sectors such as grant-financed construction, re-export of processed diamonds, and agriculture.

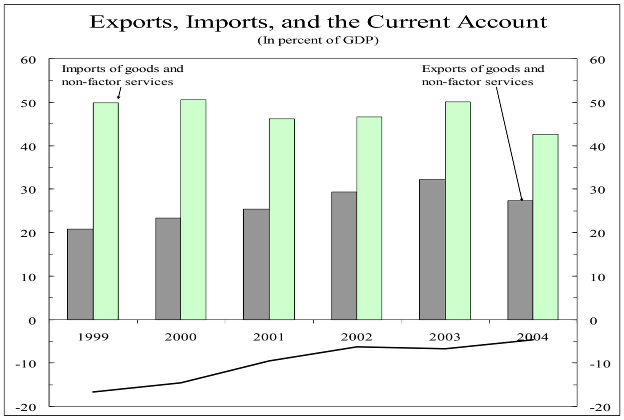


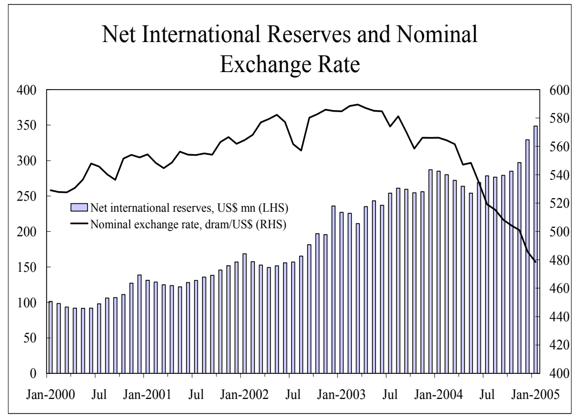




6. **The external current account balance and debt ratios improved in 2004** (Table 6). Preliminary data suggest a notable improvement in the current account deficit from 6.8 percent of GDP in 2003 to 4.7 percent in 2004, in part due to the strength of workers' remittances. Import and export growth are both estimated to have slowed during 2004, to 5.8 percent and 4.9 percent, respectively. The former was mainly due to supplier problems in the diamond sector, which, coupled with increased competition in the world diamond market, also hurt Armenia's exports. Gross international reserve coverage is estimated to have remained stable at four months of imports. Armenia's debt management strategy remains sound, relying on a mix of grants and concessional borrowing, with debt continuing to fall steadily relative to GDP from 39 percent in 2003 to 33 percent in 2004.

7. **Structural reforms continued to progress in 2004** (see MEFP, para 7 and 8). In the area of **tax administration**, the State Tax Service (STS) merged its large taxpayers unit with its central audit function. The time period for the conduct of tax audits was lengthened, although it fell short of staff recommendations. Moreover, a tax arrears collection unit was set up within the STS. Finally, the stock of value-added tax (VAT) refund arrears was reduced. The use of risk-based approaches, however, lagged, and further technical assistance will be needed before it can be successfully implemented.





8. **Banking system reforms also continued to advance**, although the financial sector remains small with total assets of under 20 percent of GDP. While progress in strengthening creditor rights has been slower than envisaged, the CBA amended its system of risk weights, making it consistent with Basel Committee recommendations under the standardized approach and tightened related-party exposure and large exposure limits. The CBA also terminated its administration of Armcommunications Bank, following capital injection from the new owners.

9. **Finally, significant progress was made in improving the financial performance of the energy and water sectors**, with collection rates rising and technical losses declining. The energy sector's transformation is particularly encouraging, driven by privatization, restructuring of the sector (especially the removal of Armenergo from transactions allowing for direct contracting between participants in the sector), and introduction of an appropriate regulatory framework. As a result, the primary balance of the energy sector has turned from deficit to surplus, and the sector, as a whole, fulfilled its tax obligation in 2004.

Armenia: Selected Indicators for the Quasi-Fiscal Sectors, 2001–04 1/

	2001	2002	2003	2004 Est.
Primary balance (in percent of GDP)	-3.6	-1.2	-0.6	-0.2
Energy	-2.5	-0.4	0.0	0.2
Water	-0.5	-0.4	-0.5	-0.3
Irrigation	-0.5	-0.4	-0.1	0.0
Electricity transmission and distribution				
Technical and other losses (in percent of electricity distributed)	26	26	4	2
Collection rate (in percent of current billings)	81	90	101	106

Sources: Armenian authorities; and Fund staff estimates.
1/ Includes state-owned companies only.

10. **The authorities met most of the quantitative and structural targets set out in their MEFP, including those with completion dates after the expiration of the previous PRGF arrangement**. Specifically, 7 of the 10 indicative targets agreed for end-December 2004 were observed (Table 7). The authorities also implemented all but one of the structural measures previously agreed to with staff for the period (Table 8). The only setbacks were the implementation of the cash register law, which was delayed until 2006, and the application of risk management approaches in performing tax audits, which was delayed due to capacity constraints.

III. Policy Discussions on The PRGF-Supported Program

11. **Despite significant progress, reforms are incomplete and vulnerabilities remain.** There is a need to consolidate macroeconomic stability, mobilize domestic revenue, and enhance the business climate. Moreover, the balance of payments remains vulnerable, notwithstanding the narrowing of external current account deficits in recent years. In particular, the diamond trade is susceptible to changes in contract terms, and official transfers are likely to decline over time in light of Armenia's strong economic performance. While the exchange rate appreciation has not seemingly affected the trade balance so far, going forward, the balance of payments could be negatively affected. The program focuses primarily on achieving three objectives, in support of the government's poverty reduction strategy:[4]

- maintaining macroeconomic stability through prudent monetary and fiscal policies;
- generating additional domestic resources to finance poverty-reducing and growth-enhancing expenditures, in particular by strengthening tax and customs administration; and
- boosting private sector activities, by fostering financial sector development and improving governance including in the corporate sector.

Armenia: Projections of Key Indicators, 2004–2008

(In percent of GDP, unless otherwise indicated)

	2004 Act.	2005	2006	2007	2008
Real GDP growth (in percent)	10.1	8.0	6.0	6.0	6.0
Investment	23.9	23.3	23.2	23.5	23.8
Inflation (average, in percent)	7.0	3.0	3.0	3.0	3.0
Inflation (end-of-period, in percent)	2.0	3.0	3.0	3.0	3.0
General government balance (commitment basis)	-1.7	-2.9	-2.7	-2.5	-2.2
External current account	-4.7	-5.1	-5.4	-5.2	-4.8
Debt-to-exports ratio	74	67	64	62	62

Sources: Armenian authorities; and Fund staff estimates.

12. **The medium-term framework of the proposed PRGF is consistent with the overall objectives of the authorities' strategy.** The framework targets real GDP growth of at least 6 percent annually—supported by robust investment—and annual inflation at 3 percent (Table 9) (see MEFP, para. 13). The fiscal deficit is projected to remain below 3 percent of GDP, although it is not expected to fall much lower as social and infrastructure needs remain high and execution rates continue to improve. The external current account deficit is projected to remain at around 5 percent of GDP, since import growth is expected to remain buoyant reflecting demand for imported capital and intermediate goods needed for growth. External debt ratios are projected to continue falling to about 60 percent of exports in net present value terms by 2008.

[4] The PRSP was adopted in August 2003. The government plans to revise the original PRSP targets and target indicators by the end of 2005, given that many of them have been significantly exceeded.

13. **Fiscal policy will focus on building capacity in tax policy and administration, while boosting the infrastructure required to foster a dynamic private sector.** On the revenue side, raising domestic resources in a transparent and nondiscretionary manner will be a primary objective of the program, not only to create a business environment conducive to economic activity, but also to create the tax base that will be needed as aid flows diminish over the medium term. It is projected that tax revenues will increase from 14.7 percent of GDP in 2005 to 15.9 percent of GDP in 2008 (specific measures to be taken in the 2005 program are identified below). On the expenditure side, implementing PRSP objectives in the social sector will be accorded high priority, together with improving expenditure execution and efficiency. Social expenditures are projected to increase from 6.5 percent of GDP in 2005 to 7.5 percent of GDP in 2008. Strengthening infrastructure, especially in rural areas, will also be important to allow for broad-based growth, with capital expenditures envisaged to increase from 4.2 percent of GDP in 2005 to 5.0 percent of GDP in 2008.[5] This will be facilitated by the resources becoming available under the Millennium Challenge Account (MCA). In the meantime, fiscal policy will stand ready to reign in potential demand pressures if private demand intensifies over the medium term.

A. The 2005 Program

Fiscal policy

14. **The 2005 budget envisages a deficit of 2.9 percent of GDP, compared to 2.4 percent earlier envisaged,[6] and 1.7 percent in 2004. The larger deficit, relative to 2004, is due to higher social and capital expenditures.** On the expenditure side, education, health, and social security expenditures are budgeted to rise from the 2004 outturn of 5.4 percent of GDP to 6.5 percent of GDP, and capital expenditures are budgeted to rise from 3.3 percent of GDP to 4.2 percent of GDP. On the revenue side, while the envisaged 0.6 percentage point increase in the tax-to-GDP ratio is ambitious, tax revenues in the first quarter were in line with the annual target, which suggests that the measures implemented in 2004 are yielding notable results. Moreover, as a contingency, the authorities agreed to reduce expenditures in the unlikely event of a revenue shortfall to ensure the deficit target is achieved. Similarly, the tax target could be adjusted upward in the event of higher-than-expected GDP growth.

15. **The 2005 budget aims to meet PRSP targets for social and capital expenditures, while maintaining macroeconomic stability.** While the 2005 budget

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[5] These PRSP priorities are appropriately reflected in the most recent MTEF for 2006-08.

[6] The overall fiscal stance, as measured by the net borrowing balance, is unchanged relative to earlier understandings, because the additional expenditures (0.5 percent of GDP) approved in the 2005 budget are financed by privatization proceeds.

represents a loosening of the fiscal stance, the authorities stressed the importance of meeting their inflation target. In this regard, increasing attention will be paid to the potential for overheating and/or the crowding out of the nascent private sector. With regard to the PRSP targets, the priority is to ensure that spending is targeted appropriately, and that these resources are used in a transparent and efficient manner. The authorities agreed that if a supplementary budget intended to provide additional resources for roads and schools is passed, it would be financed by a reallocation of existing budgeted expenditures, and/or additional revenues, and hence, would not entail a higher deficit (see MEFP, para 20).

Armenia: Functional Classification of Government Expenditures, 2003-2008

(In percent of total expenditure)

	2003 Act.	2004 Act.	2005 Proj.	2006-08 Proj.
General public services	9.1	10.1	10.0	9.7
Defense and public order	20.9	22.9	23.3	22.2
Health, education, and social security	32.0	35.2	38.2	41.3
Housing and public utilities	14.0	8.2	8.7	7.8
Transportation, construction, and agriculture	14.1	11.3	10.4	10.8
Interest on public debt	3.0	3.3	3.5	3.4
Unclassified	7.0	9.0	5.9	4.3
Total expenditure and net lending	100.0	100.0	100.0	99.5

Sources: Ministry of Finance; and Fund staff estimates and projections.

Monetary policy

16. **Monetary policy will continue to focus on price stability**. The monetary program for 2005 targets 3 percent inflation. Reserve and broad money are projected to grow by 14 percent and 18.5 percent respectively, on the assumption of continued remonitization. Against the backdrop of large remittances and capital inflows, net international reserves are programmed to increase by US$60 million compared with a US$43 million increase in 2004. To achieve the reserve money target and simultaneously manage large inflows, the program envisages a greater recourse to dram money-market operations.

17. **The CBA will continue to maintain the flexible exchange rate regime and plans to limit intervention in the foreign exchange market to smoothing out volatility in the exchange rate.** Recently, in the face of pressures on the exchange rate from large intermittent inflows, the CBA intervened in the foreign exchange market through purchases, while the dram continued to appreciate. The liquidity creating effect of the interventions was partially offset by sterilization operations. The CBA recognizes the risks associated with these interventions, particularly given the limited availability of local currency instruments, in achieving the reserve money target (Box 2). To provide support for the CBA, the government plans to increase its issuance of T-bills beyond the needs for deficit financing, the proceeds of which will be deposited in the CBA. In addition, the CBA will shortly issue its own bills to absorb liquidity, but they plan this as a transitional measure, given its potential impact of impeding the development of the government securities market. The CBA is also ready to raise the reserve requirements if necessary.

External sector policies

18. **Armenia's external current account remains sustainable, though will likely worsen somewhat in 2005.** On the import side, this will result, in part, from the fiscal loosening expected in 2005 and the high import content of the planned increase in government spending on capital projects (e.g., roads). On the export side, projected export growth incorporates uncertainties in diamond sector contracts and increased competition especially at the lower end of the market. Gross international reserve coverage is expected to remain stable at around four months of imports. Downside risks exist, with respect to both imports and remittances. Moreover, the continued surge of inflows could result in a further appreciation of the exchange rate, raising concerns about Armenia's external competitiveness (Box 3).

Structural reforms

19. **The focus of the authorities' program is on structural reforms that are macro-critical and growth promoting, in particular fiscal and financial sector reforms.** The authorities will work closely with the World Bank on reforms in the energy, water, and irrigation sectors.

Fiscal sector

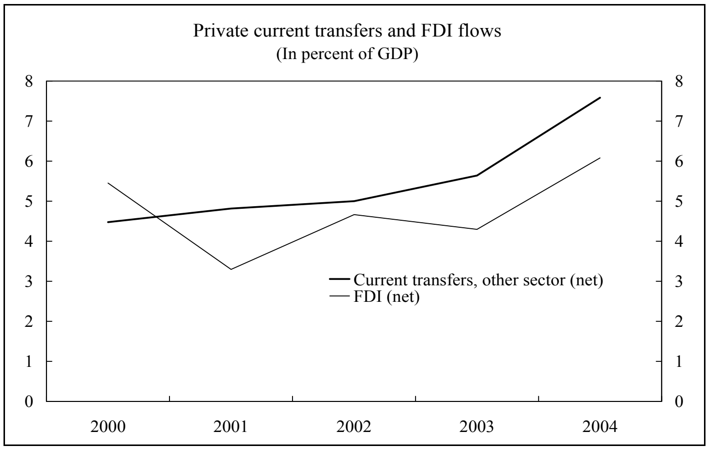
20. **The program includes an ambitious set of measures in the areas of tax policy and tax and customs reforms** (see MEFP paras. 23–27).[7] The focus is mainly on addressing three critical areas of weaknesses: (i) the VAT chain, (ii) tax audits, and (iii) the management of tax arrears and VAT refund arrears. Most notably, the authorities agreed to remove exemptions from VAT tax payments at the border amounting to about AMD 35 billion, based on import values of 2004 (structural benchmark). For the imports of large intermediate or capital goods that qualify for the capital deferral system, currently being established, a time limit for the payment of VAT will be introduced to strengthen the functioning of the VAT system (structural benchmark). With respect to tax

Summary of VAT Exemptions at the Border

	Lines	Value
(value in billions of drams)		
Goods exempt due to being in other tax regimes	5	196
Goods in capital deferral system	13	4
Retained exemptions	77	32
Abolished exemptions	139	35
Total	234	268
(in percent of total)		
Goods exempt due to being in other tax regimes	2	73
Goods in capital deferral system	6	2
Retained exemptions	33	12
Abolished exemptions	59	13
Total	100	100
Memorandum Item		
Abolished exemptions (value in billions of drams)	35	
Remaining exemptions, excluding lines taxed under other regimes (in percent of total)	12	

[7] The mission raised the issue of a potential reorganization to place the tax and customs agencies under the MFE. The authorities, however, were concerned that such a measure, if implemented in the absence of a broader, more comprehensive governmental reorganization could be counterproductive. Instead, the authorities agreed to take steps to improve information sharing between the agencies.

Box 2. Large Inflows and Monetary Policy



The recent surge in remittances and capital inflows creates opportunities and policy challenges. These inflows enable recipient country residents to finance higher consumption and investment and have the potential to facilitate higher per capita income growth. However, the inflows pose challenges to macroeconomic management policies, as they tend to lead to real appreciation of the local currency—either through nominal appreciation or inflationary pressures. While the real appreciation, measured in CPI terms, does not necessarily imply an erosion of external competitiveness (Balassa-Samuelson effect), the external position could worsen in the absence of sufficient productivity gains in the tradable sector.

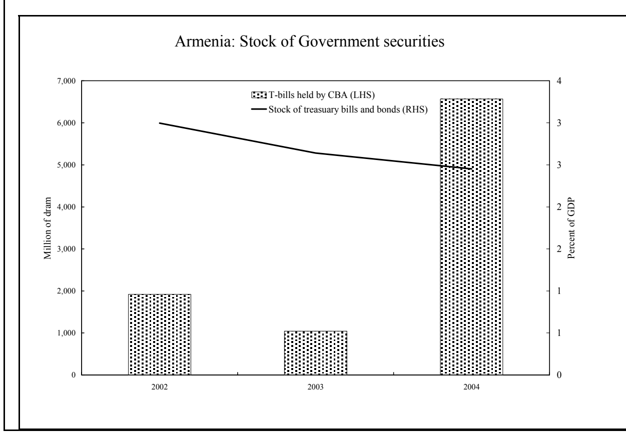
In the face of the challenge to preserve low inflation at a time of high and volatile inflows, the CBA has initiated some limited sterilization operations. However, the CBA's capacity to conduct sterilization operations is constrained by the low existing stock of local currency securities. To address this constraint, the Ministry of Finance and Economy (MFE) introduced in 2004 an arrangement under which the MFE issues treasury bills in excess of its financing needs, and recently agreed with the CBA to an even larger issuance plan for 2005. The arrangement, however, needs to be unwound by the end each calendar year, according to MFE's interpretation of the budget law. To strengthen its capacity to manage liquidity in a flexible manner, the CBA will start issuing its own securities.

Armenia: Foreign Exchange Interventions and Domestic Monetary Operations

	2004				2005
	Q1	Q2	Q3	Q4	Q1
Foreign exchange interventions (net) (In millions of U.S. dollars)	-6.7	0.0	5.8	19.5	25.4
Domestic currency monetary operations 1/ (In billions of drams)	-4.4	-2.3	1.9	-0.8	-6.6

Source: Central Bank of Armenia.
1/ Net injection (absorption) of liquidity at end-quarter in positive (negative) sign.

Sterilization has its own cost and is only a short-term policy response to the surge of inflows. Sterilization is costly to the extent that the interest rate of local currency securities exceeds the return on foreign denominated assets adjusted for capital gains/losses.



More importantly, sterilization does not address the underlying causes of the inflows and, in fact, may contribute to further inflows if they are interest sensitive, given that sterilization tends to lead to higher domestic interest rates. Over the medium-term, a more balanced policy mix—characterized by a tightening of fiscal policy—may be needed if capital inflows remain strong, causing demand pressures.

administration, the government intends to finalize an action plan on tax policy and tax and customs administration for 2005-06 in line with Fund technical assistance recommendations (prior action). It also agreed to publish the names of the 300 largest taxpayers to improve compliance (prior action). The government intends to strengthen the authority of the STS to conduct tax audits and improve the effectiveness of audits. In this regard, the STS plans to implement an annual audit plan for large enterprises based on risk classification, specifying priorities and targets for audits (structural benchmark). With additional technical assistance, it is also envisaged that its audit capacity will be increased in order to increase the use of risk-based methods (structural benchmark). In the area of customs administration, the authorities agreed to have an operational review of the State Customs Committee undertaken by a specialized international company (structural benchmark). In addition, they have agreed to accelerate the move to self assessment of importers, including through electronic declarations by direct trader input, and also to increase the share of the number of declarations of imports, which are valued according to the declared transaction price (structural benchmark). These steps should strengthen the VAT chain and enhance the governance environment, thereby promoting private sector development.

21. **Important measures are envisaged in the area of expenditure management** to address concerns of weak budget implementation, expenditure efficiency, and the monitoring of the noncommercial organizations (NCOs) (see MEFP, para 28). First, the authorities intend to prepare a public investment plan (PIP) to improve the strategic planning of capital expenditures, and the budgeting procedures for it. Second, they plan to clarify the Government Financial Statistics (GFS) compliance of the classification of capital expenditures to better target spending in this area. Third, they plan to implement their action plan, which should improve the monitoring system for the NCOs. Finally, the authorities plan to create an internal audit unit at the MFE to better judge the outcomes relative to intended objectives.

Financial sector

22. **To further expand financial intermediation, the authorities intend to step up reforms of the financial system, many of which were identified by the FSAP update mission** (Appendix V). With regards to banking supervision, the authorities plan to work on the preconditions required for risk-based supervision, while continuing with the compliance-based approach. The authorities also plan to address remaining weaknesses in banking supervision, including by empowering the CBA to conduct effective supervision of banks, particularly in the event of upward consolidation, and improving information sharing between the CBA and the external auditors (structural performance criterion). The CBA will implement a planned increase in minimum capital requirements for existing banks from the current US$2 million to US$5 million effective July 1, 2005.

23. **The authorities recognize that strengthening corporate governance, particularly of banks, is key to developing the banking sector** (see MEFP, para 31).

Higher regulatory requirements could facilitate better resource allocation and risk management, and further consolidate the banking sector. In this context, the authorities plan to clarify the definition and separation of duties and rights of shareholders, boards of directors, and executives of banks, notably the board of directors' responsibility for the safe and sound operation of the institution and reporting. Specifically, an amendment to the Law on Banks and Banking will be submitted to parliament by end-June 2005 (structural performance criterion). The authorities also plan to continue enhancing creditors' rights, including by streamlining court procedures and improving the registration system for secured lending.

24. **With regard to the development of the nonbank financial sector, the authorities intend to step up the pace of reforms** by (i) implementing an appropriate supervisory and regulatory framework in the insurance sector, (ii) studying various options for pension reforms, with a view to establishing a funded pension system, and (iii) evaluating a possible liquidity facility that could facilitate the development of the primary mortgage market.

Other structural reforms

25. **Given that the energy and water sectors continue to have fiscal and quasi-fiscal implications, their financial performance will need to be monitored and remaining reforms undertaken with the support of the World Bank**. In the energy sector, the authorities intend to liquidate Armenergo in a transparent way by end-2005, pass resolutions on market rules in the energy sector, and improve further energy sector corporate governance (see MEFP, para 34). Looking forward, two of the remaining state-owned generation companies need to be privatized or privately managed, to ensure transparency in the sector, as well as prevent a build-up of quasi-fiscal liabilities.[8] In the water sector, the authorities intend to continue to increase cash collections and raise tariffs, with the aim of reaching operations and maintenance cost recovery by 2007. Given the magnitude of the recent and planned tariff increases, it would be important for the government to assess their impact on the poor and provide targeted support.

26. **Reducing corruption is essential for the successful implementation of the reform program.** Since the adoption of the anti-corruption strategy in 2003, progress has been made in carrying out the action plan, mostly in the legislative area, with broad participation across governmental agencies and nongovernmental organizations. Going forward, the authorities will focus more on monitoring law enforcement and raising

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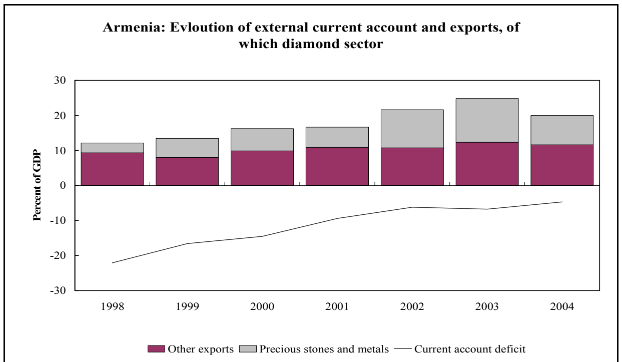
[8] The Vorotan HPP is generating strong revenues after its tariff was substantially raised, and the Yerevan TPP is selling steam to Nairit, a state-run chemical company that has a history of non-payment to the energy sector.

Box 3. Has Competitiveness Been Eroded in Armenia?

While Armenia's exports have strengthened considerably since 1998, as a result of niche market development and cost competitiveness, recent changes in real exchange rate indicators and dollar wages point to some limited erosion of the cost advantage. Measured in terms of the real effective exchange rate (REER) (CPI-based), competitiveness was on a clear improving trend from 1998 until the end of 2003. Reflecting the rapid nominal appreciation of the dram since early-2004, however, the bilateral dram/dollar real exchange rate appreciated more than 10 percent in 2004, pushing the rate above the 1999 level. In addition, the wage cost advantage relative to neighboring countries appears to have weakened somewhat in recent years. However, in real effective terms, the appreciation during 2004 was more modest as non-U.S. trading partners' currencies also generally appreciated against the U.S. dollar. Furthermore, labor productivity gains have offset, at least partially, the weakening of cost advantage.



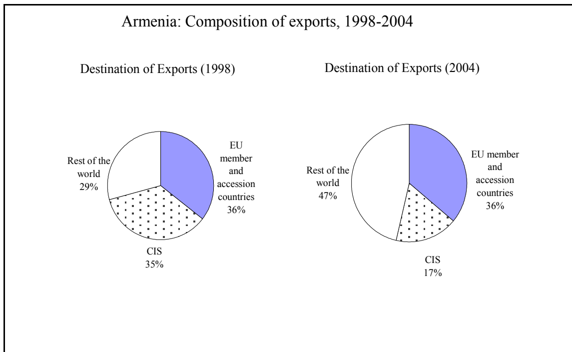
Both the destination and composition of exports changed markedly over the period, in part reflecting competitiveness of the export sector. Exports have shifted away from historical trading partners, in particular from CIS countries, toward the rest of the world, and the share of exports to EU and accession countries remained relatively stable. This redirection of exports reflect mainly Armenia's competitiveness in some niche markets (e.g., diamond processing). This is seen even more clearly in the marked shift in the composition of exports, over 40 percent of which are now accounted for by precious stones and metals.

Armenia: Indicators of External Competitiveness, 1998–2004
(Indices 1995=100; unless otherwise indicated)

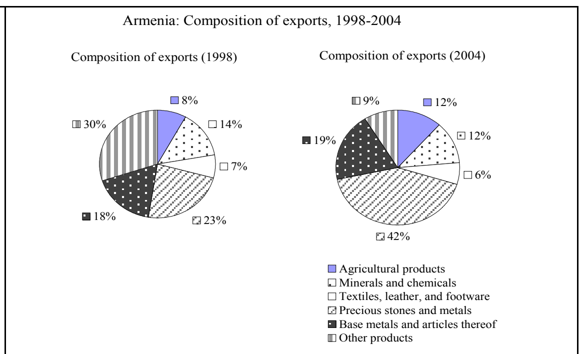
	1998	1999	2000	2001	2002	2003	2004
Real effective exchnage rate indices 1/	109.0	121.2	111.7	109.5	97.7	95.1	101.4
Bilateral US-Armenian real exchange rate indices							
Armenia's GDP deflator relative to US GDP deflator	119.6	111.4	106.6	105.1	102.5	104.3	117.4
Dollar/dram exchange rate adjusted for relative CPI	110.4	102.6	97.7	95.2	91.7	93.0	105.1
Monthly wages (In U.S. dollars)							
Armenia	30.8	34.6	39.1	42.3	45.8	57.5	79.7
Georgia	48.0	38.0	42.0	44.0	47.0	49.0	...
Azerbaijan 2/	43.5	44.7	49.5	55.8	64.8	78.8	90.6
Wages in Armenia relative to wages in (in percent)							
Georgia	64	91	93	96	97	117	...
Azerbaijan 2/	71	77	79	76	71	73	88

Source: Armenian authorities; and Fund staff estimates.
1/ An increase denotes an appreciation.
2/ January–June for 2004.

The continuation of large inflows and associated increases in wages suggest that erosion of Armenia's cost advantage might continue. While the external sector has performed strongly in recent years, continued structural reforms, aimed at improving the environment for private sector activity, will be required in order to safeguard Armenia's external competitiveness going forward.



Source: National Statistical Service; and staff estimates



Source: National Statistical Service ; and staff estimates public awareness and participation. As an important step, the authorities plan to expand the coverage of the law on financial disclosure by public officials. Reforms in other structural areas, especially tax and customs administration, are also expected to reduce rent-seeking opportunities and improve governance in general. Given the constraints in financial and human resources, donors' support would be essential in the battle against corruption.

B. Access, Capacity to Repay, Program Monitoring and Risks

27. **Program implementation will be monitored on a semi-annual basis**. The quantitative performance criteria and indicative targets for the 2005 annual program are included in Table 1 of the MEFP, while the structural measures are in Table 2 of the MEFP (see also Appendix VI). The first review under the proposed arrangement, based on the end-June test date, is expected to be completed by late October/early November. In addition to quantitative targets, this review will consider progress in the following areas: (i) amending the VAT law to remove exemptions at the border; (ii) passing a law to improve STS's ability to conduct audits; (iii) agreeing on the terms of reference for an operational review of customs; and (iv) submitting to parliament amendments to the Law on Banks and Banking.

28. **Access under the arrangement is proposed at SDR 23 million (25 percent of quota) (Table 10), below the norm for third-time PRGF users**. Under conservative assumptions—and assuming sizeable inflows from MCA during the projection period from 2006–08—a financing gap is likely to emerge if gross international reserves are to be maintained at around four months of imports. Armenia should be able to fill its medium-term financing gap based on support from the Fund and its catalytic effect on development partners (Table 11). The proposed access level of 25 percent of quota would still imply sizeable net repayments to the Fund over the program period, with outstanding credit projected to decline from SDR 140 million in 2004 to SDR 86 million in 2008 (Table 12). Armenia has a strong record of servicing its obligations to the Fund and is not expected to experience problems in servicing future obligations, including those stemming from the proposed arrangement. While Armenia's external debt is likely to remain sustainable in the medium-term (with debt ratios falling steadily (Table 6)), an updated debt sustainability analysis, based on the recently agreed template for low-income countries, will be presented alongside the first PRGF review.

29. **Armenia's economic outlook is generally favorable, although not without risks.** There are important risks both on the external and domestic fronts. On the external front, the unresolved conflict with Azerbaijan and the trade blockade by Turkey continue to hurt market access and shift needed resources away from the social sectors. In addition, limited export diversification and contract problems in the diamond sector leaves Armenia's external current account vulnerable to negative shocks in its export markets. On the macroeconomic policy front, possible overheating associated with large capital inflows needs to be monitored closely, with both fiscal and monetary policy standing ready to respond. On the structural front, the problems in tax and customs collection, and the difficulties in strengthening the legal, judiciary, and banking systems could hurt growth prospects, and hence, impede further reductions in poverty. Strong political will and leadership will be required to fight corruption

and vested interests. In this regard, the President recently made a statement on the need to move forward with tax and customs reforms. Lastly, Armenia's dependence on foreign inflows of remittances, grants, and foreign financing suggest that any disruptions in these flows will hurt the economy. This reinforces the importance of building a domestic revenue base and developing financial markets.

IV. Staff Appraisal

30. **Important progress was made in promoting economic growth and reducing poverty in recent years.** Under the previous PRGF-supported program, Armenia made considerable progress toward macroeconomic stability and important headway in structural reforms, resulting in strong economic growth, low inflation, and a noticeable reduction in poverty. Most targets under the program were met, although some structural reforms—in particular pertaining to banking and tax and customs administration—suffered from delays or implementation lags.

31. **Building on the recommendations in the ex post assessment, the 2005–08 program seeks to address the remaining reform agenda**. It aims to consolidate macroeconomic stability, achieve more broad-based growth, and generate employment-creating economic activity to further reduce poverty. The program focuses on tax and customs reforms and financial sector development.

32. **It is important that the deficit target for 2005 not be exceeded.** This will require that the authorities meet the ambitious revenue target. In this context, staff welcomes the strong revenue performance in the first quarter of 2005. Should there be a revenue shortfall during the year, however, it will be necessary to adjust expenditures accordingly to meet the overall budget target. It will also be important to be vigilant regarding expenditure efficiency.

33. **The central bank is to be commended for maintaining price stability, which has become increasingly challenging given the strong capital inflows**. The flexible exchange rate arrangement has helped absorb the external shock, although the rate of appreciation has made the policy environment more difficult. In the period ahead, it will be important for the central bank to enhance its capacity to manage liquidity by augmenting the stock of government securities. This will require greater coordination between the finance ministry and the central bank and further development of the domestic government debt market.

34. **The current policy mix relies somewhat on monetary policy to reign in potential demand pressures.** Such a reliance on monetary policy to deal with strong capital inflows could result in continued currency appreciation that may impact external competitiveness or an increase in interest rates that risks crowding out the private sector. At the same time, however, wages are very low, productivity is increasing rapidly, and government spending is focusing more on infrastructure, which would further contribute to high sustained growth. On balance, the authorities should be prepared to tighten fiscal policy over the medium term to contain possible overheating of the economy in response to strong capital inflows, while preserving PRSP priorities.

35. **It will be critical for the authorities to move forward with renewed resolve to implement remaining structural reforms.** The authorities have reiterated their strong commitment to consolidating and advancing the reform agenda, which bodes well for its success. They have already taken important measures in fiscal and banking reforms earlier this year, including publishing the names of the 300 largest taxpayers.

36. **The tax administration measures envisaged in the 2005 program are appropriately ambitious and comprehensive**. It is particularly important to strengthen the capacity of the large taxpayers unit and improve information sharing between tax and customs administrations to increase combined revenue collection.

37. **Improvements in the business climate will be difficult to achieve without reforming customs administration.** Staff recognizes that progress in this area is likely to take time. But it is important to make headway in reducing discretion and increasing transparency, to improve the business climate. In this regard, staff places high priority in moving forward with the operational review of customs in order to identify concrete ways to improve its operations.

38. **Pressures from vested interests, however, remain strong, requiring continued political support if the tax and customs reforms are to succeed.** In this regard, staff welcomes recent statements at the highest political level on the need to improve tax and customs operations and looks forward to tangible progress in this area.

39. **The financial sector will need to play a larger role for sustained strong growth over the medium-term**. This will require a further bolstering of confidence in the banking system in order to foster financial intermediation. Staff supports the CBA's intention to strengthen banking supervision and improve corporate governance of banks. It will also be important to develop the nonbank financial sector by creating an appropriate supervisory and regulatory framework.

40. **Addressing governance issues remains crucial to improve the business climate**. The authorities' anti-corruption strategy plan has thus far largely focused on improving legislation in this area. Going forward, there is also a need to focus on monitoring law enforcement and raising public awareness and participation.

41. **Progress has been made in improving the financial performance of the energy sector.** Staff supports the authorities' intention to complete liquidation of Armenergo. It is important to continue building a competitive energy sector, and the authorities should resist a return to quasi-fiscal operations.

42. **The risks to the program stem from both domestic and external sources**. In particular, strong vested interests could undermine the commitment to the program. In addition, the lack of instruments to manage strong inflows could complicate macroeconomic management. Strong program ownership and political commitment will be required to ensure program implementation.

43. **Overall, the authorities' 2005 reform agenda is appropriately ambitious**. It builds on earlier reforms and focuses on areas that are macro-critical, in line with the ex post assessment recommendations. The authorities have already demonstrated a strong commitment to remaining reforms. Based on their strong track record and the strength of the new program, staff recommends approval of the arrangement by the Executive Board.

Table 1. Armenia: Selected Economic and Financial Indicators, 2001–05

	2001	2002	2003	2004		2005
				Prog.	Act.	Proj.
	(Annual percentage change, unless otherwise indicated)					
National income and prices						
Real GDP growth	9.6	13.2	13.9	9.0	10.1	8.0
Gross domestic product (in billions of drams)	1,176	1,362	1,623	1,840	1,893	2,106
Gross domestic product (in millions of U.S. dollars)	2,120	2,373	2,805	3,408	3,552	4,217
Gross national income per capita (in U.S. dollars)	680	767	902	1,090	1,118	1,326
CPI (period average)	3.1	1.1	4.7	n.a.	7.0	3.0
CPI (end of period)	2.9	2.0	8.6	3.0	2.0	3.0
GDP deflator	4.0	2.4	4.6	4.0	5.9	3.0
Investment and saving (in percent of GDP)						
Investment	19.8	21.7	24.7	22.0	23.9	23.3
National savings	10.3	15.4	17.9	16.4	19.2	18.3
Money and credit (end of period)						
Reserve money	11.1	38.4	6.6	4.2	11.4	14.0
Broad money	4.3	34.0	10.4	15.0	22.3	18.5
Commercial banks' 3-month lending rate (in percent) 1/	27.7	23.4	22.3	...	15.4	…
Central government operations (in percent of GDP)						
Revenue and grants	17.0	18.8	17.8	15.7	15.6	15.8
of which : tax revenue	14.3	14.6	14.0	14.4	14.1	14.7
Expenditure and net lending	20.9	19.3	18.9	17.0	17.3	18.7
Overall balance on a commitment basis	-3.8	-0.4	-1.1	-1.3	-1.7	-2.9
Overall balance on a cash basis	-4.0	-2.6	-1.5	-1.3	-1.7	-2.9
Stock of domestic expenditure arrears	2.8	0.5	0.0	0.0	0.0	0.0
Government and government-guaranteed debt (in percent of GDP)	45.3	46.6	40.9	34.6	30.7	30.1
Primary balance of the energy sector (in percent of GDP) 2/	-2.5	-0.4	0.0	0.1	0.2	…
External sector						
Exports of goods and services (in millions of U.S. dollars)	540	698	903	990	970	1,037
Imports of goods and services (in millions of U.S. dollars)	-978	-1,107	-1,406	-1,511	-1,509	-1,654
Exports of goods and services	20.8	29.3	29.5	9.6	7.4	6.9
Imports of goods and services	1.2	13.2	27.0	7.4	7.3	9.6
Current account (in percent of GDP)	-9.5	-6.2	-6.8	-5.6	-4.7	-5.1
External debt-to-exports ratio 3/	132	131	87	73	74	67
Debt service ratio 4/	9.7	9.8	15.6	6.8	9.9	6.1
Import cover 5/	3.6	3.7	4.0	3.7	3.9	3.9
Nominal effective exchange rate 6/	3.4	-5.8	-4.6	…	11.8	…
Real effective exchange rate 6	-2.0	-10.8	-2.7	...	6.7	…
Memorandum item:						
Population (in millions)	3.213	3.210	3.212	...	3.214	3.246

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ End of period.

2/ Comprises state-owned energy companies. Data for 1999–02 include the electricity distribution company, Armelnet, which was privatized in late-2002. Data for 2003–04 exclude Armelnet and two generation companies that were also privatized.

3/ Three-year moving average of exports of goods and services centered on the previous year. NPV data as of 2004 Article IV consultation, December 1, 2004.

4/ In percent of exports of goods and services.

5/ Gross international reserves in months of next year's imports of goods and services.

6/ A positive sign denotes appreciation. Base year 1995=100. The calculations are based on 1999–2001 average trade weights.

Table 2. Armenia: Poverty Indicators and Millennium Development Goals, 1990-2015

	1990	1998/99	2000/01	2002/03	2015 Target
	(In percent of total population unless otherwise stated)				
1 Eradicate extreme poverty and hunger					
Population below US$2.15 (PPP) a day	...	35.8	...	...	...
Overall poverty rate	...	56.3	47.0	32.0	19.7
Rural poverty	...	47.7	45.7	33.9	...
Extreme Poverty	...	26.1	16.2	5.5	4.1
Prevalence of child malnutrition (in percent of children under 5)	...	3.3	2.6	...	1.4
2 Achieve universal primary education					
Net primary enrollment ratio (in percent of relevant age group)	...	...	84.5	...	100
Youth literacy rate (in percent of group ages 15-24)	99.5	99.7	99.8	...	100
3 Promote gender equality					
Ratio of girls to boys in primary and secondary education (in percent)	...	...	104.0	...	100
Ratio of young literate females to males (in percent of group ages 15-24)	99.7	99.8	100.1	...	...
Proportion of seats held by women in national parliament (in percent)	36.0	6.0	3.0	...	...
4 Reduce child mortality					
Under 5 mortality rate (per 1,000)	60.0	47.0	37.0	35.0	20.0
Infant mortality rate (per 1,000 live births)	26.0	…	25.0	30.0	8.7
Immunization, measles (in percent of children under 12 months)	94.8	91.0	95.6	…	...
5 Improve maternal health					
Maternal mortality ratio (modeled estimate, per 100,000 live births)	40.1	32.9	21.8	18.6	10.0
Births attended by skilled health staff (in percent of total)	99.7	98.8	…	...	...
6 Combat HIV/AIDS, malaria and other diseases					
Prevalence of HIV, female (in percent of group ages 15-24)	...	0.0	0.2	...	Stabilize and reduce
Incidence of tuberculosis (per 100,000 people)	17.6	39.2	36.5	44.6	Stabilize and reduce
Tuberculosis cases detected under DOTS (in percent)	...	8.0	27.8	...	Stabilize and reduce
7 Ensure environmental sustainability					
Nationally protected areas (in percent of total land area)	...	7.4	7.6	7.6	...
GDP per unit of energy use (PPP $ per kg oil equivalent)	…	3.5	3.3	...	...
CO2 emissions (metric tons per capita)	…	1.0	1.1	...	...
Access to an improved water source (% of population)	...	...	...	...	...
Access to improved sanitation (% of population)	...	...	...	...	...
8 Develop a Global Partnership for Development					
Fixed line and mobile telephones (per 1,000 people)	157.0	145.2	146.5	161.8	...
Personal computers (per 1,000 people)	...	5.3	9.2	15.8	...
General indicators					
Population (in millions)	3.5	3.1	3.1	3.1	...
Adult literacy rate (in percent of group ages 15 and over)	97.5	98.3	98.5	98.6	...
Total fertility rate (births per woman)	2.6	1.2	1.2	1.2	...
Life expectancy at birth (years)	71.7	73.0	73.6	74.8	...
Gini index of inequality (consumption)	...	…	34.4	27.1	...
Gini index of inequality (total income)	...	57.0	52.8	43.4	...

Source: World Bank, and Armenia authorities.

Goal 1: Halve, between 1990 and 2015, the proportion of people whose income is less than US$2.15 a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

Goal 7: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

Goal 8: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.

Table 3. Armenia: Central Government Operations, 2004–05

	2004						2005					
	Q1	Q2	Q3	Q4	Jan-Dec		Q1	Q2	Q3	Q4	Jan-Dec	
	Act.				Prog. 1/	Act.	Prog. 2/				Budget	Prog. 2/
	(In billions of drams)											
Total revenue and grants	56.0	69.4	83.7	85.8	289.7	294.9	67.1	79.4	90.9	95.4	345.3	332.8
Total revenue	55.8	68.1	79.7	80.3	273.5	283.8	66.2	76.5	86.6	91.5	333.3	320.8
Tax revenue	53.7	63.9	71.2	77.9	265.0	266.7	64.1	73.1	83.4	89.3	310.0	310.0
Nontax revenue	1.8	3.5	1.7	1.1	7.2	8.0	1.3	1.3	1.3	1.4	17.8	5.3
Capital revenue	0.3	0.7	6.8	1.3	1.3	9.1	0.8	2.0	1.9	0.8	5.5	5.5
Grants	0.3	1.4	4.0	5.4	16.2	11.1	0.9	3.0	4.3	3.9	12.1	12.1
Total expenditure	64.8	70.1	94.6	97.3	313.2	326.8	64.2	107.3	115.0	108.1	394.6	394.6
Current expenditure	52.6	57.3	71.2	72.0	242.5	253.1	53.1	83.1	78.5	80.5	295.2	295.2
Wages	8.1	9.4	9.4	13.2	41.7	40.2	9.5	11.3	11.2	14.1	29.0	46.1
Subsidies	6.1	3.4	4.9	3.9	15.6	18.2	4.7	5.0	1.7	1.7	13.1	13.1
Interest	2.4	2.2	3.0	2.2	10.9	9.8	2.5	2.6	3.8	3.2	12.1	12.1
Transfers	11.8	14.1	22.7	16.3	53.0	64.9	16.1	17.2	18.2	17.3	68.7	68.7
Goods and services	24.2	28.3	31.2	36.3	121.3	120.0	20.3	47.1	43.6	44.3	172.3	155.2
Capital expenditure and net lending	12.2	12.7	23.4	25.3	70.7	73.7	11.0	24.3	36.5	27.6	99.4	99.4
Capital expenditure 3/	10.2	9.8	20.1	22.1	59.4	62.2	8.5	20.4	32.4	28.0	89.3	89.3
Net lending	2.0	2.9	3.3	3.2	11.3	11.5	2.5	3.9	4.1	-0.4	10.1	10.1
Overall balance (commitment)(-)	-8.8	-0.6	-11.0	-11.5	-23.5	-31.9	2.9	-27.9	-24.1	-12.7	-49.3	-61.8
Net clearance of arrears (plus = accumulation) 4/	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy/financing gap	6.8	-3.9	-0.7	-2.0	0.5	0.2	0.0	0.0	0.0	0.0	0.0	-0.1
Overall balance (cash)	-1.8	-4.6	-11.6	-13.5	-23.0	-31.6	2.9	-27.9	-24.1	-12.7	-49.3	-61.9
Deficit/financing	1.8	4.6	11.6	13.5	23.0	31.6	-2.9	27.9	24.1	12.7	49.3	61.9
Domestic financing	-4.4	3.4	2.0	-4.9	-8.4	-4.0	-9.2	21.7	16.6	-1.9	14.6	27.2
Banking system	-3.4	3.7	1.7	-3.2	-10.1	-1.2	-17.2	19.2	9.2	1.6	14.6	12.9
Central Bank of Armenia	-3.8	3.0	0.8	-3.9	-9.7	-3.9	-21.3	13.5	6.6	9.9	8.7	8.7
Commercial Banks	0.4	0.7	0.9	0.7	-0.4	2.7	4.1	5.8	2.6	-8.3	5.9	4.2
Nonbank	-1.1	-0.2	0.2	-1.7	1.7	-2.7	8.0	2.5	7.4	-3.6	0.0	14.3
of which: Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	6.3	0.0	6.3	0.0	0.0	12.5
External financing	6.3	1.2	9.7	18.4	31.3	35.6	6.3	6.2	7.5	14.7	34.7	34.7
Gross inflow	8.0	7.5	10.9	19.9	45.2	46.3	9.5	7.7	9.4	17.7	44.2	44.2
Amortization due	-1.7	-6.3	-1.2	-1.5	-13.9	-10.7	-3.1	-1.5	-1.9	-3.0	-9.6	-9.5

Table 3. Armenia: Central Government Operations, 2004–05 (concluded)

	2004						2005					
	Q1	Q2	Q3	Q4	Jan-Dec		Q1	Q2	Q3	Q4	Jan-Dec	
	Act.				Prog. 1/	Act.	Prog. 2/				Budget	Prog. 2/
	(in percent of GDP unless specified otherwise)											
Total revenue and grants	3.0	3.7	4.4	4.5	15.7	15.6	3.2	3.8	4.3	4.5	16.4	15.8
Total revenue	2.9	3.6	4.2	4.2	14.9	15.0	3.1	3.6	4.1	4.3	15.8	15.2
Tax revenue	2.8	3.4	3.8	4.1	14.4	14.1	3.0	3.5	4.0	4.2	14.7	14.7
Nontax revenue	0.1	0.2	0.1	0.1	0.4	0.4	0.1	0.1	0.1	0.1	0.8	0.2
Capital revenue	0.0	0.0	0.4	0.1	0.1	0.5	0.0	0.1	0.1	0.0	0.3	0.3
Grants	0.0	0.1	0.2	0.3	0.9	0.6	0.0	0.1	0.2	0.2	0.6	0.6
Total expenditure	3.4	3.7	5.0	5.1	17.0	17.3	3.0	5.1	5.5	5.1	18.7	18.7
Current expenditure	2.8	3.0	3.8	3.8	13.2	13.4	2.5	3.9	3.7	3.8	14.0	14.0
Wages	0.4	0.5	0.5	0.7	2.3	2.1	0.5	0.5	0.5	0.7	1.4	2.2
Subsidies	0.3	0.2	0.3	0.2	0.8	1.0	0.2	0.2	0.1	0.1	0.6	0.6
Interest	0.1	0.1	0.2	0.1	0.6	0.5	0.1	0.1	0.2	0.2	0.6	0.6
Transfers	0.6	0.7	1.2	0.9	2.9	3.4	0.8	0.8	0.9	0.8	3.3	3.3
Goods and services	1.3	1.5	1.6	1.9	6.6	6.3	1.0	2.2	2.1	2.1	8.2	7.4
Capital expenditure and net lending	0.6	0.7	1.2	1.3	3.8	3.9	0.5	1.2	1.7	1.3	4.7	4.7
Capital expenditure 3/	0.5	0.5	1.1	1.2	3.2	3.3	0.4	1.0	1.5	1.3	4.2	4.2
Net lending	0.1	0.2	0.2	0.2	0.6	0.6	0.1	0.2	0.2	0.0	0.5	0.5
Overall balance (commitment)(-)	-0.5	0.0	-0.6	-0.6	-1.3	-1.7	0.1	-1.3	-1.1	-0.6	-2.3	-2.9
Net clearance of arrears (plus = accumulation) 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy/financing gap	0.4	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-0.1	-0.2	-0.6	-0.7	-1.3	-1.7	0.1	-1.3	-1.1	-0.6	-2.3	-2.9
Deficit/financing	0.1	0.2	0.6	0.7	1.3	1.7	-0.1	1.3	1.1	0.6	2.3	2.9
Domestic financing	-0.2	0.2	0.1	-0.3	-0.5	-0.2	-0.4	1.0	0.8	-0.1	0.7	1.3
Banking system	-0.2	0.2	0.1	-0.2	-0.5	-0.1	-0.8	0.9	0.4	0.1	0.7	0.6
Central Bank of Armenia	-0.2	0.2	0.0	-0.2	-0.5	-0.2	-1.0	0.6	0.3	0.5	0.4	0.4
Commercial Banks	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.1	-0.4	0.3	0.2
Nonbank	-0.1	0.0	0.0	-0.1	0.1	-0.1	0.4	0.1	0.4	-0.2	0.0	0.7
of which: Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.3	0.0	0.0	0.6
External financing	0.3	0.1	0.5	1.0	1.7	1.9	0.3	0.3	0.4	0.7	1.6	1.6
Gross inflow	0.4	0.4	0.6	1.1	2.5	2.4	0.4	0.4	0.4	0.8	2.1	2.1
Amortization due	-0.1	-0.3	-0.1	-0.1	-0.8	-0.6	-0.1	-0.1	-0.1	-0.1	-0.5	-0.5
Memorandum items												
Overall balance excluding grants (commitment)(-)	-0.5	-0.1	-0.8	-0.9	-2.2	-2.3	0.1	-1.5	-1.3	-0.8	-2.9	-3.5
Domestic expenditure arrears (stock in billions of drams)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Change in domestic expenditure arrears (in billions of drams)	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Government and government-guaranteed debt	...	...	...	...	34.6	30.7	...	...	...	...	30.1	30.1
of which: domestic debt 5/	...	...	...	...	2.4	2.3	...	...	...	...	2.4	2.4
Net borrowing/lending (commitment)(-) 6/	-0.5	0.0	-0.6	-0.6	-1.3	-1.7	0.4	-1.3	-0.8	-0.6	-2.3	-2.3
Nominal GDP (annual, in billions of drams)	1,893	1,893	1,893	1,893	1,840	1,893	2,106	2,106	2,106	2,106	2,106	2,106

Sources: Ministry of Finance and Economy, Central Bank of Armenia, and Fund staff estimates.

1/ Includes expenditure authorized by the supplementary budget, but not included in the original program.
2/ Relative to the actual budget law, the staff presentation makes the following adjustments: (i) an AMD 12.5 billion fee for the participation in the tender for the Molybdenum copper plant is recorded as privatization proceeds instead of nontax revenue, (ii) estimated military wages are reclassified from Other goods and services to Wages.
3/ Of which 36 percent concerns repairs and maintenance, which are classified as capital expenditure in Armenia.
4/ Excluding external arrears on principal which are included in external financing.
5/ Excluding domestic expenditure arrears.
6/ Overall balance plus privatization proceeds.

Table 4. Armenia: Monetary Accounts, 2004–05

	2004	2004	2005			
	Dec.	Dec. 4/	Mar.	June	Sept.	Dec.
	Act.	Act.	Est.	Prog.	Prog.	Prog.
	(In billlions of drams, unless otherwise indicated)					
Central Bank of Armenia	485.84	500.00	458.13			
Net foreign assets	162.9	167.7	165.3	183.2	193.8	221.2
Net international reserves	160.4	165.0	170.6	189.5	186.7	194.6
Special privatization account	13.7	14.1	4.7	5.1	20.8	42.6
Medium and long-term	-11.1	-11.4	-9.9	-11.4	-13.7	-15.9
Net domestic assets 1/	-30.9	-35.6	-41.7	-58.9	-62.7	-70.6
Claims on general government (net) 2/	-36.8	-36.8	-59.9	-46.4	-39.8	-29.9
of which : general government excl. central government 2/	-21.2	-21.2	-22.9	-22.9	-22.9	-22.9
central government (net)	-15.7	-15.7	-37.0	-23.5	-16.9	-7.0
of which : T-bills over issuance	0.0	0.0	-6.4	-12.9	-16.5	0.0
Claims on banks	10.9	10.9	5.1	-10.8	-5.7	-1.8
of which: KfW	11.7	11.7	11.7	11.7	13.2	14.7
Liquidity injection	1.2	1.2	...	...	...	...
Liquidity absorption	-2.0	-2.0	-6.6	-22.5	-18.9	-16.5
Other items (net) 1/	-4.9	-9.7	13.1	-1.7	-17.1	-39.0
SPA	-13.7	-14.1	-4.7	-5.1	-20.8	-42.6
Autonomous OIN	8.8	4.4	17.8	3.4	3.7	3.6
Reserve money	132.0	132.0	123.6	124.3	131.1	150.6
Currency issue	105.5	105.5	98.8	99.2	105.6	117.8
Deposits	26.5	26.5	24.8	25.1	25.5	32.8
Banking system						
Net foreign assets	222.5	229.4	228.5	239.3	248.2	274.0
Net domestic assets 1/	63.4	56.6	50.4	46.7	57.3	64.8
Claims on government (net)	-17.2	-17.2	-36.5	-17.2	-8.0	-6.3
of which: claims on central government (net)	3.9	3.9	-13.3	5.9	15.2	16.8
Claims on rest of the economy	142.5	142.5	144.3	154.9	169.7	204.4
Other items (net) 1/	-61.8	-68.6	-57.5	-91.0	-104.4	-133.2
Broad money	285.9	285.9	279.0	286.0	305.6	338.8
Currency in circulation	98.6	98.6	89.3	93.2	99.6	111.8
Deposits	187.4	187.4	189.7	192.8	205.9	227.0
Domestic currency	47.1	47.1	46.5	46.2	49.4	56.7
Foreign currency	140.2	140.2	143.2	146.6	156.6	170.4
Memorandum items						
Exchange rate (in drams per U.S. dollar, end of period)	485.8	485.8	458.1	...	...	...
Program e-rate		500.0	...	500.0	500.0	500.0
Privatization account (in millions of US$) 3/	28.1	28.1	9.4	10.2	41.6	85.1
NIR (in millions of U.S. dollars) 3/	330.1	330.1	372.3	...	...	...
NIR (in millions of U.S. dollars) 4/	320.0	330.1	375.5	379.0	373.3	389.2
Medium and long-term liabilities (in millions of U.S. dollars) 4/	20.8		22.8	22.9	27.4	31.9
NDA of the CBA (in billions of drams) 4/	-27.9	-21.6	-52.7	-53.8	-41.9	-28.1
Commercial banks' claims on central government (net).	19.6	19.6	23.7	29.4	32.1	23.8
NFA of commercial banks (in millions of USD)	122.6	123.3	138.0	112.3	108.9	105.6
12-month change in reserve money (in percent)	11.4	11.4	19.5	17.0	14.9	14.0
12-month change in broad money (in percent)	22.3	22.3	23.1	22.9	20.6	18.5
12-month change in private sector credit (in percent)	38.1	38.1	31.4	27.9	28.7	43.4
Velocity of broad money (end of period)	6.6	6.6	...	...	...	6.2
Money multiplier	2.2	2.2	2.3	2.3	2.3	2.3
Dollarization in bank deposits 5/	74.8	74.8	75.5	76.0	76.0	75.0
Dollarization in broad money 6/	49.0	49.0	51.3	51.2	51.2	50.3
Currency in circulation in percent of deposits	52.6	52.6	47.1	48.4	48.4	49.3
Stock of FCD (in millions of USD)	288.6	288.6	286.4	293.1	313.2	340.7
CBA's claims on central government excl. T-bills over issuance		-15.7	-30.6	-10.6	-0.4	-7.0
Change in net banking system claims on central government (cumulative)			-17.2	2.0	11.3	12.9
Change in net banking system claims on general government (cumulative)	-2.6	-2.6	-19.2	0.0	9.3	10.9

Sources: Central Bank of Armenia; and Fund staff estimates.

1/ The projected decline in 2005 is related to additional privatization proceeds primarily from the sale of a copper company. These proceeds will be saved in the special privatization account (SPA) which is a separate account at the CBA and is subject to regular audit by Parliament. Those proceeds are not reflected in the fiscal accounts until funds are earmarked for spending within the budget.

2/ Figures for the first quarter (program) includes AMD 2 billion accumulation due to over collection of the State Fund for Social Insurance.

3/ At actual exchange rates, excluding the SPA.

4/ At program exchange rates.

5/ Ratio of foreign currency deposits to total deposits (in percent).

6/ Ratio of foreign currency deposits to broad money (in percent).

Table 5. Armenia: Banking Sector Financial Soundness Indicators, 2002–05 1/
(In percent unless otherwise indicated)

	2002	2003 2/	2004 3/
Capital adequacy			
Total regulatory capital to risk-weighted assets	30.5	33.8	32.3
Tier I regulatory capital to risk-weighted assets	28.8	32.2	30.2
Capital to total assets	18.4	18.1	17.8
Sectoral distribution of gross domestic nongovernment loans 4/			
Agriculture	9.8	8.6	6.6
Industry excl. energy	22.3	20.1	22.2
Energy sector	16.8	11.4	5.0
Construction	3.5	5.1	4.0
Transport and communications	1.2	0.7	0.9
Trade and commerce	19.0	22.7	23.8
Other incl. consumer loans	27.4	31.4	37.5
Asset quality			
Performing loans to total gross domestic nongovernment loans 4/	87.5	90.1	92.8
Standard	85.4	86.4	91.8
Watch (up to 90 days past due) 5/	2.1	3.6	1.0
Nonperforming loans to total gross domestic nongovernment loans 4/	12.5	9.9	7.2
Substandard (91–180 days past due)	1.5	0.6	0.2
Doubtful (181–270 days past due)	0.8	0.7	0.7
Loss (>270 days past due)	10.2	8.6	6.3
Provisions to nonperforming loans 6/	95.8	103.7	107.4
Spread betw. highest and lowest local currency interbank rates	7.8	2.6	2.0
Spread betw. highest and lowest foreign currency interbank rates	3.6	3.7	1.0
Earnings and profitability			
ROA 7/	3.9	2.7	3.2
ROE 7/	21.6	14.4	18.4
Gross interest income to total gross income	63.1	62.7	63.7
Net interest margin to total gross income	37.6	42.0	44.2
Gross noninterest expense to total gross income	48.3	48.5	46.5
Liquidity			
Liquid assets to total assets 8/	44.5	47.5	47.1
Liquid assets to total short-term liabilities 8/ 9/	108.8	101.3	98.7
Customer deposits to total domestic loans 4/ 10/	195.3	177.1	177.3
Sensitivity to market risk			
Foreign currency loans to total gross domestic nongovt. loans 11/	82.5	72.7	70.4
Foreign currency liabilities to total liabilities	72.2	73.2	73.3
Gross open foreign currency position to capital	15.3	13.8	7.4

Sources: CBA; and Fund staff estimates.

1/ Excludes banks under CBA provisional administration.
2/ Includes one bank that was brought under CBA provisional administration on December 24.
3/ Sections on earnings and profitability and sensitivity to market risk exclude one bank that was under CBA provisional administration until October 29.
4/ Loans exclude correspondent accounts and other interbank deposits. Definition of nonperforming loans amended from that in IMF Country Report No. 04/136, Attachment III, Table 4 to exclude watch loans but include loss loans; nonperforming loans now include all loans overdue by more than 90 days.
5/ Classification category introduced on January 1, 2002.
6/ Assumes 100 percent coverage of loss loans.
7/ Average assets are calculated as a simple average of quarterly data. Profit is the undistributed post-tax profit from the income statement. In the calculation of ROE and ROA, the annualized profit figure (quarterly profit multiplied by 4) is taken.
8/ Liquid assets include cash, correspondent accounts and other interbank deposits, and Republic of Armenia Treasury bills.
9/ Short-term liabilities include demand liabilities and overdue liabilities.
10/ Customer deposits include bank accounts, demand deposits, and term deposits of individuals, legal entities, and nonbank financial institutions.
11/ Loans include correspondent accounts and other interbank deposits.

Table 6. Armenia: Balance of Payments, 2002–08
(in millions of U.S. dollars, unless otherwise indicated)

April 28, 12.00pm	2002	2003	2004		2005	2006	2007	2008
			Prog.	Est.	Prog.	Projections		
Current account	-148	-191	-188	-167	-213	-248	-262	-263
Trade balance	-369	-434	-451	-465	-524	-554	-561	-567
Exports, fob	514	696	775	730	785	860	944	1037
Imports, fob	-883	-1130	-1226	-1195	-1309	-1414	-1506	-1603
Services (net)	-41	-68	-69	-74	-93	-98	-102	-108
Credits	184	207	215	240	252	265	278	292
Debits	-225	-276	-285	-313	-345	-362	-380	-399
Income (net)	88	93	97	42	85	82	74	70
Transfers (net)	173	218	236	330	318	322	328	341
Private	119	158	183	269	268	272	278	291
Official	55	60	53	60	50	50	50	50
Capital and financial account	237	252	202	208	260	254	283	284
Capital transfers (net)	68	90	12	37	10	50	50	50
Foreign direct investment (net)	111	121	160	216	198	115	138	143
of which: Privatization/debt swap	7	61	46	51	114	0	0	0
Portfolio investment (net)	2	0	0	-3	0	0	0	0
Public sector (net)	71	13	29	38	48	47	50	45
Disbursements	89	92	83	88	67	63	60	58
of which: World Bank program support	36	43	20	20	...	...	...	...
Amortization	-18	-80	-54	-49	-19	-16	-10	-13
Other capital (net)	-15	29	1	-81	4	43	45	46
of which: Special Privatization Account	-7	2	-16	-20	-57	0	0	0
Errors and omissions	-18	-2	0	5	0	0	0	0
Overall balance	71	59	14	46	47	6	21	21
Financing	-70	-59	-14	-46	-77	-37	-46	-50
Gross international reserves (increase: -)	-82	-46	-5	-39	-41	-5	-23	-24
Use of Fund credit, net	7	2	-8	-6	-36	-33	-24	-26
Disbursements	25	30	28	28	...	...	...	...
Repurchases/repayments	-18	-28	-37	-35	-36	-33	-24	-26
Exceptional financing	5	-15	0	0	0	0.8	1.1	1.2
Arrears to Russia (+increase)	5	-17	0	0	0	0	0	0
Debt relief 1/	0	-1	0	0	0	0.8	1.1	1.2
Debt deferral 2/	0	3	0	0	0	0	0	0
Financing gap	...	...	...	...	30	30	25	28
IMF	...	...	...	...	10	10	10	5
World Bank	...	...	...	...	20	20	15	...
Memorandum items:								
Current account (in percent of GDP)	-6.2	-6.8	-5.6	-4.7	-5.1	-5.4	-5.2	-4.8
Trade balance (in percent of GDP)	-15.5	-15.5	-12.7	-13.1	-12.4	-12.0	-11.2	-10.3
Gross international reserves (end of period)	430	502	507	541	582	587	610	635
In months of imports	3.7	4.0	3.7	3.9	3.9	3.7	3.7	3.6
Merchandise export growth, percent change	45.5	35.5	11.3	4.9	7.5	9.5	9.8	9.8
Merchandise import growth, percent change	14.1	28.1	8.5	5.8	9.5	8.0	6.5	6.5
Nominal external debt 3/	1026	1098	1109	1183	1229	1280	1367	1354
Nominal external debt stock (in percent of GDP)	43	39	31	33	29	28	27	25
NPV of external debt in percent of exports 4/	131	87	73	74	67	64	62	62
External debt service in percent of exports	9.8	15.6	6.8	9.9	6.1	5.4	4.2	3.9
Stock of external arrears	17	0	0	0	0	0	0	0

Sources: Data provided by the Armenian authorities; and staff estimates.

1/ From Turkmenistan in 2003, and the United Kingdom from 2006 to 2008.

2/ The figure for 2003 reflects a Lincy foundation loan onlent to small- and medium-sized enterprises. The government repaid US$15 million of the US$18 million loan. The Lincy Foundation agreed to wait for the balance of the repayment.

3/ Government and government-guaranteed medium- and long-term debt.

4/Three-year moving average of exports of goods and services centered on the previous year. NPV data as of 2004 Article IV consultation, December 1, 2004.

Table 7. Armenia: Quantitative Targets, 2004 1/
(End of period ceilings on stocks, unless otherwise specified)

	2004				
	Jun.	Sep.		Dec.	
	Act.	Prog. 2/	Act.	Prog. 2/	Act.
	(in billions of drams)				
Net domestic assets of the CBA 3/	-33.4	-27.9	-22.8	-26.0	-27.9
Net banking system credit to the government	-14.3	-11.0	-14.3	-24.7	-17.2
Domestic arrears of the central government and the State Fund for Social Insurance	0.0	0.0	0.0	0.0	0.0
Tax revenues of the central government (floor) 4/	117.6	184.2	188.8	265.0	266.7
Balance of the central government on a cash basis (floor) 4/	-6.5	-27.9	-18.1	-23.0	-31.6
Reserve money (band/level)	106.3	(110-114)	114.1	(121-126)	132.0
Primary balance of the energy sector (floor) 4/	2.9	0.0	-0.1	1.2	3.2
	(in millions of dollars)				
Contracting or guaranteeing of new nonconcessional external debt 4/ 5/	0	0	0	0	0
External arrears (continuous criterion)	0	0	0	0	0
Net official international reserves (floor)	268.9	268.3	277.1	300.0	320.0

1/ The definitions of the line items and the adjusters on the fiscal balance, NIR, NDA, anet credit to the govenrment and the stock of domestic arrears are specified in IMF Country Report No. 04/136, Attachment III.
2/ Indicative targets.
3/ At end-June exchange rate (534.5 dram per U.S. dollar).
4/ Cumulative flow from the beginning of the year until the end of the month indicated.
5/ Includes debt with maturity of more than a year as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

Table 8. Armenia: Structural Measures, October 2004–March 2005

Measures	Target Date 1/	Status
Prepare a two-year program of priority reforms in tax policy and tax and customs administration in line with recent staff recommendations.	Oct-04	Done
The central bank will terminate its administration of Armcommunications Bank, either after its sale or prior to its liquidation.	15-Nov-04	Done
Parliament will pass legislation to regulate the use of cash registers and register traders (as businesses) at large retail markets.	15-Nov-04	Done. However, implementation has been delayed until December 2005
Enact amendment to the law on taxes providing the STS authority to write off uncollectible debts from its accounts and draft a decree establishing corresponding STS procedures in consultation with Fund staff.	Dec-04	Done
Enact legislation in line with recent IMF recommendations to facilitate the carrying out of effective tax audits, particularly in relation to large enterprises.	Jan-05	Done
Replace the differentiated tax rate structure in the simplified tax with one tax rate on turnover and with no deductions for expenses and take action to remove large taxpayers from the simplified tax regime and move them to the regular regime (VAT and profit tax).	Jan-05	Done
Implement risk management approaches in performing tax audits, collecting arrears, and processing VAT refunds	Mar-05	Partially done. Future progress will require additional technical assistance

1/ End of period.

Table 9. Armenia: Medium-Term Macroeconomic Framework, 2003–08

	2003 Act.	2004 Act.	2005	2006	2007	2008
			Projections			
	(In percent of GDP, unless otherwise indicated)					
National income and prices						
Real GDP growth (percent change)	13.9	10.1	8.0	6.0	6.0	6.0
Gross domestic product (in millions of U.S. dollars)	2,805	3,552	4,217	4,607	5,029	5,491
Gross national income per capita (in U.S. dollars)	902	1,118	1,326	1,412	1,503	1,602
CPI inflation, end-of-peiod (annual percent change)	8.6	2.0	3.0	3.0	3.0	3.0
Investment and saving						
Investment	24.7	23.9	23.3	23.2	23.5	23.8
Government	5.7	3.3	4.2	4.8	4.9	5.0
Other	19.0	20.6	19.1	18.4	18.6	18.8
National savings	17.9	19.2	18.3	17.8	18.3	19.0
Government	5.0	2.2	1.8	2.8	3.0	3.3
Other	12.9	17.0	16.5	15.0	15.3	15.7
Government operations						
Revenue and grants	17.8	15.6	15.8	16.6	16.7	16.8
of which: tax revenue	14.0	14.1	14.7	15.1	15.5	15.9
grants 1/	3.2	0.6	0.6	1.3	0.9	0.7
Expenditure	18.9	17.3	18.7	19.1	19.1	19.0
of which: social expenditure 2/	5.0	5.4	6.5	6.9	7.3	7.5
Current expenditure	12.8	13.4	14.0	13.8	13.7	13.6
Capital expenditure	5.7	3.3	4.2	4.8	4.9	5.0
Overall balance (including grants) 3/	-1.1	-1.7	-2.9	-2.7	-2.5	-2.2
Domestic financing	-0.2	-0.2	1.3	1.2	1.0	1.1
External financing	1.7	1.9	1.6	1.5	1.5	1.1
Government and government-guaranteed debt	40.9	30.7	30.1	28.3	27.3	24.4
External sector						
Exports of goods and services	32.2	27.4	24.6	24.4	24.3	24.2
Imports of goods and services	50.1	42.6	39.3	38.6	37.5	36.5
Current account	-6.8	-4.7	-5.1	-5.4	-5.2	-4.8
Current account (in millions of U.S. dollars)	-191	-167	-213	-248	-262	-263
Capital and financial account (in millions of U.S. dollars)	252	208	260	254	283	284
of which: direct foreign investment	121	216	198	115	138	143
public sector disbursements	92	88	67	63	60	58
Change in gross international reserves (in millions of U.S. dollars) 4/	-46	-39	-41	-5	-23	-24
Arrears and debt relief (in millions of U.S. dollars)	-15	0	0	1	1	1
Financing/gap (in millions of U.S. dollars)	0	0	30	30	25	28
of which: IMF	...	0	10	10	10	5
World Bank	...	0	20	20	15	...
External debt (NPV, in percent of exports of goods and services) 5/	87	74	67	64	62	62
Debt service (in percent of exports of goods and services)	15.6	9.9	6.1	5.4	4.2	3.9
Gross international reserves in months of imports	4.0	3.9	3.9	3.7	3.7	3.6

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ For 2006-08, the figures include preliminary projections for disbursements under the U.S. Millennium Challenge Account (US $100 million).

2/ Defined as total expenditure on health, education, and social security.

3/ In 2003, the difference between financing and the overall balance is due to arrears accumulation of 0.4 percent of GDP.

4/ A negative figure indicates an increase.

5/ Three-year moving average of exports of goods and services centered on the previous year. NPV data as of 2004 Article IV consultation, December 1, 2004.

Table 10. Armenia: Fund Disbursements and Timing of Reviews Under the Prospective Three-Year PRGF Arrangement, 2005–08

Date of Availability	Conditions	Amount (in millions of SDRs)
May 25, 2005	Board approval of the PRGF arrangement	3.28
November 1, 2005	Completion of first review (end-June 2005 quantitative performance criteria and relevant structural performance criteria)	3.28
May 15, 2006	Completion of second review (end-December 2005 quantitative performance criteria and relevant structural performance criteria)	3.28
November 15, 2006	Completion of third review (end-June 2006 quantitative performance criteria and relevant structural performance criteria)	3.28
May 15, 2007	Completion of fourth review (end-December 2006 quantitative performance criteria and relevant structural performance criteria)	3.28
November 15, 2007	Completion of fifth review (end-June 2007 quantitative performance criteria and relevant structural performance criteria)	3.28
May 15, 2008	Completion of sixth review (end-December 2007 quantitative performance criteria and relevant structural performance criteria)	3.32

Sources: Fund staff estimates.

Table 11. Armenia: External Financing Requirements and Sources, 2002–08
(In millions of U.S. dollars, unless otherwise indicated)

April 28, 12.00pm	2002	2003	2004	2005	2006	2007	2008
			Est.	Prog.	Projections		
Total Requirements	439	563	620	627	624	647	668
External current account deficit (exc. transfers)	321	409	497	531	570	590	604
Debt amortization	18	80	49	19	16	10	13
Gross international reserve accumulation	82	46	39	41	5	23	24
IMF repurchases and repayments	18	28	35	36	33	24	26
Available financing	439	563	620	627	624	647	644
Capital Account and Current Transfers	410	548	592	597	592	621	638
Capital transfers (net)	68	90	37	10	50	50	50
Foreign Direct Investment	111	121	216	198	115	138	143
Public Sector Disbursements	89	92	88	67	63	60	58
Other Capital 1/	-32	27	-78	4	43	45	46
Current transfers	173	218	330	318	322	328	341
Private	119	158	269	268	272	278	291
Official	55	60	60	50	50	50	50
Exceptional Financing	30	15	28	30	31	26	6
IMF	25	30	28	10	10	10	5
World Bank	0	0	0	20	20	15	0
Change in Arrears (+ increase)	5	-17	0	0	0	0	0
Debt Relief 2/	0	2	0	0	1	1	1
Financing gap	0	0	0	0	0	0	23

Sources: Data provided by the Armenian authorities; and staff estimates.

1/ Includes portfolio investment and net errors and omissions.

2/ Includes debt deferal from the Lincy Foundation in 2003, and debt relief from Turkmenistan in 2003 and from the United Kingdom from 2006 to 2008.

Table 12. Armenia: Indicators of Fund Credit, 2003-08

	2003	2004	2005	2006	2007	2008
			Projections			
	(In units indicated)					
Existing and prospective Fund oustanding credit 1/						
In millions of SDRs	144.4	140.1	123.4	108.8	100.0	86.2
In percent of exports 2/	22.4	21.4	17.6	14.3	12.1	9.6
In percent of external debt	18.4	17.6	14.9	12.6	10.8	9.4
In percent of gross reserves	40.2	38.4	31.4	27.5	24.3	20.1
In percent of quota	157.0	152.3	134.2	118.3	108.6	93.7
Existing Fund outstanding credit 1/						
In millions of SDRs	144.44	140.1	116.9	95.7	80.2	63.2
In percent of exports 2/	22.4	21.4	16.7	12.6	9.7	7.0
In percent of external debt	18.4	17.6	14.1	11.1	8.7	6.9
In percent of gross reserves	40.2	38.4	29.8	24.2	19.5	14.7
In percent of quota	157.0	152.3	127.0	104.0	87.2	68.7
Prospective Fund outstanding credit 1/						
In millions of SDRs	…	…	6.6	13.1	19.7	23.0
In percent of exports 2/	…	…	0.9	1.7	2.4	2.6
In percent of external debt	…	…	0.8	1.5	2.1	2.5
In percent of gross reserves	…	…	1.7	3.3	4.8	5.4
In percent of quota	…	…	7.1	14.3	21.4	25.0
Repurchases, repayments, and charges due from existing and prospective drawings						
In millions of SDRs	…	…	24.0	21.8	16.0	17.5
In percent of exports 2/	…	…	3.4	2.9	1.9	2.0
In percent of external debt	…	…	2.9	2.5	1.7	1.9
In percent of gross reserves	…	…	6.1	5.5	3.9	4.1
In percent of quota	…	…	26.1	23.7	17.3	19.1
Repurchases and charges due from existing drawings						
In millions of SDRs	…	…	24.0	21.7	15.9	17.4
In percent of exports 2/	…	…	3.4	2.9	1.9	1.9
In percent of external debt	…	…	2.9	2.5	1.7	1.9
In percent of gross reserves	…	…	6.1	5.5	3.9	4.1
In percent of quota	…	…	26.0	23.6	17.3	18.9
Repurchases and charges due from prospective drawings						
In millions of SDRs	…	…	0.0	0.0	0.1	0.1
In percent of exports 2/	…	…	0.0	0.0	0.0	0.0
In percent of external debt	…	…	0.0	0.0	0.0	0.0
In percent of gross reserves	…	…	0.0	0.0	0.0	0.0
In percent of quota	…	…	0.0	0.1	0.1	0.1

Sources: Armenian authorities and Fund staff estimates.

1/ End of period stocks.
2/ Exports of goods and services.

May 10, 2005

Republic of Armenia—Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Attached hereto is a letter dated May 10, 2005 from the Prime Minister, and the Minister of Finance and Economy of the Republic of Armenia, and the Chairman of the Central Bank of Armenia (the "Letter"), with an attached Memorandum of Economic and Financial Policies (the "Memorandum") and Technical Memorandum of Understanding (the "TMU"), requesting from the International Monetary Fund as Trustee of the Poverty Reduction and Growth Facility Trust (the "Trustee") a three-year arrangement under the Poverty Reduction and Growth Facility, as amended, and setting forth:

(a) the three-year macroeconomic and structural adjustment program which the authorities of the Republic of Armenia intend to pursue with the support of the three-year arrangement under the Poverty Reduction and Growth Facility Trust;

(b) a detailed statement of the policies and measures which the authorities of the Republic of Armenia intend to pursue during the first year of the arrangement, in line with the objectives and policies of the authorities' three-year program; and

(c) understandings of the Republic of Armenia with the Trustee regarding reviews which will be made of progress in realizing the objectives of the program and of the policies and measures which the authorities of the Republic of Armenia will pursue for the second and third years of the arrangement.

To support these objectives and policies, the Trustee grants the requested three-year arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Facility Trust.

1. (a) For a period of three years from the date on which this arrangement becomes effective, the Republic of Armenia will have the right to request loan disbursements from the Trustee in a total amount equivalent to SDR 23 million, subject to the availability of resources in the Poverty Reduction and Growth Facility Trust.

(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 9.84 million until the beginning of the second year of the arrangement and the equivalent of SDR 16.40 million until the beginning of the third year of the arrangement.

2. During the period of the arrangement:

(a) the first disbursement, in an amount equivalent to SDR 3.28 million, will be available upon effectiveness of the arrangement, at the request of the Republic of Armenia; and

(b) the second disbursement, in an amount equivalent to SDR 3.28 million, will be available on or after November 1, 2005, at the request of the Republic of Armenia and subject to paragraphs 4 and 5 below;

(c) the third disbursement, in an amount equivalent to SDR 3.28 million, will be available on or after May 15, 2006, at the request of the Republic of Armenia and subject to paragraphs 4 and 5 below.

3. The right of the Republic of Armenia to request additional disbursements during the second and third years of this arrangement shall be subject to such phasing and conditions as shall be determined by the Trustee at later reviews.

4. The Republic of Armenia will not request the second or third disbursements specified in paragraphs 2(b) and (c) above:

(a) if the Managing Director of the Trustee finds that, with respect to the second disbursement, the data as of June 30, 2005, and, with respect to the third disbursement, the data as of December 31, 2005, indicate that:

(i) the floor on net official international reserves; or

(ii) the ceiling on the net domestic assets of the Central Bank of Armenia ("CBA"); or

(iii) the ceiling of net banking system credit to the government; or

(iv) the ceiling on the contracting or guaranteeing by the government or the CBA or any other agency acting on behalf of the government of new nonconcessional external debt with an original maturity of one year or more

(v) the ceiling on the contracting or guaranteeing by the government or the CBA or any other agency acting on behalf of the government of new nonconcessional external debt with an original maturity of less than one year, excluding normal import-related credits;

(vi) the floor on tax revenue collections of the central government;

(vii) the floor on the balance of the central government on a cash basis;

(viii) the ceiling on the domestic arrears of the central government and the State Fund for Social Insurance;

as set out in Table 1 of the Memorandum and further specified in the TMU was not observed; or

(b) if the Managing Director of the Trustee finds that the Republic of Armenia has not carried out its intentions:

(i) with respect to the second disbursement, by June 30, 2005,

(a) to submit to Parliament an amendment to the Law on Banks and Banking to empower the CBA, in the event of an upward consolidation, to identify beneficial owners on a chain of ownership as far as the CBA sees appropriate for supervisory purposes; or

(b) to submit to Parliament an amendment to the Law on Banks and Banking to define: (i) the separation of duties and rights of shareholders, boards of directors, and executives; (ii) disclosure requirements in respect of potential conflicts of interest of board members; and (iii) requirements for public disclosure of information on ownership and control of banks, specifically lists of founders and copies of the bank's statutes, in line with the concept note prepared by the CBA on corporate governance of banks,

As set out in Table 2 to the Memorandum and further specified in paragraphs 23 and 24 of the TMU; or

(c) until the Trustee has determined:

(i) with respect to the second disbursement, that the first review, and

(ii) with respect to the third disbursement, that the second review,

of the Republic of Armenia's program referred to in the fourth paragraph of the Letter has been completed.

5. The Republic of Armenia will not request any disbursement under this arrangement if, at any time during the period of this arrangement:

(a) data indicates that the ceiling on new external payments arrears, as specified in Table 1 of the Memorandum and in the TMU, was not observed; or

(b) the Republic of Armenia has:

(i) imposed or intensified restrictions on payments and transfers for current international transactions; or

(ii) introduced or modified multiple currency practices; or

(iii) concluded bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposed or intensified import restrictions for balance of payments reasons.

6. If the Republic of Armenia is prevented from requesting any disbursement under this arrangement because of paragraphs 4 or 5 above, that disbursement will be made available only after consultation has taken place between the Trustee and the Republic of Armenia and understandings have been reached regarding the circumstances in which the Republic of Armenia may request the disbursement.

7. In accordance with the fourth paragraph of the Letter, the Republic of Armenia will provide the Trustee with such information as the Trustee requests in connection with the progress of the Republic of Armenia in implementing the policies and reaching the objectives of the program supported by this arrangement.

8. In accordance with the fourth paragraph of the Letter, during the period of this arrangement, the Republic of Armenia shall consult with the Trustee on the adoption of any measure which may be appropriate at the initiative of the Government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while the Republic of Armenia has outstanding financial obligations to the Trustee arising from loan disbursements under this arrangement, the Republic of Armenia will consult with the Trustee from time to time, at the initiative of the Government or whenever the Managing Director of the Trustee requests consultation, on the Republic of Armenia's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to the Republic of Armenia or of representatives of the Republic of Armenia to the Trustee.

May 10, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

The implementation of prudent policies and structural reforms over the past several years has contributed to macroeconomic stability, consistently high growth, and significant reductions in poverty. Indeed, the strong growth of recent years has brought real output back to the 1989 level. We recognize, however, that despite the significant progress, the reform agenda is incomplete. There is a need to maintain macroeconomic stability, increase domestic revenue mobilization, enhance the business climate, and support PRSP implementation.

The attached Memorandum of Economic and Financial Policies (MEFP) outlines our broad macroeconomic objectives for 2005-08 and provides specific measures for 2005. There are two elements at the center of the program, namely (i) raising domestic resources in a transparent and non-discretionary manner, not only to create a business environment conducive to economic activity, but also to create a tax base to finance our PRSP priorities; and (ii) boosting private sector activities by fostering financial sector development and improving governance, including in the corporate sector.

In support of our economic reform program, the Government of the Republic of Armenia requests a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 23 million (25 percent of quota), following implementation of the prior actions set out in Table 2 of the MEFP.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but it will take other measures that may become necessary for this purpose. The Government will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. Moreover, after the period of the PRGF arrangement, and while Armenia has outstanding financial obligations to the Fund from loans on earlier arrangements, the Government will consult with the Fund on Armenia's economic and financial policies from time to time, at the initiative of the Government or at the request of the Managing Director. We expect to complete the first semi-annual review under the proposed arrangement by late October/early November 2005.

Very truly yours,

/s/
Andranik Margaryan
Prime Minister
Republic of Armenia

/s/
Vardan Khachatryan
Minister of Finance and Economy
Republic of Armenia

/s/
Tigran S. Sargsyan
Chairman of the Central Bank
Republic of Armenia

Republic of Armenia
Memorandum of Economic and Financial Policies for 2005-08

I. Introduction

1. This Memorandum sets out the economic and financial policies of the Armenian government for 2005, which are aimed at sustaining economic growth and reducing poverty. These policies form the basis for a new three-year Fund-supported program under a PRGF arrangement.

2. The new program will build on the substantial progress already achieved under the PRGF-supported arrangement that expired on December 31, 2004. The focus will be on maintaining macroeconomic stability with prudent monetary and fiscal policies and financial sector reforms. Fiscal reforms are critical to mobilize additional domestic resources to finance growth-enhancing investment and pro-poor programs while financial sector reforms are important to increase financial intermediation and support growth of the private sector.

3. This Memorandum presents a brief summary of developments under the government's 2001–04 program, outlines the medium-term objectives and policy framework for 2005–08, and sets out specific economic and financial policies for 2005. We have reached understandings with Fund staff on a set of macroeconomic targets and structural benchmarks for 2005 (Tables 1 and 2), which are specified in the attached Technical Memorandum of Understanding (TMU). Policies described in the Memorandum are consistent with our Poverty Reduction Strategy Paper (PRSP), the government's Medium-Term Expenditure Framework for 2005-08, and the 2005 budget as passed by parliament in late December.

II. Economic Performance in 2001–04

4. We made notable improvements in economic policy implementation under the recent PRGF-supported arrangement. With the assistance of the international community, including the Fund, we implemented prudent policies and pushed ahead with structural reforms, which contributed to macroeconomic stability, consistently high growth, and significant reductions in poverty. In fact, with financial support and technical assistance from the Fund and the rest of the donor community, we were very successful in attaining the program's broad objectives as outlined in our April 2001 memorandum to the Managing Director. In most key areas, we achieved outcomes that were better than initially targeted. We plan to revise the main indicators of the medium-term macroeconomic and fiscal framework as well as poverty indicators by end-2005 as part of the PRSP update.[9]

[9] We adopted the PRSP in August 2003, and drafted our first annual Progress Report covering the period August 2003 to December 2004, which is posted on the government's website (http://www.mfe.am).

5. Economic growth averaged nearly 12 percent over the period 2001-04 and the poverty rate declined from 55 percent in 1999 to 43 percent in 2003, compared with the PRSP target for the latter of 46 percent in 2003. The reduction in extreme poverty during this period was even more significant, falling from 23 percent to around 7 percent, compared with the PRSP target of 15 percent by 2003. Growth was broad based and supported by private and public investment, which was in turn financed by grants, concessional lending, and remittances from Armenians living abroad. Inflation averaged about 4 percent over the same period reflecting a prudent monetary stance and flexible exchange rate regime. The balance of payments improved and official gross reserves reached 4 months of import coverage at end-2004. External debt indicators improved, with the debt-to-exports ratio declining from 132 percent in 2001 to 74 percent in 2004 in net present value terms.

6. Fiscal consolidation was a central part of our strategy under the previous three-year program and contributed to our macroeconomic performance. The overall fiscal deficit was reduced from 6.4 percent of GDP in 2000 to 1.7 percent of GDP in 2004. Most of the consolidation was achieved through expenditure compression as progress with revenue mobilization was limited. Total expenditures were reduced by 3.4 percent of GDP during 2001-04, while tax revenues declined slightly as a share of GDP due to decreases in collections of taxes on profits and income. During the period, the Central Bank of Armenia (CBA) enhanced its implementation of monetary policy by the adoption of indirect instruments; improvements in the treasury bill market; and the use of open market operations to enhance liquidity management.

7. More recently, we have made important progress in ***fiscal structural reforms.*** Achievements included reducing access to the simplified tax, reducing the stock of VAT refund arrears, and publishing the names of the 300 largest taxpayers. A special division responsible for tax arrears collection was created and a law was passed giving authorization to the STS to write-off unrecoverable tax arrears. The large taxpayers unit (LTU) of the State Tax Service (STS) was merged with its central audit department, and the collection function of the State Fund of Social Insurance (SFSI) was moved to the STS, the latter already showing improved performance. Decrees were passed setting the selection criteria for tax audits, and lengthening the time for the conduct of audits to a maximum of 45 days, although this still is not enough time to conduct thorough audits. Parliament was presented with a VAT deferral law which included setting a maximum limit for the time when VAT comes due after goods cross the border, and an electronic signature law needed for trader self-input systems was passed. For the first time, an annex on expenditures of non-commercial organizations (NCOs) was included in the 2005 budget law. We have also made progress in enhancing Customs administration. We have increased the share of transactions for which customs duties are assessed according to transaction prices to 61 percent in 2004. The post-clearance verification unit is now operational and is generating additional revenues.

8. ***Banking system reforms*** have continued to progress, although progress in creditor rights has been slower than envisaged. The CBA amended its system of risk weights, making it consistent with Basel Committee recommendations under the standardized approach and

tightened related-party exposure and large exposure limits. The CBA also terminated its administration of Armcommunications Bank following capital injection from the new owners. To strengthen creditor rights, the government has been amending legislation on secured credit and simplifying procedures for registration of pledges, supported by the World Bank. In particular, an amendment to the Law on the Registration of Pledges of Moveable Property was passed to bring rules for the registration of pledges in line with the recommendations of the technical assistance provided by the World Bank. We have established a Financial Intelligence Unit aimed at combating money laundering and the financing of terrorism. Finally, the CBA has brought micro credit institutions into the supervisory framework.

9. We made good progress on the remaining structural reform agenda, which concentrated on reducing quasi-fiscal deficits (mainly in the energy sector), and enhancing governance. In the ***energy sector***, we have achieved a major turnaround in the financial situation, with its primary balance turning from deficit to surplus and tax obligations being fulfilled in a timely manner. Our success in this sector has been driven through privatization, the development of corporate governance structures, as well as an appropriate regulatory framework. The financial performance of the water and irrigation sectors has also shown a trend of improvement, owing to tariff increases and better collection.

10. Since the adoption of ***anti-corruption strategy*** in 2003, we have made progress on the action plan especially in the legislative area. Working groups were established in 2004 with broad participation across governmental agencies and a strong presence of non-government organizations to begin to address corruption in different sectors. In addition, liaison offices were set up in line ministries. Other reforms carried out to improve governance included the simplification of licensing procedures, civil service reform, adoption of a new criminal code, and more widespread dissemination of laws and regulations.

11. Despite significant progress, we recognize that the reform agenda remains incomplete, and we will be working to move forward in these areas. In the area of tax policy and tax and customs administration, the two-year program of priority reforms needs to be finalized, and the time to conduct audits will need to be further lengthened for effective tax audits. The use of risk-based approaches in the areas of audits, arrears collection, and VAT refunds will need further technical assistance before its successful implementation. We have passed legislation to regulate the use of cash registers but have decided to delay implementation until December 2005 following consultation with small traders. We are acutely aware that we need to build institutional capacity in these areas to make significant progress in tax and customs collections. In addition, we will strengthen financial sector development in order to support growth of the private sector.

III. PROGRAM OBJECTIVES AND STRATEGY FOR 2005–08

12. The new program builds on our past achievements and our strategy to implement the PRSP, and will seek to address the remaining reform agenda. It aims to further consolidate

macroeconomic stability, achieve more broad-based growth, and reduce unemployment and poverty.

13. Continued sound macroeconomic policies and effective implementation of structural reforms would support real growth rates of at least 6 percent in the medium-term. Growth will be increasingly supported by strong private investment, and public investment aimed primarily at strengthening infrastructure. Monetary policy will aim to contain annual inflation to 3 percent. The fiscal deficit is projected to remain generally below 3 percent of GDP, but is not expected to fall much lower as social and infrastructure needs remain important and expenditure execution improves. The share of social expenditure (including health, education, and social security) is envisaged to increase from 5.5 percent of GDP in 2004 to 7.0–7.5 percent in 2008. These policies will go a long way towards achieving a further reduction in the poverty rate to around 30 percent by 2008—a key objective of the PRSP. The external current account deficit will gradually decline to about 5 percent of GDP in 2008 with import growth remaining buoyant reflecting strong demand for imported capital and intermediate goods needed to support growth. External debt ratios are projected to continue to fall to about 60 percent of exports by 2008 in present value terms.

14. The program will focus on five policy challenges, namely:

- maintaining macroeconomic stability by implementing prudent monetary and fiscal policies, particularly during a period of large capital inflows in the presence of underdeveloped financial markets.
- raising tax revenue by strengthening tax and customs administrations, and tax policy reforms,
- improving budgetary expenditure management to link the budgetary process more closely with the PRSP priorities,
- fostering financial intermediation by strengthening supervision of financial institutions and improving corporate governance, and
- improving governance by increasing transparency and reducing rent-seeking opportunities, with a view towards bringing the shadow economy to the formal economy.

15. The program's fiscal objectives will focus on reigning in potential demand pressures as private demand picks up over the medium term. On the revenue side, raising domestic resources in a transparent and non-discretionary manner will be a primary objective of the program, not only to create a business environment conducive to economic activity, but also to create a tax base that will become more important as aid flows diminish over the medium term. On the expenditure side, implementing PRSP objectives in the social sector will be accorded high priority. Strengthening infrastructure, especially in the rural areas, will also be important to allow for broad-based growth.

IV. The 2005 Program

16. The principal goal of the 2005 program is to achieve a significant increase in tax revenues in a stable macroeconomic environment, with growth targeted at about 8 percent and consumer price inflation at 3 percent.

A. Fiscal Policy

17. The **2005 budget** aims for a deficit of AMD 49.3 billion (2.3 percent of GDP), which includes AMD 12.5 billion (0.6 percent of GDP) of privatization fees as nontax revenues.[10]. Tax revenues and total expenditures are budgeted to increase by 0.6 percent of GDP (to AMD 310 billion) and 1.4 percent of GDP (to AMD 394.6 billion), respectively relative to 2004 outturn. The budget does not include any potential disbursements from the Millennium Challenge Account (MCA). In the event of disbursements in 2005, a supplementary budget would be passed to allocate all funds from the MCA to additional capital expenditure.

18. The increase in tax revenue hinges on improving tax and customs administration. We recognize that the tax target is ambitious but are confident that it will be achieved given the tax policy and administration measures recently implemented. Indeed, there are initial indications that these measures are already yielding notable results, with tax collections increasing by 24 percent in January and February 2005 relative to the same period in 2004. Nevertheless, should there be a revenue shortfall during the year, we will adjust expenditures accordingly to meet the overall budget target. The targets for the second half of the year may be adjusted if GDP developments during the first half of the year lead to a change in the annual projection.

19. On the expenditure side, the budget allocates significant increases to social and capital expenditures. This increase provides for a catch-up relative to the PRSP targets. Specifically, health spending is budgeted to increase from an outturn of 1.3 percent of GDP in 2004 to 1.5 percent of GDP, education spending is budgeted to increase from 2.3 to 2.7 percent of GDP, and social security spending is budgeted to increase from 1.9 to 2.2 percent of GDP. Given the large increases envisaged, we will be particularly vigilant regarding expenditure efficiency.

20. We are considering passing a supplementary budget to finance an increase in capital expenditure on road and school construction by AMD 4-5 billion. If we decide on a supplementary budget, the additional spending will be financed by additional tax revenue and reallocation of existing expenditures, thereby keeping the overall fiscal deficit for 2005 unchanged. We will not use the funds in the Special Privatization Account to finance additional spending in 2005. We recognize the need for contingency measures in the event of

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[10] In IMF classification, the overall deficit is AMD 61.8 billion (2.9 percent of GDP) as the privatization receipt is classified as a financing item.

a revenue shortfall during the year. Specifically, we will authorize expenditures beyond the plans for the original budget only insofar as tax revenues beyond those envisaged in the original budget accrue during the year.

B. Monetary and Exchange Rate Policy

21. Price stability will continue to be the main objective of monetary policy. The CBA will aim at an inflation target of 3 percent for 2005. Base and broad money are projected to grow by 14.0 and 18.5 percent, respectively. The CBA will limit its intervention in the foreign exchange market to smoothing out excessive volatility in the exchange rate. To further enhance the coordination between fiscal and monetary policy management, the Ministry of Finance and Economy (MFE) and CBA have agreed a mechanism to support the CBA's efforts to enhance its liquidity management capacity and to develop the domestic government debt market. The government will increase the intra-year issuance of government securities by at least AMD 15 billion, and the proceeds will subsequently be deposited and maintained in its accounts at the CBA. The CBA will pay the interest cost for the above issuance. To ensure adequate instruments for flexible money-market operations, the MFE and CBA have also agreed that the CBA issue its own securities as needed. The MFE and CBA will revisit, as necessary, the arrangement regarding government securities with a view to ensuring adequate instruments for macroeconomic stability. In view of the rapid expansion of credit to the economy, the CBA will monitor lending practices and the quality of loan portfolios.

C. Structural Policies

22. We will pursue an ambitious structural reform agenda that focuses on fiscal and financial sector reforms. We will work closely with the World Bank on reforms in energy, water, and irrigation sectors, among others.

Fiscal reforms

23. The centerpiece of the program will be reforms in tax policy and tax and customs administration. We have finalized a two-year action plan, that is closely in line with IMF Fiscal Affairs Department recommendations, and which was approved by the government. We will establish a High Level Working Group on Revenue Mobilization to enhance inter-agency coordination and revenue mobilization, and coordinate the implementation of the action plan. Specific measures that we intend to take in 2005 are discussed below.

24. Our **tax policy** measures aim to broaden the tax base without raising rates:

- We are committed to strengthening the VAT chain of credits. Effective 2006, VAT exemptions at the border will be further restricted. Imports of the re-export sectors (diamond and gold) will be covered by the temporary import-export regime; and gas will continue to be taxed at the first point of sale. Of the remaining 234 exempted lines, 139 exemptions will be abolished. Based on the total import value during

2004, we will remove a minimum of AMD 35 billion. In line with IMF technical assistance, we will introduce a pilot capital deferral system. On an interim basis, some VAT exemptions will remain on certain capital goods. We intend to eliminate these exemptions to capital deferral system when it becomes fully operational. A small number of exemptions will remain, but they will be restricted to import lines in the areas of agriculture, health, newsprint, and other political and socially sensitive goods. No further VAT exemptions will be introduced.

- We will introduce a time limit after which VAT must be paid under the capital deferral system, effective 2006.

- In January 2006, we will abolish the presumptive social security payment for simplified taxpayers, and incorporate them into the regular social security tax payments system.

25. Additional tax policy measures that we are considering implementing over the medium term include the finalization of a unified tax code; and moving large-scale operations from the presumptive tax to the VAT. Also, we plan to allow the current profit tax exemptions for large foreign investments to lapse in 2007 as stipulated in the law.

26. In **tax administration**, we will focus in 2005 on improving tax audits, tax arrears collection, and the VAT refund mechanism. We will continue to press ahead with improvements in the STS's structure, management, and procedures. In this context, we intend to implement the following measures:

- improve the STS's ability to conduct audits by passing a separate law on tax audits, including provisions that specifically permit off-site audits and several types of audits at a time; extend the time limit for budget audits of large enterprises to at least 3 months; and extend the time limit for drafting the audit report to at least 3 weeks. To avoid the harassment of taxpayers, more detailed justifications for audits will be required, and all visits to taxpayers will have to be filed by the inspectors as proper audits,

- finalize, in consultation with Fund staff, a plan for the collection of tax arrears with specific targets by inspectorate with a view to collecting arrears or writing off the unrecoverable part of the end-2004 stock of tax arrears by the end of 2006; we intend to collect at least AMD 4 billion in tax arrears in 2005,

- implement an annual audit plan for large enterprises based on risk-classification and specifying priorities and targets, with a view to move to fully automatic risk-based audit selection for all enterprises at the beginning of 2006,

- repay at least AMD 4 billion of the stock in VAT refund arrears owed to exporters at the end of 2004 and ensure that no new arrears are incurred in 2005 on a monthly basis. Furthermore, we are working on a fully automatic system for VAT refunds, including accompanying legislation that excludes expenses particularly prone to fraud from refund eligibility,

- improve the information sharing between the STS and the SCC, potentially including through a partly shared IT system, to increase combined revenue collection,

- establish an IT strategy plan for the STS, specifying the requirements particularly in the context of (i) risk-based selection criteria in the areas of audits, arrears collection, and VAT refund processing, and (ii) improving resource efficiency by better information sharing between the regional tax inspectorates and the various headquarter functions. Based on this plan, we will seek donor support and allocate own resources to IT improvements. We also aim at better utilization of existing IT, and

- strengthen the capacity of the LTU. We will introduce a rotation system for inspectors in the LTU to prevent collusion with taxpayers. We are reorganizing the LTU along sectoral lines to maximize revenues.

27. To improve the functioning of **customs administration**, we intend to:

- agree with IMF and World Bank staffs, by June 2005, the terms of reference for an operational review of the State Customs Committee to be conducted by a specialized international company.

- increase the share of the number of declarations of imports (taxable at the border under ad valorem taxes), for which the approved customs value is determined on the basis of declared transaction prices by 5 percentage points in 2005. This will be confirmed by reports obtained directly from the ASYCUDA system. Progress in this area will be confirmed during the year by quarterly reports published on the State Customs Committee's website,

- accelerate the move to self-assessment of importers, including through electronic declarations by direct trader input, building on the system recently installed. We aim to increase the share of imports processed through the direct input system. We will report on end-June information by July 2005 on the efforts we have undertaken to encourage the use of direct trader input. Such reports will also include information on the use of the direct trader input system, including the number of traders registered, the number of declarations processed by this method, and the total number of declarations. In addition, given the recent passage of the Law on Electronic Signatures, we will advertise in the mass media the opportunity this creates in allowing direct input by traders from remote locations,

- expand the use of the examination selectivity module in ASYCUDA to all customs houses by December 2005. Refine the selectivity criteria used to reduce progressively the share of import consignments, especially those from low-risk countries, selected for physical examination. We will monitor the progress made towards this goal and report, on a quarterly basis, the number and percentage of declarations selected for examination, and,

- strengthen further the operations of the internal audit unit and the post-clearance verification audit unit and continue the regular preparation of audit reports. We will also develop, by August 2005, a plan for post clearance verification audits and will report regularly on progress against the plan.

28. We recognize the importance of better targeting of government **expenditures** to ensure adequate public investment and social spending and high expenditure quality. Improvements in this area will be even more crucial against the background of the expenditure increases envisaged for 2005 and the medium-term. In this regard, we plan to:

- improve the consistency of the annual and quarterly budgets with the actual outturns by measures to raise expenditure execution, particularly in the first half of the year. We will improve the procurement and bidding process, particularly regarding the cooperation between the MFE and the line ministries, possibly by introducing a computerized procurement network system,

- prepare a public investment plan (PIP) to improve strategic planning of capital expenditure, and improve the GFS compliance of the classification of capital expenditure,

- monitor closely recent decentralization measures and capacity building. A large portion of Armenia's social spending is now channeled through government-owned noncommercial organizations (NCOs). Specifically, we will implement the action plan for improving the monitoring system, encompassing staff recruitment, software development, training, and legislative change, and will seek donor support,

- press ahead with the Accounting and Second Generation Treasury Reform (A2GTR) project and will specifically assign MFE staff to this project,

- seek agreement with donors on the strategy paper on an internal audit unit in the MFE and will subsequently begin with its creation and assignment of staff, and

- conduct an external audit of the State Fund of Social Insurance (SFSI).

Financial sector reform

29. We recognize the importance of improving further confidence in the banking system in order to foster financial intermediation. In this context, the CBA intends to strengthen **banking supervision.** We continue to work to build the preconditions for risk-based supervision, including: risk-rating process; greater focus on bank management; and increased emphasis on banks' internal policies, controls and business strategies. The supervisory

authorities covering banking, insurance, and the securities market will enter into bilateral or multilateral memoranda of understanding for information sharing. We will also submit to Parliament, by end-June, an amendment to the Law on Banks and Banking to empower it to identify the ultimate beneficial owners of banks, in the event of upward consolidation. We expect the law to be passed by the end of 2005. We also intend to submit to Parliament an amendment to the Law on Banks and Banking that requires external auditors of commercial banks to enter into tri-party agreements to report to the CBA issues of material importance arising from their audits, including on unsound operations and mismanagement. The amendment should empower the CBA to have access to the information from the external audits. We expect the amendment to be passed by December 2005.

30. With a view to encouraging **banking sector consolidation** and new shareholder entry, we will proceed with a planned increase in minimum capital requirements to US$5 million effective July 1, 2005, with eligible capital to remain as is currently defined. Banks that fail to meet the minimum capital requirement will be promptly liquidated or converted into nonbank credit institutions.

31. We plan to address key weaknesses in **corporate governance of banks**. We will clarify in law the definition and separation of duties and rights of shareholders, boards of directors, and executives. Duties of boards of directors should include (i) responsibility for the safe and sound operation of the institution; (ii) being informed of their banks' operating condition, in part through ensuring adequate external and internal audit process; and (iii) providing accurate reporting to the public and the CBA. Furthermore, to improve the **credit culture**, we will continue the work on enhancing creditors' rights, including streamlining court procedures and improving the registration system for secured lending.

32. We also plan to develop the non-bank financial sector by creating an appropriate supervisory and regulatory framework. In the insurance sector, we plan to implement regulations to improve accounting, auditing, and financial reporting; solvency and reserves; and oversight of insurance. With regard to the pension system, we are considering a funded system that would balance competing objectives of raising current pensions and diverting resources to individual accounts while maintaining fiscal sustainability. As a first step, we will carry out extensive actuarial projections on various reform options before determining the optimal approach. With regard to the mortgage market, we will focus on the development of the primary mortgage market to promote housing for moderate and low income households. Before going forward, we will evaluate the costs and benefits of a liquidity facility targeted to this segment of the population to provide a basis for the extent of government support.

V. Other Structural Reforms

33. We are committed firmly to following through on our efforts to improve **governance** and reduce corruption. We will continue to implement the anti-corruption strategy action plan, and focus more on monitoring law enforcement and raising public awareness and participation. As an important step, we will expand the coverage of the law on financial

disclosure by public officials. We will also work with international donors to resolve financial and human resource constraints in combating corruption.

34. We will build on our success in the **energy sector** and address the remaining issues. With the assistance of the World Bank, we intend to audit Armenergo's balance sheet for 2004, followed by the creation of a liquidation commission, with the aim to complete the liquidation process in a transparent way by end-2005. To ensure the proper functioning of, and transparency in, the energy sector, the Public Service Regulatory Commission plans to pass resolutions on audit procedures for power sector entities, and market rules including power export model contracts, and dispatching relationships between the system operator and other entities of the system. We will also work closely with the World Bank to improve further energy sector corporate governance, including by setting up independent boards of directors for the remaining state owned energy sector enterprises. To further reduce the losses of the water and irrigation sector, we will continue to increase the collection ratio and raise tariffs along the lines of the Integrated Financial Rehabilitation Plan, with the aim of reaching operations and maintenance cost recovery level by 2007. In the meantime, we will try to minimize the impact of tariff increases on the poor through targeted support.

V. PROGRAM MONITORING

35. Progress in implementing the program will be monitored through quantitative performance criteria and indicative targets set forth in the attached Table 1 as well as structural performance criteria and benchmarks as listed in Table 2. The TMU attached to this Memorandum defines the quantitative targets of Table 1, the program adjustors, and specifies reporting requirements. Semiannual performance criteria will be monitored under two reviews. The quantitative targets include floors on tax revenues of the central government and social contributions (see Table 1). There will be two structural performance criteria on submission to Parliament of an amendment to the Law on Banks and Banking, one relating to strengthening banking supervision, and the other to improving corporate governance (see Table 2). There will also be two prior actions, one relating to the finalization of an action plan for reforms of tax policy and customs administration, and one relating to the publication of the list of names of the 300 largest taxpayers.

Table 1. Armenia: Quantitative Targets, 2004–2005 1/
(End of period ceilings on stocks, unless otherwise specified)

	2004	2005			
	Dec.	Mar.	Jun.	Sept.	Dec.
	Act.	Est.	Prog. 2/	Prog. 3/	Prog. 2/
		(in billions of drams)			
Net domestic assets of the CBA 4/	-21.6	-52.7	-53.8	-41.9	-28.1
Net banking system credit to the government	-17.2	-36.5	-17.2	-8.0	-6.3
Domestic arrears of the central government and the State Fund for Social Insurance	0.0	0.0	0.0	0.0	0.0
Tax revenues of the central government (floor) 5/	266.7	64.1	137.3	220.7	310.0
Balance of the central government on a cash basis (floor) 5/	-31.6	2.9	-25.0	-49.1	-61.8
Reserve money (band/level) 3/	132.0	123.6	(122-127)	(129-134)	(148-154)
Contributions to the State Fund for Social Insurance 3/ 5/	48.8	13.9	29.8	46.4	64.8
		(in millions of dollars)			
Contracting or guaranteeing of new nonconcessional external debt 5/ 6/	0	0	0	0	0
External arrears (continuous criterion)	0	0	0	0	0
Net official international reserves (floor)	330.1	375.5	379.0	373.3	389.2

1/ All items as defined in the Technical Memorandum of Understanding.
2/ Performance criterion.
3/ Indicative target.
4/ NDA valued at program exchange rate (500 dram per U.S. dollar).
5/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.
6/ Includes debt with maturity of more than a year as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

Table 2. Structural Measures for Fiscal and Financial Sector Reform in 2005

Measure	Type of Conditionality	Target Date (End of Period)
Tax policy		
Submit to parliament an amendment to the VAT law to become effective January 1, 2006, that will reduce the list of goods exempt from VAT payment at the border as specified in paragraph 24 of the MEFP and introduce a time limit after which VAT must be paid under the capital deferral system, both effective 2006.	Structural Benchmark	June 2005
Tax administration		
Finalize, in consultation with Fund staff, an action plan for 2005-06 approved by the government, with a timeline for reforms of tax policy and tax and customs administration that are closely in line with Fund technical assistance reports.	Prior Action	
Publish the names of the 300 largest taxpayers.	Prior Action	
Improve the STS's ability to conduct audits by passing a law on tax audits, including provisions to: permit off-site audits and several types of audits at a time; extend the time limit for budget audits of large enterprises to at least 3 months; and, extend the time limit for drafting the audit report to at least 3 weeks.	Structural Benchmark	June 2005
Approve an annual audit plan for large enterprises based on risk-classification and specifying priorities and targets.	Structural Benchmark	December 2005
Customs administration		
Agree on the terms of reference for an operational review of the State Customs Committee by a specialized international company in preparation for tender.	Structural Benchmark	June 2005
Increase by 5 percentage points the share of the number of declarations of imports for which the approved customs value is determined on the basis of declared transaction prices.	Structural Benchmark	December 2005
Financial Sector		
(i) Submit to Parliament an amendment to the Law on Banks and Banking to empower the CBA to identify ultimate beneficial owners, in the event of upward consolidation; and (ii) pass the amendment.	(i) Structural Performance Criterion (ii) Structural Benchmark	(i) June 2005 (ii) December 2005
(i) Submit to Parliament an amendment to the Law on Banks and Banking that defines the separate duties and rights of shareholders, boards of directors, and executives of banks; requires disclosure of potential conflicts of interest of board members; and requires public disclosure of information on ownership and control of banks, including list of founders and copies of the company's statues; and (ii) pass the amendment.	(i) Structural Performance Criterion (ii) Structural Benchmark	(i) June 2005 (ii) December 2005

GOVERNMENT OF ARMENIA
TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the benchmarks, performance criteria, indicative targets, adjustors, and reporting modalities referred to in the Memorandum of Economic and Financial Policies (MEFP).

I. Quantitative Targets

1. The program targets a minimum level of **net official international reserves (NIR)** of the Central Bank of Armenia (CBA). The stock of such reserves will be calculated as the difference between total official gross international reserves and official gross reserve liabilities. Total gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral or in swaps), holdings of Special Drawing Rights (SDRs), any reserve position in the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). Gross reserves held in the form of securities and other financial instruments are marked to market. Gross reserves are reported separate from the balance on the government's Special Privatization Account (SPA) and exclude capital subscriptions in foreign financial institutions and illiquid foreign assets. Official reserve liabilities shall be defined as outstanding liabilities to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year. NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the exchange rates as specified in Attachment III, Table 1.

2. The program targets a maximum level of **net domestic assets (NDA)** of the CBA. For program purposes, NDA is defined as reserve money minus NIR plus medium- and long-term liabilities (i.e. liabilities with a maturity of one year or more) of the CBA. To evaluate program targets, the dram-equivalent values of NIR and medium- and long-term liabilities are calculated at the program exchange rate of dram 500.00 per U.S. dollar. NDA is composed of net CBA credit to the general government; outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money (exclusive of accrued interest), and other items net.

3. **Reserve money** targets are indicative and include a floor and a ceiling. They are subject to a daily bound of plus or minus 2 percent computed from the quarterly average standard deviation of excess reserves held by banks in percent of quarterly reserve money during the previous four years. Reserve money is defined as the sum of currency issued,

required and excess reserves, and current and time deposit accounts of certain resident agents.[11]

4. **The stock of net credit from the CBA to the government** includes the CBA's holdings of treasury bills and treasury bonds less all types of government deposits with the CBA (including deposits of donor-financed project implementation units, the Lincy foundation, and balances of proceeds from the sale of humanitarian assistance). Treasury bonds are valued at the purchase price and excluding accrued interest and treasury bills are valued at the purchase price plus the implicit accrued interest.

5. **Net credit from commercial banks to the government** includes: (1) gross commercial bank credit to the government less government deposits with commercial banks (including the counterpart funds of certain government onlending to the economy financed by the Lincy Foundation and the World Bank); and (2) banks' holdings of treasury bonds (valued at the purchase price and excluding accrued interest) and treasury bills (valued at the purchase price plus the implicit accrued interest). **Net credit of the banking system to the government** is the sum of net credit from the CBA and net credit from commercial banks to the government.

6. **External debt ceilings** apply to all forms of new nonconcessional medium- and long-term external debt[12] with original maturities of more than one year, which are contracted or guaranteed by the government or the CBA or any other agency acting on behalf of the government. It does include debt with maturity of one year or less. Excluded from the limits are changes in indebtedness resulting from refinancing credits or rescheduling operations, sales of treasury bills or treasury bonds to nonresidents (provided the sales go through the regular auction mechanism and involve no exchange rate guarantees), concessional loans, and credits extended by the IMF.[13] Except for normal import-related credits, there is a zero limit on short-term external debt (obligations with original maturities of up to one year) contracted or guaranteed by the government or the CBA. Transactions subject to debt ceilings shall be valued in the contracted currencies and converted into U.S. dollars at the average monthly market exchange rate in the month when the commitment was contracted.

[11] Liquidity absorbing transactions under reverse repurchase agreements, the CBA's deposit facility, and foreign currency swaps are netted out from claims on banks, i.e., they are excluded from the reserve money definition.

[12] The term "debt" shall have the meaning set forth in Section 9(a) of the Guidelines on performance criteria on external debt, as modified by the Executive Board Decision No. 12274-(00/85) of August 24, 2000.

[13] For program purposes, a loan is considered concessional if the grant element is at least 35 percent calculated using a discount factor based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the loan maturity. The margins are: 0.75 percent for repayment periods of less than 15 years, 1 percent for 15–19 years, 1.15 percent for 20–29 years, and 1.25 percent for 30 years or more. The average of the CIRRs over the last ten years will be used for loans with a maturity of at least 15 years and the average of the CIRRs for the preceding six months will be used for shorter maturities.

7. **External arrears** will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed including unpaid penalties or interest charges associated with these arrears.

8. **Balance of the central government on a cash basis** is defined as the sum of domestic banking system net financing, domestic nonbank net financing, and external net financing to the government. **Net banking system credit to the government** equals the change during the period of net credit to the government. **Nonbank net financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[14] and (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the special privatization account or the treasury subaccount containing privatization proceeds in dram, less amortizations made by the central government to private resident nonbank agents. **External net financing** equals total debt-increasing disbursements from non-residents to the central government less total amortizations from the central government to non-residents. All foreign-currency denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

9. The project implementation units, which carry out projects financed by the US-based Lincy Foundation, maintain accounts at the CBA. These grants are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed capital expenditure on the expenditure side. In addition, any loans extended by the US-based Lincy foundation to finance investments and that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending.

10. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The account is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any budgeted withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Any unanticipated withdrawal from the SPA will be recorded below the line as privatization receipts; these withdrawals, however, will be replenished during the same fiscal year. Domestic currency proceeds from selling enterprises to residents are deposited in a subaccount of the treasury single account.

11. **Tax revenues** of the central government are defined in accordance with Government Financial Statistics (GFS), 1986, section IV.A.1. Total revenues collected by the State Tax

[14] Domestic nonbank holdings of treasury bills and treasury bonds are defined as total outstanding treasury bills and bonds less holdings by the banking system and the SFSI.

Service (STS) and the Customs Committee (CC) are classified as follows: VAT (of which: presumptive tax on cigarettes, petroleum, and diesel), excises (of which: presumptive tax on cigarettes, petroleum, and diesel), enterprise profit tax, personal income tax, land tax, customs duties (of which: presumptive tax on cigarettes), other presumptive taxes, simplified tax, property tax, and other taxes (of which stamp duties and environmental taxes). **Payroll contributions to the State Fund for Social Insurance (SFSI)** are not included in tax revenue. For evaluating the performance criterion on tax collection, recorded tax revenues will exclude any tax payment related to non-programmed transfer, loan, or recapitalization operation carried out with state-owned companies or any VAT refunds in arrears.

12. The program targets ceilings for the stock of **domestic arrears of the central government and the State Fund for Social Insurance** (SFSI). Domestic arrears are defined as follows. With respect to wages, contributions to the pension fund, family allowances, and amortization and domestic interest payments, the stock of arrears is defined as all unpaid claims outstanding at the end of the month. This excludes technical arrears of up to AMD 0.5 billion that could arise because of minor delays in the execution of these expenditures. For all other expenditure categories, arrears are defined as the stock of unpaid claims, as verified by the recipient of the goods and services, which has been outstanding for more than 30 days as of the end of the month. However, at year-end all outstanding claims must be settled as required in the budget law.

II. ADJUSTERS

13. The quantitative performance criteria and benchmarks under the program are subject to the following adjusters:

- **Foreign-financed project loan disbursements:** the target on the cash balance of the central government will be adjusted downward (upward) by the full amount of cumulative higher (lower) than programmed foreign-financed project disbursements. The programmed amounts are shown in Table 2 below.

- **World Bank budget support:** the following targets will be adjusted by the full amount of lower than programmed World Bank direct budget support: NIR (downward), NDA of the CBA (upward), and net credit to the government (upward). The programmed amount is shown in Table 3 below.

- **KfW loan disbursements**: the target on the NDA of the CBA will be adjusted upward (downward) by the full amount of any non-programmed disbursement (repayment) from (to) KfW. The adjustment will be made at program exchange rates. The programmed amount is shown in Table 4 below.

III. PRIOR ACTIONS, STRUCTURAL PERFORMANCE CRITERIA, BENCHMARKS, ND OTHER MEASURES

14. **Changes to the VAT law** (Structural Benchmark). See Paragraph 24 of the MEFP. Only the following currently exempt import lines will be moved to the capital deferral system: 8426, 8429, 8443, 8452, 8453, 8484, 8485, 8475, 8478, 8479, 8532, 8533, 8534, 8541, 8542, and 8545.

15. **Action plan** (Prior Action). The plan will contain a timeline for the implementation of a set of measures over 2005-2006 in the areas of tax policy and tax and customs administration in line with technical assistance recommendations of the IMF Fiscal Affairs Department. The plan will be prepared jointly by the Ministry of Finance and Economy, the State Tax Service, and the State Customs Committee in consultation with Fund staff. Subsequently, it will be approved by the government.

16. **Largest taxpayers** (Prior Action). The names of the 300 largest taxpayers will be published on a regular basis in the mass media.

17. **Law on tax audits** (Structural Benchmark). See Paragraph 26 of the MEFP.

18. **Audit plan** (Structural Benchmark). An audit plan for large enterprises with headquarters setting numerical targets for regional offices in terms of the economic sectors and types of taxpayers that are to be audited, as well as for the types of audits (partial audits, advisory visits, and VAT refunds examinations). The plan will be prepared on an annual basis with quarterly reporting and midterm reviews and with emphasis on partial audits. Comprehensive audits should be used only for high risk tax payers or when partial audits reveal serious underpayment of tax liabilities. The plan will be based on risk analysis and will be prepared with a view to extend it in 2006 to an encompassing audit plan.

19. **Operational Review of the State Customs Committee (SCC)** (Structural benchmark). Agree with IMF and World Bank staffs, by June 2005, the terms of reference for an operational review of the SCC to be conducted by a specialized international company. The broad objectives of the review should be to: i) assess the operational efficiency of customs processes, including in comparison with other similar countries; ii) identify any capacity constraints and shortcomings in administration, which hamper revenue collection; iii) recommend specific reforms aimed at enhancing operational efficiency and revenue mobilization; and iv) in so doing, identify priority areas for further technical assistance.

20. **Valuation of imports at declared transaction prices** (Structural benchmark). On the basis of reports obtained directly from the ASYCUDA system, demonstrate an increase of 5 percentage points, over 2004, in the number of declarations of imports (taxable at the border under ad valorem taxes), for which customs value is determined on the basis of the declared transaction price. Progress during the year will be reported quarterly, also on the basis of reports obtained directly from the ASYCUDA system. To support the use of

transaction prices, the customs valuation database will be published, and kept up to date, on the SCC website.

21. **Self-assessment of importers**. The report, to be prepared by July 2005, on the basis of end June information, will outline the specific actions undertaken by the government to encourage the use of direct trader input. The report will also provide the following data, on a quarterly basis, relating to the use of the direct trader system, namely: i) the number of traders registered; ii) the number of declarations processed by the direct trader method; iii) the total number of declarations processed; iv) the value of the declarations processed by the direct trader method; and v) the total value of declarations processed. Advertisements will be placed in the mass media to outline the opportunity the new law on [Electronic Signatures] provides in allowing direct input by traders from remote locations.

22. **Customs examination selectivity**. Reports will be provided quarterly, within 45 days of the end of each quarter, on the number and percentage of customs declarations selected for inspection, by country and selectivity lines. The reports will also outline progress towards the expansion of the examination selectivity module in ASYCUDA to all customs houses.

23. **Law on the Banks and Banking.** An amendment to the Law on the Banks and Banking will be submitted to the Parliament by end June 2005 (Structural Performance Criterion). The amendment will clearly stipulate that, in the event of upward consolidation, the CBA is empowered to identify beneficial owners on a chain of ownership as far as the CBA sees appropriate for supervisory purpose. The amendment will be passed by the Parliament by end-2005 (Structural Benchmark).

24. **Law on the Banks and Banking.** The amendment on the Law on Banks and Banking will define the separate duties and rights of shareholders, boards of directors, and executives of banks, notably the board of directors' responsibility for the safe and sound operation of the institution and reporting; require the disclosure of potential conflicts of interest of board members; and require the public disclosure of information on ownership and control of banks, including list of founders and copies of the bank's statues. Its submission to Parliament will be a Structural Performance Criterion for end-June 2005. The amendment will be passed by the Parliament by end-2005 (Structural Benchmark). The amendment will be in line with the concept note on corporate governance of banks prepared by the CBA.

IV. DATA REPORTING

25. The government will provide the IMF the information specified in the following table.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA[15]	CBA balance sheet	Summary	Weekly	Within 1 day of the end of each week
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank and the consolidated balance sheet of commercial banks at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within 21 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Weekly	Within 1 day of the end of each week
		By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Monthly	Within 21 days of the end of each month
	Foreign exchange market	Official exchange rates (buying and selling); interbank turnover; and volume of CBA interventions, including foreign exchange swaps	Weekly	Within 1 day of the end of each week
	Interest rates	Repo rate; interbank rate; by volume and maturity, T-bill rate, bond yield; and by maturity, deposit and lending rates	Monthly	Within 7 days of the end of each month
	CBA operations	Repo (reverse repo) operations; Lombard credits; and deposit facility	Monthly	Within 7 days of the end of each month
	Bank liquidity	Reserves and excess reserves	Biweekly	Within 7 days of the end of each month
	Special privatization account (SPA)	Monthly flows	Monthly	Within 7 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms (Tables 5 and 6)	Quarterly	Within 30 days of the end of each quarter
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each

[15] As defined in CBA resolution No. 201 (December 6, 1999).

				month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
Customs Committee	Report on the operations of the post verification unit	The report will include: information on the number of audits conducted, the number of infractions found, the amounts involved, and remedial measures taken	Quarterly	Within 30 days of the end of each quarter
	Report of the operations of the internal audit unit	The report will include: the number of written appeals, complaints, and requests submitted to the IAUCC; the sources of the written submissions (e.g. President's Office, the Prime Minister's Office, other Government officials, National Assembly, line Ministries, Law Enforcement bodies, individuals, non-government organizations); the IAUCC's actions in response to the written submissions; the number and type of audits/investigations undertaken by the IAUCC; the overall results of the audits/investigations undertaken; and the actions taken by the IAUCC in response to the results of the audits/investigations undertaken	Quarterly	Within 30 days of the end of each quarter
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; and 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices	Quarterly	Within 30 days of the end of each quarter
Ministry of Finance and	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month

Economy (MFE)	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the SFSI, the STS, and the CC, including revenue by individual tax	Monthly	Within 7 days of the end of each month
	Expenditure arrears	Government and SFSI separately (Table 7)	Monthly	Within 20 days of the end of each month for SFSI arrears and within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, pension fund, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget and SFSI	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments 1/	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments 1/	Annual	Within 180 days of the end of each year
MFE/SFSI	Budget execution	All cash receipts, cash expenditures, including debt-service payments, and external and domestic borrowing operations; expenditure data will be provided according to both economic and functional classifications, consistent with the GFS methodology	Monthly	Within one month following the end of each quarter.
NSS	Balance of payments	Detailed export and import data	Monthly	Within 28 days of the end of each month

		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	GDP	Estimates	Monthly	Within 30 days of the end of each month
	CPI	By category	Monthly	Within 5 days of the end of each month
STS	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each month
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day processing period. Number of refund applications processed per month.	Monthly	Within 30 days of the end of each month

1/ Until NCE quarterly data reporting has been established, central government is defined as state budget (budgetary) + SFSI (social security fund). Once NCE quarterly data reporting has been established, central government is defined as state budget (budgetary) + NCEs that belong within the general government (extrabudgetary) + SFSI (social security fund). General government = central government + local governments.

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 30, 2004 for dollars per currency rates. Drams per currency rates are calculated using the 500 drams per U.S. dollar rate)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	389.85	0.779701
Canadian dollar	406.67	0.813334
Swiss franc	441.45	0.882904
Danish krone	91.47	0.182941
Euro	680.40	1.360798
Pound sterling	962.90	1.925799
Japanese yen	4.838	0.009676
Norwegian krone	82.40	0.164807
Swedish krone	75.85	0.151696
U.S. dollar	500.00	1
SDR	791.92	1.583834
Gold 1/	7,129.43	14.25885

1/ Per gram.

Table 2. Armenia: Cumulative Foreign-Financed Project Loan Disbursements 1/
(In billions of drams)

2005			
March	June	September	December
9.5	17.1	26.6	44.2

1/ Cumulative from December 2004, at program exchange rates.

Table 3. Armenia: World Bank Lending1/
(In billions of drams)

2005			
March	June	September	December
0	0	0	10.0

1/ Cumulative from December 2004, at program exchange rates.

Table 4. Armenia: KfW Loan disbursements 1/
(In billions of drams)

2005			
March	June	September	December
0	0	1.5	3

1/ Cumulative from December 2004, at program exchange rates.

ARMENIA: RELATIONS WITH THE FUND
(As of March 31, 2005)

I. **Membership Status:** Joined 05/28/1992; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	92.00	100.00
Fund holdings of currency	93.41	101.53

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	4.35	n.a.

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
PRGF arrangements	135.35	147.12
Systemic transformation	1.41	1.53

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	05/23/2001	12/31/2004	69.00	69.00
ESAF/PRGF	02/14/1996	12/20/1999	109.35	109.35
SBA	06/28/1995	02/14/1996	43.88	13.50

VI. **Projected Obligations to Fund** (SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	19.90	21.18	15.43	17.06	15.19
Charges/interest	0.67	0.54	0.45	0.36	0.28
Total	20.57	21.72	15.88	17.42	15.47

VII. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, the Central Bank of Armenia (CBA) is subject to a full safeguards assessment with respect to the anticipated arrangement. The authorities have provided most of the requested documentation. An on-site assessment of the CBA under the previous arrangement was completed on February 19, 2002 and proposed specific measures to address the weaknesses, as reported in IMF Country Report No. 02/228. The CBA has implemented all the measures recommended.

VIII. **Exchange Rate Arrangement**

(a) On November 22, 1993, the Republic of Armenia introduced its national currency, the dram, at a rate of 200 Armenian rubles per dram. The exchange rate has been allowed to float since then with minimal intervention by the central bank. The official exchange rate is quoted daily as a weighted average of the previous day's interbank exchange rates.

(b) Armenia maintains no exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

IX. **Article IV Consultations**

The 2004 Article IV consultation with Armenia was concluded on December 1, 2004. Armenia is subject to the 24-month consultation cycle.

X. **FSAP Participation and ROSCs**

A joint World Bank-International Monetary Fund mission assessed Armenia's financial sector as part of the Financial Sector Assessment Program (FSAP) update during February 16–March 4, 2005. The Financial Sector Stability Assessment (FSSA) report is slated to be discussed by the Executive Board along with the staff report for request for a three-year arrangement under the Poverty Reduction and Growth Facility.

ROSC Modules

Standard	Timing	Publication Status	Document Number
Basel Core Principles for Effective Banking Supervision (BCP)	April 2001	Unpublished	…
Core Principles for Systemically Important Payments Systems (CPSS)	April 2001	Unpublished	…
Insurance Principles set by the International Association of Insurance Supervisors (IAIS)	2001	Unpublished	…
Principles set by the International Organization of Securities Commissions (IOSCO)	2001	Unpublished	…
Code of Good Practices in Monetary and Financial Policy Transparency (MFPT)	April 2001	Unpublished	…
Code of Good Practices on Fiscal Transparency	March 2001	Published	02/37
Data ROSC module	September 2000	Published	02/06
AML-CFT assessment by MONEYVAL	July 2004	Unpublished	...
Basel Core Principles for Effective Banking Supervision (BCP) update	2005	...	...
Corporate Governance	2005	...	...

XI. **Resident Representatives**

Mr. James McHugh, since September 2002.

XII. **Technical Assistance**

The following table summarizes the Fund's technical assistance to Armenia since 2002.

Armenia: Technical Assistance from the Fund, 2002–05

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax policy and administration	Short-term	September 17–October 3, 2003	MFE, State Tax Service (STS), and Customs Committee
Tax policy	Short-term	April 22–May 6, 2004	MFE, STS, and Customs Committee
Tax administration	Short-term	July 13–July 27, 2004	MFE, STS, and Customs Committee
Monetary and Exchange Affairs Department			
Banking system issues	Short-term	April 15–19, 2002	CBA
Banking system, deposit insurance, foreign exchange market development, and CBA monetary operations.	Short-term	June 24–July 4, 2002	CBA
Unified financial supervision, mortgage financing markets and inflation targeting	Short-term	January 26–February 6, 2004	CBA
Financial sector assessment program update	Short-term	February 16–March 4, 2005	CBA
Statistics Department			
Data dissemination standards	Short-term	September 18–25, 2003	National Statistical Service

ARMENIA: RELATIONS WITH THE WORLD BANK
(As of April 15, 2005)

Country Director: Donna Dowsett-Coirolo Telephone: (202) 473-0121

I. IMPLEMENTATION OF STRUCTURAL REFORM MEASURES

A. Legal Framework

The World Bank has supported the Armenian government to establish the core legal framework necessary for private sector operations, including the Civil Procedure Code, the Procurement law, the Business Registration law and the Public Auction law. The fully restructured and enacted Bankruptcy law is now harmonized with the Civil Code and the Civil Procedure Code, and strengthens the enforcement mechanisms for bankruptcy procedures. The Concession law has been enacted and the National Assembly has adopted a new Labor Code, which is compatible with the requirements of a market economy and is an important instrument of flexible job-creation. The government also established a plan to strengthen creditor rights, improve civil procedures for debt recovery, and simplify procedures for certification for property sales and registration of secured credit.

B. Business Environment

The World Bank has supported the government to make satisfactory progress in removing administrative barriers for business and investment and has strengthened the consultative mechanisms with the business community. The steps taken include, inter alia, consolidating, downsizing, and clarifying mandates of various government inspections; enacting the new law on business registration; streamlining licensing procedures; issuing new accounting recommendations for small and medium-sized enterprises; establishing a regulatory framework that allows privatization of urban land by business entities; and adopting simplified procedures for obtaining site development and construction permits. The capacity of the Armenian Development Agency as a focal point for government's efforts to promote investment and exports as well as for identifying the remaining bottlenecks in the business environment has been strengthened. The functioning of the Business Council has been improved and the private sector's awareness of its activities has been enhanced.

The recent business surveys of Armenian entrepreneurs during 2002, 2003 and 2004, suggest that these efforts have already resulted in a more positive private sector perception of the business and investment environment. For example, the average time necessary to get construction and building renovation permits was reduced from 310 days in 2001 to 76 days in 2003. The number of goods subject to mandatory certification at the border was reduced from 80 in 2001 to 60 in 2003. The number of registered joint ventures increased by 25 percent from January 1, 2002 to November 1, 2003, and the FDI (outside the energy sector) increased by 44 percent in the first nine months of 2003 compared with a similar period in 2002. The State Customs Committee's websites became operational and during

2003, on average 467 references per month were made to it. The government adopted decision announcing its intention to widen participation in the provision of international civil aviation services, raise efficiency and cut costs and initiated policy work. Despite these improvements, there is still considerable scope for further reforms in the areas of competition, deregulation and strengthening of business and investment climate, especially in commercial debt recovery procedures, improvements in the transparency and efficiency of the judicial system, tax and customs administrations, improvements in governance and implementing the anti-corruption strategy.

C. Energy and Infrastructure

Since its privatization in the second half of 2002, the Electricity Distribution Company has remained in compliance with its licenses agreement as confirmed by making full payments to the generation and service providers, reporting to the regulator on a timely basis, and submitting investment plan to the regulator. Supported by the World Bank, the government has also made satisfactory efforts to improve the legal and regulatory framework in the energy sector in order to establish a supportive environment for the new private operator. Budget allocations have been increased to ensure full payments to the energy sector by the budgetary organizations and public utilities. Despite this satisfactory performance, continued efforts are crucial for improvements in the energy sector through restructuring the midstream companies and strengthening the regulatory framework to ensure adequate functioning, transparency, and reliability of this sector.

There has been limited progress in improving fiscal discipline and reducing losses in the irrigation and water sectors. The World Bank has been working with the government to: (i) upgrade the management capacity of public companies in these sectors; (ii) ensure a gradual increase in tariffs to cost recovery; (iii) provide additional investments to improve technical efficiency; and (iv) ensure that the budget provides adequate financing for water consumed by public sector entities. The government has adopted the medium-term Infrastructure Rehabilitation Plan to provide further guidelines for restructuring in water, irrigation, and public transportation. To provide full cost recovery, the government has adopted a schedule for irrigation tariff increase in 2002–2007 in order to achieve full cost recovery in the irrigation system by 2007.

D. Education and Health

The World Bank has supported reforms in education and health. The government implemented a major rationalization program during the 2003 school year. As a result, 37 schools were merged or closed and about 3,500 teachers were made redundant. The medium-term action plan for improving the financial management, accounting, and financial reporting for higher education institutions was adopted by the government on January 26, 2003. Accountants at the higher institutions have been trained and special software has been prepared for use. Since the second quarter of 2003, the new accounting procedures are being used. The government increased the state budget allocation for primary and secondary education and improved teachers' salaries. The government also developed an action plan and cleared arrears in the education sector and prevented further arrears in this sector. Despite these improvements, there is scope for further reforms in education, including adoption of new curricula for secondary education, enhancement of standards for higher education to make it more responsive to employers' needs, improving preschool systems, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the education sector.

The government adopted the hospital master plan for Yerevan in late 2002. As a result, the remaining public hospitals in Yerevan were to be merged into smaller number of hospital networks with necessary steps to be taken to restructure them. The government adopted a decree on November 21, 2003, identifying the configuration of ten hospital networks through consolidation of twenty-four public hospitals and thirteen outpatient health care institutions. Directors for nine of these hospital networks have been appointed. While the hospital merger process is being implemented, introduction of further appropriate adjustments may be required. The medium-term action plan for improving financial management accounting and reporting for the public hospitals was adopted by the government on September 14, 2003, to prepare new reporting and accounting procedures and cost accounting manuals.

Implementation progress has been satisfactory and about 200 hospital accountants have been trained in new accounting procedures. The government developed an action plan for clearing the accumulated arrears in the health sector and prevented further arrears in this sector. The government also adopted a decision to introduce further reforms in the Basic Benefit Package in the health sector. Further reforms are needed in increasing the population overall health status, reducing child and maternal mortality, increasing use of healthcare system by rural and low-income groups, monitoring public health and promoting better health behavior, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the health sector.

E. Social Protection and Insurance

Since 1999, the government has been replacing a range of fragmented cash and non-cash benefits and privileges with better-targeted transfers to families. The government has been supported by the World Bank to complete several important steps to enhance its capacity for administration of transfers to families, including: (i) re-registration of poverty benefit recipients; (ii) beneficiary assessment of the existing benefits; and (iii) establishment of a central database for poverty benefit recipients. Data from the recent household survey suggest that the system of benefits and transfers to the poor has become an efficient instrument for reducing extreme poverty. Continued efforts are needed to ensure the adequacy of the level and administrative capacity of the social protection systems to guarantee coverage of transfers to people with special needs.

The law on Public Pension focuses on strengthening and streamlining the pension system. It provides significant improvements in the pension systems, including: (i) introduction of an equal retirement age for men and women at age 63; (ii) separation of social insurance benefits from social pensions; (iii) elimination of most early retirement provisions; (iv) indexation of pension to inflation; and (v) establishment of more direct links between benefits and contributions, with adequate provision for a minimum benefit. Following adoption of the law, the government has made satisfactory progress in its implementation. The government Decree No. 309 of July 2003, established an inter agency working group to monitor introduction of the Personal Identification Numbers (PINs) into the pension system. Additionally, a range of necessary implementation regulations, based on the Public Pension Law, was developed, including: (i) the documents required for award of pensions; (ii) rules for awarding and making payments for partial pensions to those with less than the minimum required length of insurance history; (iii) procedures for making payments of the survivors' pensions to children under full state custody; and (iv) procedures for awarding, computing and making payments of the privileged pensions. While the fiscal performance of the Sate Pension Fund has improved and as a result, the average pension has increased, the level, coverage and sustainability of pensions are issues for further elaboration.

II. Lending

World Bank lending to Armenia as of April 15, 2005 totals US$861.0 million, of which US$721.0 million has been disbursed. Of the 37 projects, 20 have closed.

Building on the major Poverty Reduction Strategy Paper's (PRSP) themes, the fourth Country Assistance Strategy (CAS) for Armenia was discussed in the World Bank Board of Executive Directors on June 10, 2004 to focus on three main objectives of: (i) promoting private sector led economic growth; (ii) making growth more pro-poor; and (iii) reducing non-income poverty. Unless the high case is reached, IDA lending is expected to be up to $45 million a year during the forthcoming CAS period and could reach up to $55 million a year if Armenia moves into the high case during the FY05–08 CAS period. Towards the end of the CAS period, there could be a first IBRD loan if Armenia's creditworthiness improves sufficiently. The CAS includes three Poverty Reduction Support Credits (PRSCs) for FY05, 06 and 07. These will support the PRSP objectives and could focus on four main components: (i) supporting private sector development; (ii) advancing public infrastructure reforms; (iii) improving core public sector functions; and (iv) enhancing human development and improving social safety nets. Macroeconomic stability is a precondition for the PRSC and is vital for facilitating an enabling environment necessary for successful structural reforms implementation. The PRSC's preparation is being closely coordinated with the IMF Poverty Reduction and Growth Facility (PRGF). The first PRSC was approved by the World Bank Board on November 18, 2004, became effective and disbursement of about $21 million was made in December 2004.

List of World Bank Lending to Armenia
(In millions of U.S. dollars)

	Active Projects	Credit Amount as of 04/15/05	Disbursement as of 04/15/05	Approval Date	Closing Date
Active Projects		*267.7*	*132.0*		
1.	Agric. Reform support	16.3	16.0	01/27/98	06/30/05
2.	Municipal development	30.0	28.7	06/11/98	10/31/05
3.	Electric. Trans. & dist.	21.0	19.3	03/04/99	12/31/05
4.	Irrigation dam safety	26.6	17.3	06/24/99	09/30/07
5.	Social Investment Fund II	20.0	16.6	05/11/00	12/31/05
6.	Judicial reform	11.4	7.7	09/14/00	06/30/06
7.	Irrigation development	24.9	14.3	08/30/01	03/31/07
8.	Enterprise incubator	5.0	2.2	11/30/01	06/30/05
9.	Investment and export facilitation	1.0	0.7	04/16/02	12/31/05
10.	Natural resource management	8.3	1.5	06/04/02	07/31/08
	Natural resource management (GEF)	5.1	0.8		
11.	Municipal water and WW	23.0	3.7	05/04/04	02/28/09
12.	Educ. qual. & relevance (APL #1)	19.0	2.0	01/20/04	11/30/08
13.	Yerevan water/ww services	20.0	0..0	02/24/05	02/28/11
14.	Health system mod.	19.0	0.8	06/10/04	06/30/09
15.	Social protection admin.	5.2	0.3	06/10/04	12/31/07
16.	Irrigation dam safety 2	6.8	0.4	06/10/04	03/31/09
17.	Public sector mod.	10.2	0.5	05/04/04	03/31/09
Completed Projects		*593.3*	*588.1*		
18.	Irrigation rehabilitation	43.0	40.9	12/08/94	05/31/01
19.	Highway	31.0	29.5	09/14/95	12/31/00
20.	Social Investment Fund	12.0	11.1	11/09/95	12/31/00
21.	Institution building	12.0	10.7	03/30/93	11/30/97
22	Earthquake rehabilitation	28.0	29.7	02/01/94	06/30/97
23.	Power maintenance	13.7	13.2	12/08/94	06/30/99
24.	Economic rehabilitation	60.0	64.3	02/28/95	06/30/96
25.	SAC	60.0	58.5	02/29/96	12/31/97
26.	SAC II	60.0	58.6	08/26/97	06/30/99
27.	SATAC I	3.8	2.8	02/29/96	06/30/00
28.	SAC III	65.0	63.4	12/22/98	06/30/01
29.	Enterprise development	16.8	15.3	12/24/96	07/01/02
30.	SATAC II	5.0	4.7	08/26/97	12/31/02
31.	Education	15.0	14.6	11/20/97	10/31/02
32.	SAC IV	50.0	49.4	05/22/01	03/31/03
33.	SAC V	40.0	42.8	03/13/03	06/30/04
34.	Health	10.0	9.3	07/29/97	12/30/03
35.	PRSC	20.0	21.1	18/11/04	12/31/05
36.	Title registration	8.0	7.8	10/13/98	09/30/04
37.	Transport	40.0	40.4	06/08/00	12/31/04
	Total	**861.0**	**720.1**		

ARMENIA: RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of April 1, 2005)

As of April 1, 2005, the EBRD had signed 17 projects in the power, transport, agribusiness, textile, mining, construction and financial sectors. Total commitments amounted to EUR 90.3 million.

There are two sovereign projects. First, the EBRD approved a sovereign guaranteed loan of EUR 54.8 million for construction of the Hrazdan Unit 5 thermal power plant in March 1993, partly aimed at the eventual closure of Armenia's nuclear plant in Medzamor. The government is contemplating the privatization of Hrazdan Unit 5 as the completion of this plant is constrained by limited budgetary resources. The EBRD had funded technical assistance for the Hrazdan privatization prospectus and continues to follow the privatization process. The Hrazdan Thermal Power Complex excluding the unfinished Unit 5 has been transferred to the Russian Federation in the context of the debt-for-equity deal. Second, in November 1994, the agreement on a EUR 21.8 million loan to build an air cargo terminal in Zvartnots airport was signed under a guarantee by the Armenian government. The airport was transferred to private management in 2002. The new management has prepared a master plan for the development of the airport, which is expected to generate further cargo traffic for the cargo terminal.

There have also been a number of private sector projects in Armenia. The EBRD has provided a loan to the Yerevan Brandy Company owned by Pernod Ricard of France (EUR 19.1 million). In the banking sector, an equity participation in the Commercial Bank of Greece-Armenia (EUR 1.1 million) was approved in late 1999. Moreover, a multi-bank on-lending facility of EUR 10 million was activated in early 2000. Within the framework of multi-bank facility the Bank currently has credit lines for micro and small enterprises with three local banks (a total of EUR 5.1 million). The EBRD is committed to further expanding lending under this facility to other banks. A Trade Facilitation Program with the purpose to facilitate access of Armenian banks to trade financing was also made available to four Armenian banks. In 2002, a loan to finance EUR 2.9 million in working capital expansion was signed with the Armenian Copper Programme (the only copper smelter in the region), and a new loan (EUR 4.3 million), including the refinancing of the existing loan, was signed in August 2004. Moreover, the EBRD has launched the Turn Around Management (TAM) and Business Advisory Service programmes in Armenia in 2003, funded by the EU-Tacis program, to support micro, small, and medium-sized enterprises. There were seven new projects completed during 2004 for a total amount of EUR 6.7 million. Two of them are in the banking sector (including equity investment), one in general industry sector (direct investment in equity of a local enterprise), one pre-export finance facility with a local company in the extractive industry and three trade facilitation programmes with local commercial banks. In the first quarter of 2005 EBRD signed another trade facilitation project with a local bank and the first direct lending facility with a private textile company. The total new commitments amount to EUR 1.2 million.

The key priorities of the EBRD for the coming years are: (i) development of alternative energy sources; (ii) enterprise sector; (iii) financial sector; (iv) portfolio monitoring and implementation support; and (v) infrastructure and state-owned public utilities. The EBRD's new country strategy was approved in November 2003 and a new country strategy will be developed through 2005.

ARMENIA: STATISTICAL ISSUES

The overall quality, timeliness, and coverage of macroeconomic statistics in Armenia have improved significantly over the past few years. The Fund has substantially participated in this process, through technical assistance from the Statistics Department, the Fiscal Affairs Department, and the Monetary and Exchange Affairs Department. On November 7, 2003 Armenia subscribed to the Special Data Dissemination Standard (SDDS) and has since then provided timely data for all SDDS prescribed data categories. Further improvements are needed in real, fiscal, and external sector statistics in order to enhance the design and monitoring of economic policies. The accompanying Table of Common Indicators Required for Surveillance (TCIRS) shows the availability of key macroeconomic data and the authorities' publication policy.

National accounts and price statistics. The National Statistics Service has made significant changes to the national accounts methodology to bring it in line with best international practices. Progress has been made in developing estimates of monthly quarterly real GDP that are now published. Basic data collection procedures have also improved, with national accounts adopting the concept of gross value based on accrued sales valued at transaction prices. However, progress has been slow in improving the compilation of national accounts at constant prices; these data are still derived by re-valuing current output and inputs at previous year prices instead of deflating them by the relevant components of the producer price index. Data on the consumer price index and wages are reported on a timely basis, but wage data are still limited to average nominal wage.

Fiscal statistics. The budget execution reporting system is compiled on a cash-basis and supplemented with monthly reports on arrears and quarterly reports on receivables and payables. However, the system to track arrears is cumbersome and there is a 45-day lag in the compilation of the data. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days. The Ministry of Finance is undertaking a comprehensive reform of the treasury system, including the introduction of an internal auditing system in line ministries and their budgetary institutions. A single treasury account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for Project Implementation Units that are required by donors to operate with commercial banks' accounts. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts. They have just started reporting data on their operations to the Ministry of Finance. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments. Classification of government transactions by function and economic category are generally in line with the *Manual on Government Finance Statistics 1986*, and monthly data on central government operations are disseminated within 40 days of the end of the month. However, the budget presentation and the classification of items under the economic and functional classification of expenditures needs to be made more transparent; for instance, the data has been subject to frequent reclassifications and wages for military personnel are reported in the broader category of "other" goods and services rather than as a wage item. The reconciliation of central government with general government operations is also difficult because of the need to manually identify transactions among central government, local government, and the Social Insurance State Fund. The authorities submitted cash data, converted to the framework of the *Government Finance Statistics Manual 2001*, for publication in the *2004 Government Finance Statistics Yearbook*. Although the authorities expected to begin providing data for publication in the *IFS* in early 2005, no such data yet have been received. The *GFSM 2001* implementation plan is currently limited to bringing the classification of budgetary central government revenue, expense, and transactions in nonfinancial assets in line with international practices.

Money and banking statistics. Money and banking statistics are provided on a timely basis. Daily data on the accounts of the CBA are provided weekly with a one-day lag, while weekly data on the monetary survey are provided with a one-week lag. Monthly interest rate data are provided with an one-week lag. A new chart of accounts meeting International Accounting Standards (IAS) was introduced in January 1998. Since then, the balance sheets of the CBA and of the deposit money banks follow IAS methodology.

External sector statistics. The coverage of external sector data has improved in recent years. Trade statistics are provided on a timely basis, and trade data by origin or destination and by commodity are generally available within a month. Price data for exports and imports are available less readily. Quarterly balance of payment data are generally available with a three-month lag. However, data on private non-guaranteed external debt and on direct investment abroad are not compiled, and capital outflows are likely underestimated. The balance of payments data will need to be revised in light of recent studies showing that remittance inflows have been underestimated. The absence of a fully established (comprehensive and updated) business register in Armenia hampers a wider coverage of transactions and institutional units. The international investment position for 1997–2003 has been compiled and published.

Armenia: Table of Common Indicators Required for Surveillance

(As of April 25, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	4/15/05	4/15/05	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/7/05	4/15/05	D	W	M
Reserve/Base Money	4/14/05	4/15/05	D	W	M
Broad Money	2/05	3/21/05	M	M	M
Central Bank Balance Sheet	4/14/05	4/15/05	D	W	M
Consolidated Balance Sheet of the Banking System	2/05	3/21/05	M	W	M
Interest Rates[2]	4/10/05	4/15/05	W	W	M
Consumer Price Index	3/05	4/5/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q4/04	2/28/05	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	2/05	3/15/05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4/04	2/28/05	Q	Q	Q
External Current Account Balance	Q4/04	3/21/05	Q	Q	Q
Exports and Imports of Goods and Services	Q4/04	3/21/05	Q	Q	Q
GDP/GNP	2/05	3/25/05	M	M	Q
Gross External Debt	Q4/04	3/31/04	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

KEY FSAP UPDATE RECOMMENDATIONS

Monetary operations. (i) improve local currency liquidity management by increasing the stock of dram monetary instruments, and rely less on foreign exchange operations that can contribute to exchange rate volatility; (ii) conduct monetary operations more frequently and on a larger scale with a view to encouraging the development of deeper and more liquid money markets; (iii) modify the requirement that a large stock of T-bills issues to facilitate the CBA's liquidity management mature by year-end; and (iv) consider a reallocation of sterilization cost from the CBA to the budget.

Banking. (i) continue to rely on compliance-based supervision while shifting toward more risk-based supervision once the preconditions are in place; (ii) improve communication between the CBA and external auditors of banks; (iii) amend the CBA law to provide explicitly protection for bank supervisors from civil liability; (iv) amend Law on Bankruptcy of Banks and Credit Institutions to extinguish bank owners' shareholder rights in case of insolvency; (v) continue efforts to address corporate governance issues for the banks through legal and regulatory measures (as outlined in the CBA's concept note) but not through further increases in the minimum absolute capital requirement; (vi) enhance monitoring of macro-prudential risks in the banking system; and (vii) implement upward consolidated supervision to monitor banks' activities vis-à-vis their beneficial owners.

Insurance. (i) implement the new insurance law with an initial focus on licensing, accounting, auditing and financial reporting, solvency and technical reserve requirements, and reinsurance; (ii) dedicate more resources to the supervisory unit to improve staff capabilities including through adequate training; and (iii) take steps to ensures successful implementation of the compulsory third-party-liability motor insurance.

Corporate governance. (i) strengthen implementation of Company Law; (ii) improve accounting and auditing practices and financial reporting requirements; (iii) strengthen disclosure of beneficial owners; and (iv) strengthen creditor rights and the enforcement in the court system.

Pension reform. (i) conduct extensive analysis of options before deciding on a pension reform strategy, including actuarial projections and issues such as fiscal sustainability, lack of financial instruments, and regulatory requirements and responsibilities; and (ii) consider reforms to the existing defined-benefit, pay-as-you-go pension system that better link benefits to wages to improve the perceived fairness of the system.

Housing finance. Focus reforms on the development of a primary mortgage market for moderate and low income households.

Statement by the IMF Staff Representative
May 25, 2005

1. The following information has become available since the issuance of the staff report. It does not change the thrust of the staff appraisal.

2. Real GDP grew by 7.8 percent year-on-year in the first quarter of 2005 while 12-month inflation fell to 1.3 percent in April, with the latter helped by the continued strengthening of the dram. The dram appreciated by about 4 percent in nominal effective terms in the first quarter of 2005 despite interventions by the central bank, due to strong capital inflows. More recently, the dram's appreciation against the dollar has moderated, but volatility has increased. Mainly as a result of interventions to smooth out volatility in the foreign exchange market, reserve money grew by 25 percent (year-on-year) in April.

3. Tax revenue collection increased by 24 percent through April, on track to reach the annual target of 310 billion drams. But expenditure execution, particularly in expenditures on goods and services, remains well short of the annual target, in line with past seasonal patterns.

4. The authorities met the two prior actions outlined in the MEFP. The names of the 300 largest taxpayers were published on April 25 in three of the largest newspapers. The list was also posted on the website of the State Tax Service. This reform will significantly increase transparency and put public pressure on large taxpayers who are currently under-reporting their taxable income. The government also approved an action plan for tax and customs reforms on May 12 that draws a roadmap for reforms in the areas of tax and customs administration and tax policy, in line with FAD recommendations. These two measures give further indication of the authorities' commitment to take concrete steps to improve tax and customs collection.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 05/123
FOR IMMEDIATE RELEASE
May 25, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves Three Year, US$34.2 Million Poverty Reduction and Growth Facility Arrangement for the Republic of Armenia

The Executive Board of the International Monetary Fund (IMF) today approved a three year, SDR 23 million (about US$34.2 million) arrangement under the Poverty Reduction and Growth Facility (PRGF) for the Republic of Armenia to support the government's economic program through 2008. The decision will enable the Republic of Armenia to draw an amount equivalent to SDR 3.28 million (about US$4.9 million) from the IMF immediately.

Following the Executive Board's discussion, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair, said:

"Armenia's economic performance continued to be strong in 2004 and early 2005. Real GDP grew strongly, mainly driven by a boom in agriculture and construction, while inflation fell, aided by an appropriately tight monetary policy and the continued appreciation of the dram. Encouragingly, poverty and inequality indicators have improved notably in recent years, owing mainly to higher salaries, private transfers from abroad, and state social assistance.

"The authorities' new three-year PRGF-supported program aims at consolidating macroeconomic stability, generating additional domestic resources to finance poverty-reducing and growth-enhancing expenditures, and boosting private sector activities. Tax and customs administration reforms, the heart of the program, will focus on raising domestic resources in a transparent and nondiscretionary manner, thereby helping to create a business climate conducive to economic activity and strengthening the tax base, which will be needed as external aid flows diminish over the medium term.

"The Central Bank of Armenia (CBA) will continue to focus on maintaining price stability, amid strong capital and remittance inflows. The CBA will maintain the flexible exchange rate regime, while enhancing the instruments for sterilizing capital inflows. Fiscal consolidation over the medium term will facilitate containing the monetary effect of capital inflows.

"The program envisages financial sector reforms. The authorities will strengthen banking supervision and improve corporate governance, particularly of banks, to expand financial intermediation. They will step up the pace of reforms in the nonbank financial sector, including by implementing an appropriate supervisory and regulatory framework in the insurance sector.

The authorities are determined to address remaining problems in the energy and water sectors, with the support of the World Bank," Mr. Carstens stated.

The PRGF is the IMF's concessional facility for low income countries. It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a PRSP. This is to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

ANNEX

Recent Economic Developments

Armenia's macroeconomic performance was strong in 2004. Real GDP grew by 10.1 percent, driven by a boom in agriculture and continued private construction activities. The 12-month CPI inflation fell from 8.6 percent in 2003 to 2 percent in December 2004, aided by tight monetary policy and the continued nominal appreciation of the dram. Strong macroeconomic performance continued in early 2005, with real GDP growing by 7.8 percent (year-on-year) in the first quarter, led by construction, and 12-months inflation at 1.3 percent in April.

Fiscal policy remained sound in 2004. Both expenditures and tax revenues were in line with program targets. The central government deficit of 1.7 percent of GDP, however, was somewhat higher than programmed, mainly due to the deferment of a major grant to 2005. Fiscal performance in early 2005 was on track to meet the overall budget deficit of 2.9 percent of GDP.

Program Summary

Armenia's economic program, which is to be supported by the new arrangement under the Poverty Reduction and Growth Facility, aims to achieve more broad-based growth and generate employment-creating economic activities in order to further reduce poverty. A main pillar of the reform program is to generate additional domestic resources, which would finance poverty-reducing and growth-enhancing expenditures as official assistance is likely to decline over time. Prudent monetary and fiscal policies aim at maintaining macroeconomic stability, while financial sector development and the improved governance envisage by the program would support dynamic economic growth.

Program targets for 2005 comprise 8 percent real GDP growth, 3 percent annual inflation and an overall fiscal deficit of 2.9 percent of GDP. The medium-term outlook through 2008 envisages annual real GDP growth of at least 6 percent, supported by robust investment in the private sector. Monetary policy would target annual inflation of 3 percent. The fiscal deficit would be maintained below 3 percent of GDP, although it is not expected to fall much lower as social and infrastructure needs remain high and execution rates continue to improve.

Republic of Armenia: Selected Economic Indicators, 2001-2005

	2001	2002	2003	2004	2005 Prog.
Real Sector					
Real GDP growth (percent change)	9.6	13.2	13.9	10.1	8.0
GDP (in millions of U.S. dollars)	2,120	2,373	2,805	3,552	4,217
GNI per capita	680	767	902	1,118	1,326
Inflation (in percent)					
Period average	3.1	1.1	4.7	7.0	3.0
End-of-period	2.9	2.0	8.6	2.0	3.0
Central government operations (in percent of GDP)					
Revenue and grants	17.0	18.8	17.8	15.6	15.8
Expenditure	20.9	19.3	18.9	17.3	18.7
Overall balance (commitment basis)	-3.8	-0.4	-1.1	-1.7	-2.9
Monetary Indicators					
Reserve money (end-of-period growth rate, in percent)	11.1	38.4	6.6	11.4	14.0
Broad money (end-of-period growth rate, in percent)	4.3	34.0	10.4	22.3	18.5
Broad money velocity	7.4	6.4	6.9	6.6	6.2
External Sector					
Current account balance (including transfers)					
In millions of U.S. dollars	-200	-148	-191	-167	-213
In percent of GDP	-9.5	-6.2	-6.8	-4.7	-5.1
External debt					
In millions of U.S. dollars	906	1,026	1,098	1,183	1,229
In percent of exports of goods and services	132	131	87	74	67
Gross official international reserves (in millions of U.S. dollars)	329	430	502	541	582
In months of imports of goods and services	3.6	3.7	4.0	3.9	3.9

Sources: Armenian authorities; and IMF Staff estimates.