Евразийский Банк Развития

Resources Manager of Eurasian Fund for Stabilization and Development

31 October 2016

Evaluation of the Implementation of the Programme Supported with EFSD Financial Credit to the Republic of Armenia

(prepared based on the Report of the Ministry of Finance of the Republic of Armenia on compliance with the conditions for the second tranche of the credit)

The Programme supported with a financial credit of the EFSD specifies 24 conditions for the second tranche, of which 10 are benchmarks and 14 are performance indicators. All the conditions, except for one performance indicator, have been met. The measures specified in the matrix are aimed at achieving the following objectives:

- Improving the financial stability of the RA energy sector through better forecasting of electricity generation and consumption and more flexible tariff policies, including mechanisms to manage demand and supply shocks to avoid accumulation of arrears among energy market participants;
- Reducing the debt burden on the state budget and improving the efficiency of public finance use relying on state budget deficit control, stronger competition and greater transparency in the process of public procurement, *inter alia* owing to expanded practice of e-procurement, better quality of social services ensured by channelling social assistance through multifunction centres operating based on the "one stop-shop" principle, greater transparency of government operations ensured through implementation of improved accounting standards based on international ones;
- Improving the environment for doing business by means of reducing the regulatory burden through simplification of procedures related to doing business and introduction of electronic registration to get permits and file tax reports, better awareness of the population of regulatory procedures, and expanded access of the private sector to credit owing to creation of a register of movable property, and
- Improving the flexibility of the exchanges rate, reducing dollarization of the financial sector, and building up the credibility of the financial system.

The condition that is not met aims at creation of 10 new regional centres offering social services to the population and operating based on the "one stop-shop" principle over the period of October 2015 – September 2016 (in addition to 18 centres created by the control date of the first tranche). No centres were actually put into operation in the reporting period. Failure to implement this measure is explained by the fact that the premises transferred to the Ministry of Labour and Social Affairs (ML&SA) in late 2015 – early 2016 to house multifunctional centres did not meet the seismic resistance standards. Therefore, some additional work had to be performed that resulted in delays in meeting the condition, including making decisions on allocation sites for construction of new facilities, preparation of design documentation for construction or renovation of facilities, arranging tenders to select contractors, and performing the construction or renovation of the facilities.

In view of the time needed to perform that work, in early 2016 the ML&SA prepared a schedule of launching 20 new multifunction centres, under which only two centres would be put into operation by the control date of the third tranche (1 October 2017), while the rest of the centres are to be launched by end-2018. It actually means that the condition of the third tranche—putting 38 multifunction centres (on a cumulative basis) into operation—would not be met either.

The Manager is planning to hold negotiations with the Beneficiary by end-2016 to discuss amendments and addenda to the conditionality for the third tranche, *inter alia* revising the indicator related to establishing the multifunctional centres. The Manager is also planning to discuss implementation of this measure with the World Bank team responsible for implementation of the Second Social Protection Administration Project supporting creation of multifunctional centres.

The Manager is concerned about the decision of the RA Government to expand the state budget deficit for 2016 to 5.9% of GDP against 4.1% of GDP projected earlier. Although the budget deficit expansion is primarily related to deceleration of economic activity in the country and the region that negatively affected the level of budget revenues, and is agreed within the framework of the IMF-supported programme, its financing would result in further increase of the debt burden on the budget. Therefore, the Manager welcomes the authorities' preparedness to bring the budget deficit down in 2017 to 2.8% of GDP. However, as the control date for the third tranche of the credit is 1 October 2017, the Manager will be unable to evaluate the actual compliance with the condition related to the budget deficit.

To address that issue, the Manager will negotiate with the RA authorities the prospects of adding to the Reform Matrix of the Government and the Central Bank of Armenia, supported with the financial credit of the EFSD, a benchmark setting the RA public debt ceiling as at 1 October 2017 at a level agreed by the Manager and RA that would serve as a condition for the third tranche of the credit.

In view of satisfactory compliance with the conditions set for the second tranche, including compliance with all the benchmarks, in its Evaluation Report the Manager recommends to disburse the second tranche to the Republic of Armenia in the amount of US$ 100 million.

Current Macroeconomic Situation in RA

Despite the significant acceleration of export growth—the key driver of growth since 2013—the rate of GDP growth dropped in the first half of 2016 to 2.8% from 3.6% in the same period of 2015 against the background of lower contribution of net exports to growth and further decline in fixed capital formation. In the first half of 2016, the rate of export growth went up to 17.4%—against 5.2% in the same period of 2015—owing to diamond cutting and exports and consumer exports to the Russian Federation[1] that was *inter alia* a result of RA membership in the EEU[2]. However, the real exchange rate appreciation (+0.8%) and declining import prices (-6.5%) contributed to growing demand for imports—+1.5% in January-June 2016 compared to a decline of 16.5% in January-June 2015—that partially offset the positive contribution of net exports to the GDP growth. The rate of growth of gross savings, which had been stagnating since 2009, remained negative (-4.5% in the first half of 2016 against -7% in the first half of 2015), while fixed capital formation dropped by 7.6% that was accompanied by growth in inventories owing to imports of machinery and equipment.

Based on current data provided by Armstat, the economic activity[3] decelerated further in the third quarter of 2016. The rate of growth of economic activity went down to 1.6% in January-September 2016 compared to 4.8% in January-June 2016 and 3.7% in January-September 2015. That deceleration was accompanied by continued recession in the construction sector (-9.3% compared to -7.8% in January-June 2016), declining agricultural output (-2.6% compared to +3.3% in January-June 2016), and decelerating rate of growth in industry (+7.1% against +8.9% in January-June 2016). This pattern was a result of the high base of the previous year for agriculture and mining. However, the decelerating decline in trade is explained by recovery of consumption and growth of bank lending to this sector.

The average price level[4] has been declining in Armenia since December 2015. Against the background of continued tight monetary conditions, the consumer price deflation in September 2016 was 1.9% for 12 months due to declining domestic demand and import prices. Lower investments, which were somewhat off-set by insignificant growth of consumption, resulted in domestic demand reduction by 0.2% in the first half of 2016. The international energy and food prices, which in total account for about 60% of the consumer basket, went down correspondingly by 31.1% and 3.3%. In addition, according to the results of surveys run by the CBA, the inflation expectations of financial institutions and households in the second and third quarters of 2016 were significantly below the target[5]. In this context, the CBA was easing its monetary policies in a staged way, *inter alia* by reducing the policy interest rate,[6] to gradually bring inflation to the target range of 2.5%-5.5%. But the effects of weakening domestic demand and external prices on the overall level of inflation were stronger than the effect of monetary

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[1] Due to sanctions against imports, primarily imports of agricultural products and food from Turkey, that created niches for Armenian products in the market of the Russian Federation. For instance, in the first half of 2016, exports of tomatoes to Russia grew by the factor of 40, while in the same period of 2015 that growth was 20.3 times due to sanctions of the Russian Federation against the EU, Ukraine, and the USA.

[2] On 1 January 2015, duties on diamonds imported from Russia to Armenia were lifted.

[3] The indicator of economic activity that is monthly published by Armstat is a working short-term indicator reflecting the pattern of development of sectors of the country's economy.

[4] The inflation is defined as a 12-month change of the consumer price index.

[5] The CBA's medium-term inflation target is 4 +/-1.5%.

[6] From 10.5% in July 2015 to 8.75% in December 2015 and 6.75% in September 2016.

policy easing in the short term. Effects of monetary policy easing can, however, materialise in 2017, with the inflation reaching the floor of the target range.

The state budget deficit grew owing to social spending and debt interest payments, as well as lower inflows of external grants and non-tax revenues combined with some insignificant growth of tax revenues. In January-August 2016, the budget deficit was AMD 82.8 billion that was 1.5 times higher than in the same period of 2015 (AMD 54.8 billion)[7]. The overall budget expenditures increased by 2.6% (in January-August 2015 their growth was 14.4%) due to the growth of social benefits[8] and pensions by 3.6% as a result of changes in the legislation on benefits, transfers – by 9.6%, including VAT refunds to exporters that increased by 27.1%, as well as public debt interest payments – by 31.5%, and salaries and wages by 2.8%. The budget deficit expanded in spite of a significant decline in capital spending (-20.3% compared to their growth by 20.7% in January-August 2015) and some consolidation of expenditures on procurement of goods and services and subsidies (-1.2%)[9]. The overall decline in state budget revenues by 0.84% was a result of a decline in non-tax revenues by 20.4%[10] and grants[11] – by 23%[12]. The budget deficit expansion was somewhat off-set by growth of tax revenues by 0.4% (compared to growth of +1.3% in January-August 2015) owing to the profit tax, personal income tax, and turnover tax growth. The growth of the latter is partially explained by the fact that the VAT threshold was raised by the factor of two, thus, a range of VAT payers moved to the category of turnover tax payers. As result of this measure, as well as owing to an increase in the share of exempted exports and introduction of several preferences[13], revenues from VAT dropped by 12.7% in January-August 2016 (-3% in January-August 2015). Lower imports in the EEU member states resulted in lower revenues from customs duties,[14] which declined by 15% (-3% in January-August 2015).

The increase over the last two years of the state budget deficit, which is primarily financed from external sources, resulted in rapid public debt growth from 39.4% of GDP in December 2014 to 46.6% of GDP in August 2016 that is close to the ceiling of 50% of GDP established by the fiscal rule[15]. The RA authorities forecast additional shortfalls of revenues from foreign economic activities and state budget deficit expansion to 5.9% of GDP by the end of the year (against 4.1% of GDP planned earlier and 2.9% of GDP in the first half of

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[7] For 9 months of 2016, the state budget deficit expanded to AMD 93.6 billion compared to AMD 66.9 billion in the same period of 2015.

[8] The social spending increased as a result of changes in the legislation on payment of maternity benefits to mothers—starting from the beginning of 2016, this category includes mothers, who are not working—and an increase in lump-sum benefits for child birth, as well as benefits for children under two.

[9] Owing to expenditures on education and health being moved from "procurement of goods and services" to the category of "subsidies", it is impossible to analyse these items separately.

[10] Revenues from property dropped by 45%, from sales of goods – by 12.9%, and fines declined by 7.0%.

[11] The decline in grants in January-August is explained by their uneven distribution throughout the year according to the plan (in the first half of the year the growth of grants was 38.1%).

[12] Non-tax revenues and grants account for 5.1% of the RA total state budget revenues.

[13] The VAT threshold was raised by the factor of two from AMD 58.35 million to AMD 115 million from 1 July 2015. 4 groups of goods were exempted from the VAT from 1 January 2016, including imports of bees, other animals, hemp, and prefabricated frames for greenhouses. Imports of automobiles from the EEU member states were exempted from the VAT from 31 March 2016.

[14] Customs duties are shared between the EEU member states based on the overall value of customs duties received from imports of goods to the EEU and shares established for its member states. Armenia's share is 1.13%.

[15] Under the fiscal rule, with the public debt of the central government exceeding the threshold of 50% of GDP, the state budget deficit of the next year is to be within 3% of the arithmetic average of GDP over the last 3 years.

2016) that was agreed in the framework of the IMF-supported programme. However, in view of the higher external debt related payments, further budget consolidation and deficit reduction are needed starting already from next year to ensure debt sustainability.[16] In the framework of the budget consolidation, it is planned to raise additional revenues through expansion of the tax base as a result of enforcement of the tax code. The contributing factors will include elimination of inefficient tax and customs preferences and improved tax discipline. Additional revenues will help maintain the level of social and capital spending and improve debt sustainability.

The current account deficit improvement contributed to some marginal growth of international reserves. In the context of a significant growth of export volumes[17] and improved terms of trade, the current account deficit went down from US$ 236.9 million (5.7% of GDP) in the first half of 2015 to US$ 166.6 million (4% of GDP) in the first half of 2016. In spite of some slight appreciation of the real effective exchange rate, the significant growth of exports was generated owing to niches opening in the market of the Russian Federation as a result of sanctions and manufacturing industry producing goods to be exported (jewellery and food). An outflow of resources related to servicing the external debt of the banking and corporate sectors (US$ 183.4 million) off-set the capital inflow under the financial account (the line items of foreign direct investments – US$ 81.1 million and public sector borrowings – US$ 78.6 million). That resulted in a decline of the country's gross international reserves by US$ 216.4 million in January-June 2016. But disbursements under external loans to the RA Government, as well as operations of the CBA related to purchases of foreign currency contributed to a recovery of the international reserves, which went up to US$ 1.8 billion that is 2.6% higher compared to the year start.

Against the background of subsiding depreciation expectations, deposit dollarization is going down, while dollarization of banks' loan portfolios remains unchanged. In September 2016, the annual growth of banks' loan portfolio[18] was 7.9%, while one year earlier it declined by 3.4%. The subsiding depreciation expectations promoted local currency deposit growth and lower deposit dollarization. The deposit base grew at the fixed exchange rate by 16.5% (YoY) in September 2016 compared to the growth of 0.3% (YoY) for the same period of the previous year, while the share of foreign currency deposits dropped from 70.1% in September 2015 to 66.8% in September 2016. The growing time deposits in the banking system—with the annual growth of AMD time deposits of residents being 32.3% in September 2016 compared to 1% a year before—and the declining dollarization are also a result of changes in the RA legislation aimed at building up the credibility of the banking system and promoting de-dollarization. However, loan dollarization remained at 65.6% that is partially explained by a significant acceleration of export growth this year, which for the last four years has been and still is the key driver of growth, keeping the demand for foreign currency loans unchanged.

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[16] The state budget approved by the RA Government for 2017 provides for reduction of the deficit to 2.7% of GDP.
[17] In the first half of the year, the drivers of export growth included diamonds and precious metals, alcohol products (growth by the factor of 2.1 against a decline of 0.4%), tomatoes (see footnote 1), and tobacco products (growth by 7.8% against 62.7%).
[18] The growth of the loan portfolio and deposit base of commercial banks was calculated at a fixed exchange rate.

Status of compliance with conditions for the second tranche of the EFSD financial credit

I. Measures aimed at improving financial stability of the energy sector.

PI.1 The maximum amount of accumulated arrears of distribution networks payable to generating companies does not exceed US$ 50 million as at 1 October 2016.

Status: met.

As reported by the Ministry of Energy Infrastructures and Natural Resources (MENR) and the Public Service Regulatory Commission (PSRC), the accumulated arrears of *Electric Networks of Armenia* CJSC (hereinafter – ENA CJSC) payable to energy generating and transmitting companies have been fully repaid. It should be noted that the Matrix of measures for the period of the EFSD financial credit implementation (October 2015 – October 2017) provides for reduction of arrears from US$ 50 million to US$ 30 million.

This measure is aimed at improving the financial health of generating companies by reducing the arrears accumulated by the distribution company. The arrears were mainly accumulated in 2014-2015 as a result of a significant deviation of the actual cost of electricity generation beyond its forecasted level due to a shift in generation to more expensive heat energy. In the context of fixed tariffs calculated based on the forecasted balance, it resulted in accumulation of arrears.

The repayment of arrears was enabled by amendments in the methodology of tariff margin calculation used for payments for services of electricity distribution networks. The new methodology provides for revising the tariff margin and, thus, the tariff set for electricity consumers twice per year by an amount that helps eliminate accumulated losses or excess profits within one year instead of three years as defined under the old methodology. Therefore, the tariff margin was revised in August 2015 based on the new methodology that helped the distribution company fully repay its arrears to generating companies within one year. In its turn, the methodology of estimating the electricity generation and distribution balance, which was improved under the first tranche, ensures preparation of better forecasts and its adjustments throughout the year that facilitates more smooth tariff policy adjustment.

As arrears accumulated in the past have been fully repaid, the MENR is proposing the following condition for the third tranche: “No accumulated arrears of distribution networks payable to generating companies”.

BM.1.1 Making necessary updates and amendments to the existing methodology of estimating the electricity generation and distribution balance[19] based on evaluation of results of its application.

Status: met.

According to the MENR and the PSRC, the practice of application of the methodology approved by Order of the RA Minister of Energy Infrastructures and Natural Resources No. 138

[19] The methodology was approved by Order of the RA Minister of Energy Infrastructures and Natural Resources No. 138-N of 5 May 2015. Adoption of the methodology was part of the conditionality for the first tranche of the financial credit.

of 5 May 2015[20] has not disclosed any significant faults. As of now, no methodology adjustments or improvements are required.

This measure aims at strengthening the financial performance of the energy sector by improving the methodology of estimating electricity generation and distribution ensuring efficient management of electricity supply and demand shocks.

Under the new methodology, it is recommended to estimate the volume and composition of electricity generation based on its actual output by types of generation in the past three years with an adjustment made to the weather forecast and planned repair work, and not based on the maximum potential capacity of electricity generating companies as was defined under the old methodology. The methodology also enables revisions in the estimated balance if actual values deviate from forecasted ones for four months by more than 5% that, in its turn, serves as the basis for revising tariffs for final consumers. Thus, the methodology has helped reduce deviations of the actual volume and composition of electricity generation from the forecast.

PI.1.3 Proposals to develop tools for mitigating financial risks in energy sector are formulated.

Status: met.

The new methodologies of calculating the tariff margin for ENA CJSC (No. 98A of 29 April 2016) and tariffs for major electricity generating companies (No. 127 of 25 May 2016) set forth mechanisms to mitigate shocks in electricity generation and distribution by strengthening the flexibility of the tariff policies.

This measure aims at strengthening the financial performance of the energy sector by improving the tariff-setting mechanisms.

For instance, the new methodology of calculating the tariff margin establishes that the losses or benefits of ENA CJSC resulting from the actual tariff margin deviation from its estimated amount[21], as well as the interest payments made/received in relation to penalties are to be compensated within one year instead of three years as defined under the old methodology. This change would help ENA CJSC and energy generating companies quite quickly respond to the issue of arrears accumulated during the year by incorporating that into the calculation of the new tariff margin, which serves as a basis for tariff revisions. The methodology includes annual indexation of repair costs and other material expenses, used for tariff margin calculation, to inflation to avoid a deterioration of the financial health of the energy market participants. This methodology also aims at streamlining ENA CJSC's costs in the medium-term perspective through consistent reduction of the level of allowable technical and commercial losses[22] in the distribution network and the amount of costs[23] included into the tariff margin calculation.

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[20] Posted on the website of the Ministry of Energy Infrastructures and Natural Resources http://minenergy.am/storage/files/news/news_4231969966361_0_Hraman_138_N.pdf

[21] As a result of deviation of the actual composition of the electricity generation and distribution balance from the forecasted one that was used for setting the tariff margin.

[22] Allowable losses include losses of the distribution and transmitting networks. Losses of the distribution network include technical and commercial ones arising due to meter errors. Other commercial losses are included in the tariff margin calculation based on reports on licensed activity, but in an amount of no less than 1% of the total volume of energy bought and no more than the amount of the difference between the actual and estimated technological losses in the previous year. The amount of electricity losses in the transmitting network for each estimated year is provided by the electricity market operator based on the balance of forecasted electricity generation and sales in the estimated

Under the amended methodology of tariff calculation for major energy generating companies, their losses or benefits resulting from deviation of the actual fuel cost from its estimate due to exchange rate fluctuations are also to be considered at tariff revisions.

II. Improvement of public finance management.

BM II. The state budget deficit at year-end does not exceed 4.1% of GDP under the IMF-supported programme.

Status: met.

Based on a review of the budget execution in January-August 2016, which showed a budget deficit expansion by the factor of 1.5 compared to the same period of 2015, and the forecast of RA economic development and other indicators, which are key for the budget parameters, the RA authorities have agreed with the IMF to revise the budget deficit for 2016 upward from 4.1% of GDP to 5.9% of GDP. The deficit expansion is a result of a revenue shortfall due to deceleration of economic activity and lower import duties in the context of imports compression in the EEU member states that was accompanied by higher VAT refunds to Armenian exporters.[24] The primary source of the deficit financing will be external debt growth (+3.7% of GDP).

The aim of this condition is to bring down the debt burden of the RA Government through budget deficit reduction in the context of countercyclical fiscal policies to support economic growth.

While the budget deficit expansion is related mainly to the overall deceleration of economic activity in the region, the Manager urges the RA authorities to take further efforts to close fiscal gaps in the medium-term perspective to improve debt sustainability, and welcomes the authorities’ intention to bring the budget deficit down to 2.8% of GDP in 2017. However, taking into account that the control date for evaluation of compliance for the third tranche of the credit is 1 October 2017, the Manager is unable to evaluate the actual compliance with budget deficit condition. Therefore, the Manager proposes to add to the Reform Matrix of the Government and the Central Bank of Armenia, supported with the financial credit of the EFSD, a benchmark setting the RA public debt ceiling as at 1 October 2017 at a level of no more than US$ 5.1 billion and get an official confirmation from Armenia that it would serve as a prior action for disbursement of the second tranche.

BM 2. A draft Tax Code submitted to the National Assembly

Status: met.

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year. Under the methodology, the allowable losses in the distribution network would equal 11.03% for the five-year period starting from 2016 and that is consistent to their actual amount for the period of 1 April 2015 to 1 April 2016, and after the end of that period it would be defined based on the methodology, but would not exceed 9%.

[23] After the end of the five-year period, the costs of operation and maintenance will be defined based on the assumption that the number of employees in the system is reduced by 13%, while the repair and material costs used for the tariff margin calculation are 10% lower.

[24] A review of the RA budget execution in January-August 2016 is presented above in the section *Key Results of RA Social and Economic Development in January-September 2016*.

The draft RA Tax Code (hereinafter – the TC) was adopted by the RA National Assembly in early October 2016.

The aim of this measure is to ensure long-term growth by streamlining and improving the tax legislation of RA within the framework of one document, to improve transparency of fiscal policies, create a level playing field for taxpayers, and generate growth of budget revenues.

Prior to adoption of the TC, the RA tax legislation included a package of separate laws and regulations covering certain issues of taxation. In the process of bringing them together under a single code, these documents were reviewed to improve tax policies by simplifying and clarifying provisions of the tax legislation, *inter alia* those on legal relations, which were not regulated in the past, the requirements to tax accounting and reporting were revised to alleviate the burden on economic entities, clarifications were introduced concerning the range of taxpayers, tax rates, settlement procedure and deadlines, payment and collection of tax liabilities, including tax preferences. The amendments and clarifications introduced to the TC are expected to strengthen the sustainability and predictability of the RA tax system that is an important prerequisite for improving the country's attractiveness for investors, including foreign ones.

The TC provides for reduction of tax preferences in a number of areas in the medium-term perspective that—other things being equal—would lead to greater budget revenues, as well as a few innovations to facilitate small and medium business development owing to simplified tax administration and lower burden for businesses. In particular, it is expected that the VAT balance standing to the debit would be paid out under the TC also to those taxpayers, who sell their products in the domestic market; an alternative profit tax advance payment system will be introduced.[25] The authorities expect that the TC enforcement would have a positive effect with the tax share in GDP cumulatively increasing by 2% over the period of 2017-2021 as a result of an increase in the rates of certain types of taxes[26], reduction of tax preferences,[27] and improvement of tax administration. Some provisions of the new TC will come into force already in 2017, while the whole code will become effective in 2018.

BM.3.1. Draft amendments to the Law *On Procurement* submitted to the RA National Assembly with a view to broadening the scope of electronic procurement to cover the needs of government bodies.

Status: met.

A draft new version of the RA Law *On Procurement* was presented by the RA Government to the RA National Assembly in late September 2016 following the established procedure.

This measure aims at improving the efficiency of budget resource use, ensuring budget consolidation, and mitigating corruption risks in public procurement.

[25] The alternative profit tax advance payment system enables advance payments in the current year based not on the amount of the tax for the previous year, but on the amount of product sales in the previous quarter.

[26] In particular, excise tax rates are to be raised for tobacco products, alcohol, petrol, and compressed natural gas.

[27] Elimination of VAT preferences for import and/or sales of diesel fuel and transition to the VAT calculation in the sphere of tourism based on common principles. In addition, profit tax exemptions for incomes from sales of agricultural products and VAT exemptions for certain transaction with the state will be removed starting from 2025.

The draft Law was prepared pursuant to the provisions of the WTO Agreement on Government Procurement and the Treaty on the Eurasian Economic Union of 29 May 2014. The draft Law provides for narrowing the range of procurement methods from 7[28] to 4, including: competitive tender, electronic auction, request for quotation, and single source procurement[29]. The fact that the electronic auction is reflected as a separate procurement method and its rules are regulated by the draft Law would promote expansion of the share of e-procurement. The draft Law also states that competitive tenders (except for those held in two stages that involves several rounds of negotiations), should also be held electronically through the portal of the RA MoF.

The Draft Law also provides for improved independence of the Complaints Board for Procurement by giving it the status of a separate specialised body, with its chair and members appointed by the President on recommendation of the Prime Minister, expanding the range of conditions for adding procurement participants to the list of unfair companies, establishing the period for keeping the companies on the list, and tightening the terms of security for application and contract execution. When in force, these measures would promote greater efficiency of public procurement based on higher quality of tenders and fair competition, as well as careful execution of obligations undertaken by procurement participants.

According to the RA MoF, nearly all public procurement not related to copyright and related rights, as well as special or exclusive rights is held electronically. In 2016, the share of competitive e-procurement will be 91.4% of total procurement of this category (against 83.2% in 2015), and in 2017 it will reach 93%.

BM.3.2. Accounting system in accordance with new accounting rules (including the new chart of accounts) implemented by no less than 16 public-sector organizations

Status: met.

In accordance with the schedule approved by the RA Minister of Finance to meet the requirements of the RA Law *On Accounting in Public Sector Organisations*, new reporting rules were introduced from 1 January 2016 in 16 public-sector institutions (ministries, agencies).

This measure aims at strengthening the transparency of budget operations and harmonisation of accounting reports of budgetary institutions with the public finance statistics.

The new reporting format is a simplified version of the IFRS for public sector enterprises that enables more adequate analysis of performance and financial status of these enterprises and organisations and incorporates the requirements set forth in the public finance statistics manual and the national accounts system.

All public-sector organisations are to switch fully to the new standards in 2020 and that will lay the basis for the preparation of consolidated public sector reports and creation of a

[28] The existing legislation provides for the following types of procurement: (1) open procedure, (2) limited procedure, (3) competitive dialogue, (4) negotiations, (5) simplified procedure, (6) procurement under framework agreements, and (7) procurement of goods, work, and services through exchanges.

[29] Single source procurement is related to copyright and related rights, as well as special and exclusive rights. This type of procurement *inter alia* covers procurement of electricity and gas for the needs of the budget from monopolies that explains the quite significant share of this type in total procurement (52% in 2016).

comprehensive regulatory framework for reporting. There are also plans to change the methodology of data collection by statistical bodies based on the new framework.

PI.4 At least 28 multifunction centres established and operate.

Status: not met.

Over the period of October 2015 through September 2016, 10 new regional centres offering integrated social services (in addition to 18 centres created by the control date of the first tranche) were to have been created. However, no centres were actually put into operation in that period.

This measure aims at improving the quality of social services by simplifying and accelerating the procedure of filing applications and getting paperwork done to get benefits at multifunction centres operating based on the “one stop-shop” principle, and providing more targeted social protection by accumulating comprehensive information on applicants at the point, where they file applications, that enables more precise identification of the type of social support for each consumer of social services.

Functioning multifunction centres perform their functions well, operating based on the “one stop-shop” principle. They are able to do paperwork and establish eligibility to practically all types of social services in a centralised way. At present, these centres rely on the principle of registration, i.e. only inhabitants of relevant districts apply to them, while inhabitants of other districts still have to apply for their benefits at several social institutions functioning autonomously. Starting from 2017, the principle of registration is to be cancelled for pension benefits. Citizens will be able to apply for assignment and recalculation of pensions and benefits, recovery of their rights to pensions at any regional department of the State Social Security Service.

Failure to implement this measure is explained by the fact that the premises transferred to the Ministry of Labour and Social Affairs (ML&SA) in late 2015 – early 2016 to house multifunction centres did not meet the seismic resistance standards. Therefore, some addition work had to be performed that resulted in delays in meeting the condition. The additional work included making decisions on allocating sites for construction of new facilities, preparation of design documentation for construction or renovation of facilities, arranging tenders to select contractors, and performing the construction or renovation of the facilities.

In view of the time needed to perform that work, in early 2016 the ML&SA prepared a schedule of launching 20 new multifunction centres, under which only two centres would be put into operation by the control date of the third tranche (1 October 2017), while the rest of the centres are to be launched by end-2018. It actually means that the condition of the third tranche—putting 38 multifunction centres (on a cumulative basis) into operation—would not be met either.

Therefore, the RA Government proposes to replace the condition for the third tranche, which entails establishing at least 38 multifunction centres, with the following condition: “20 multifunction centres established and operate, conditions created to launch additionally at least 18 regional multifunction centres of social services.”

PI.6.2 Publication of printed information materials describing procedures for different site development.

Status: met.

In the framework of implementation of the *Programme of Measures to Improve Business Environment in Armenia* approved by Decision of the RA Government No. 110A of 11 February 2016, the Urban Development Committee under the RA Government prepared a *Developer Manual* and posted it on its official website (www.minurban.am). The manual defines the preparatory steps to be taken in Armenia in the process of development in line with the requirements set forth for sites of varied complexity and includes references to relevant legal acts. This information, as well as other explanatory materials were also published in the form of printed brochures disseminated among the population through centres at the Government and at city administrations, "one stop-shop" centres, and other state and municipal bodies.

It is proposed to add versions of the *Developer Manual* in Russian and English to this webpage by 15 December 2016.

This measure aims at mobilising investors in the construction sector by simplifying their access to information detailing the regulatory requirements to developers at each stage of construction and procedures to be followed to obtain permits.

PI.6.3 An electronic system of issuing construction permits implemented pursuant to the new policy for issuing construction permits and other construction-related documents.

Status: met.

An electronic system of issuing construction permits has been functioning since July 2016.

This measure aims at promoting construction sector development by reducing the regulatory burden and mitigating corruption risks.

According to the Ministry of Urban Development, the electronic system of issuing construction permits is not mandatory, *inert alia* due to insufficient computerisation of the country. In the context of decelerating construction activity, it was decided to maintain a hybrid system of issuing permits, which combines the electronic system with the traditional form of direct contacts with relevant regulatory bodies. 3 construction permits had been issued through the electronic system by the control date for the tranche.

PI.7 Developing software for establishing registration of rights to movable property.

Status: met.

At present, an electronic system of registration of rights to movable property is established and operates (can be accessed at: www.registration.am). Since putting the registration system into operation is a condition for the third tranche, we can note ahead-of-schedule implementation of this measure.

This measure aims at simplifying the process of getting loans, *inter alia* for small and medium enterprises, by introducing a system of secured transactions, which offers borrowers the option to use movable property as collateral[30] and bringing down the cost of loans by lowering the risk premium.

The system has operated since October 2015. By now, the Agency of Movable Property Right Registration (AMPRR) has made 12,000 registration records, and each of those could include several assets. Over the period of 1 January – 30 August 2016, the number of registration records on rights to movable property was 51% higher than in the same period of 2015. The registration is voluntary, but it is normally required by banks when they provide loans and do paperwork for collateral.

In the context of credit growth over 8 months of 2016 by 3%[31] compared to the relevant period of 2015 (in 2015, the growth was +26.7%), some sectors represented mainly by small and medium businesses showed significantly higher rates of credit growth that *inter alia* can be explained by implementation of the above measure[32]. For example, the growth of loans to the food manufacturing sector was 19.4% (5.4% in 2015), sector of tourist services – 33.7% (105.9%), hotel services – 67.7% (-67%), telecommunications – 129.5% (-33%), and manufacturing of beverages – 165.4% (+2.2%).

In view of the ahead-of-schedule implementation of this measure and plans to merge the AMPRR with the Agency of State Register of Legal Entities (ASRLE), the RA Government proposes to add a new measure to serve as a condition for the third tranche: "Building up the relevant capacity of regional offices of the ASRLE in registration of rights to movable property".

PI 8. Software for accepting tax reports and statements in electronic format completed. Inventory of forms of tax reports and statements for reprogramming or new programming in connection with the adoption of the Tax Code is taken

Status: met.

At present, 7 out of 10 forms of tax reports are filed electronically. The efforts taken in the reporting period to improve the system of filing tax reports covered programming 4 new forms of tax reports and reprogramming 3 such forms. An inventory of forms of tax reports, tax calculation, tax documents and forms to be programmed in connection with the adoption of the Tax Code has been made.

This measure aims at alleviating the burden for economic entities related to compliance with tax obligations and reducing corruption risks by narrowing direct contacts between taxpayers and government bodies.

In the reporting period, the following new forms of tax reports were programmed: 1) tax declaration for imports of EEU member states; 2) tax declaration for exports; 3) statement on import of goods and payment of indirect taxes; 4) statement on suspension of VAT payment deferral under Article 6.1 of the RA Law *On Value Added Tax*. In parallel, based on amendments to the legislation, calculation forms for the following taxes were reprogrammed: 1) VAT; 2) excise tax; 3) turnover tax.

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[30] Regulated by Law *On Registration of Secured Rights to Movable Property*, which came into force on 1 October 2015.

[31] At the current exchange rate.

[32] The Manager does not have data on the rate of credit growth broken down by size of economic entities.

There is some progress in transition to filing declarations on environmental taxes in electronic form that aims at reduction of corruption risks. To comply with this condition, an interagency task force comprising competent experts has been created. The RA Committee on Public Revenues drafted the procedure of preparing calculations for environmental taxes, which has been presented for discussion by stakeholder units.

PI 9.1. Digitalization and public disclosure of information on subsoil exploration and exploitation completed. At least 50% of geologic library materials digitized.

Status: met.

As at 1 October 2016, 51.3% of geologic library materials were digitized.

The measure aims at improving the transparency and competition in the mining sector to ensure equal access to the right to subsoil development.

An Internet portal has been created to post already digitalized materials for users, an interactive map and a search tool.

BM 9.2. Draft Law *On Subsoil*, which *inter alia* regulates access to competitive bidding for subsoil development submitted to the National Assembly.

Status: met.

Draft amendments to the Law *On Subsoil* were submitted by the RA Government to the National Assembly on 29 September 2016.

The aim of this measure is to establish a fair and predictable environment for investors in the area geological exploration.

Amendments to the law provide for granting the right to geological development of radioactive deposits based on competitive bidding.

BM 10. Road Network Development Strategy implementation launched. The baseline cost estimates under the Strategy are used for the Medium-Term Plan of public spending on road infrastructure for 2017- 2019 and the budget funding request for 2017.

Status: met.

The requests for the medium-term expenditure framework for 2017-2019 and the budget for 2017 were prepared in accordance with the Road Network Development Strategy. According to the Ministry of Transport and Communication (MTC), the share of republican and regional roads, which are properly maintained with regular work performed, is 57% compared to 55% planned under the Matrix.

This measure aims at improving the predictability of budget allocations for the road sector and the quality of road infrastructure by ensuring its timely repair.

Under the adopted strategy, the average annual financing needs related to road maintenance and major repair is around AMD 24 billion. In 2016, the state budget included allocations for these purposes in the amount of AMD 34.6 billion, in 2017 – AMD 26.6 billion.

At present, the roads that need current repair are determined by the MTC based on laboratory data that reflect the status of the road network. A specialised road infrastructure model prepared under the ADB project is expected to be launched by end-2016; it would enable automation of calculations of financing needs for repair of certain road sections.

III. Measures aimed at increasing the flexibility of the exchange rate, reducing dollarization, and building up the credibility of the financial system

PI.11.1 Actions on the foreign exchange market aimed exclusively at reducing sharp variations of the exchange rate.[33]

Status: met.

So far in 2016, the CBA has engaged in foreign exchange interventions only to smooth sharp variations in the exchange rate of the local currency caused, among other things, by the seasonality of transactions in the balance of payments.

This measure aims at improving the exchange rate flexibility that would improve the resilience to external shocks and support the GIR growth.

In 2016, the CBA performed interventions selling foreign exchange only in January and first two weeks of February, when the Armenian dram was under pressure due to depreciation in Russia in the context of falling oil prices, and in June, August, and September – buying foreign exchange in the interbank market. Net purchases of foreign exchange in January-September 2016 were US$ 6.6 million—the CBA sold foreign exchange in the amount of US$ 94.6 million in January-February and purchased US$ 101.2 million over the period of March through October. In contrast, for the first nine months of 2015 net sales of foreign exchange were US$ 206.5 million—except for a couple of months of 2015, the CBA was a net seller of foreign exchange. Thus, while in 2015, the CBA was actively supporting the exchange rate of its local currency, in 2016 its impact on the exchange rate was neutral over the long-term period.

The IMF describes the RA exchange rate regime as a floating exchange rate system. The GIR increased from 3.9 months of imports in early October 2015 to 5 months of imports in early October 2016 that is partially explained by some decline in imports.

PI.12.1. During estimation of the credit risk, to be factored into the calculation of the capital adequacy requirement, higher risk weights should be applied in respect of foreign currency assets. For assets in foreign currency credit risks are assumed at a level 50% higher than for assets in AMD. Continuous monitoring and making changes, when appropriate.

Status: met.

Under Decision of the CBA Board No. 6-N of 21 January 2015, the risks weights established for similar assets in AMD apply to foreign exchange assets provided to borrowers engaged in exports and meeting certain requirements (they should be legal entities; have a cash inflow generated by exports; their cash inflow, excluding loans, exceeds their cash outflow). For

[33] The data on foreign exchange interventions and the GIR presented in the text are calculated by the Manager based on the information provided by the CBA under the Technical Memorandum. In the CBA’s comments to an intermediary version of the Preliminary Appraisal, numbers for foreign exchange interventions and the GIR differed from those submitted under the Technical Memorandum.

the rest of assets in foreign currency credit risks are assumed at a level 50% higher than for assets in AMD.

Over the period of the second tranche, the risk weights for assets in foreign currency were 50% higher than for assets in local currency. For a number of risks related to mortgage loans, foreign exchange risk weights were 100% higher than for AMD risks.

This measure aims at ensuring access of exporters to foreign exchange loans that would help mitigate the impact of de-dollarization measures on enterprises generating export proceeds and reduce foreign exchange lending to borrowers not generating proceeds in foreign currency.

In spite of this measure, dollarization of loans in January-September 2016 remained unchanged at 66.1% compared to the average level of 2015. However, the Manager notes that this result could influence the growth of foreign exchange loans in the context of recovery of export-oriented sectors of the economy, primarily agriculture.

PI.12.2. Maintaining higher thresholds for provisions for potential losses on assets in foreign currency. Provisions for potential losses on assets in foreign currency exceed provisions for assets in the national currency by 20%. Compliance monitoring and, if necessary, making changes to the regulatory documents of the CBA.

Status: met.

Under Decision of the CBA Board No. 147-R of 29 June 2010, the provisioning requirement for potential losses on assets in foreign currency exceeds provisions for assets in the national currency by 20%.

This measure aims at strengthening incentives for banks to lend in local currency that should help reduce dollarization of assets.

As noted above, in spite of the measures taken, the level of dollarization of loans has remained unchanged owing to the development of export-oriented sectors.

PI.12.3. Maintaining a higher rate of reserve requirement for assets borrowed in foreign currency. Compliance monitoring and, if necessary, making changes to the regulatory documents of the CBA.

Status: met.

This measure is in force from February 2007.[34] Under Decisions of the CBA Board No. 299-N of 24 December 2013 and No. 146-N of 20 September 2016, the reserve requirement for assets borrowed in AMD remains at 2%, while that for assets borrowed in foreign exchange is set at 18%. In the past, the reserve requirement for assets borrowed in foreign exchange varied and averaged at 12%, while that for assets borrowed in AMD was 2% throughout the whole period.

This measure aims at reducing the level of deposit dollarization and is related to PI 12.2. As at end-September 2016, the level of deposit dollarization was 66.8%, having gone down from 70.1% a year earlier. The reasons for deposit dollarization reduction included both the measures

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[34] Decision of the CBA Board on approving Regulations 2 *Regulation of Banking Activity, Key Prudential Requirements for Bank* (No. 39-N of 9 February 2007).

taken the CBA and subsiding depreciation expectations in the context of stability of the AMD exchange rate.

PI.13. Growth rate of deposits at a constant exchange rate: at least 5% per annum.

Status: met.

As at 1 October 2016, the 12-month deposit base growth was 16.5%, with deposits totalling AMD 2,125.6 billion (at the programme exchange rate as at 1 October 2015).

This condition aims at improving the monetisation of the economy by expanding the deposit base and strengthening banks' investment capacity to reverse the recent persistent trend of declining fixed capital formation in the RA.

In the context of quite unfavourable conditions, including deceleration of remittances from Russia, oil price volatility, depreciation of the local currency and currencies of major trading partners, the deposit base growth was achieved owing to building up the credibility of the banking system and improving the banking legislation (see conditions 13.1-13.4).

BM.13.1. Increasing the period, during which depositors, if the bank is found to be insolvent, may claim recovery of their guaranteed deposits. Regulatory documents adopted to ensure implementation of the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals.*

Status: met.

Recent amendments to the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals*, which came into force on 1 March 2016, provide for the ability of depositors to claim recovery of their guaranteed deposits, after their bank is found insolvent, within three years following the date the recovery case occurs, instead of one year under the previous version of the law.

This measure aims at promoting deposits by extending the period of guaranteed deposit recovery that would help boost deposits of citizens absent from the country for a long time for certain reasons (work, education, medical treatment abroad).

BM.13.2. Reduction of the time needed to launch the process of recovery of guaranteed deposits. Regulatory documents adopted to ensure implementation of the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals.*

Status: met.

Recent amendments to the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals,* which came into force on 1 March 2016, provide for the responsibility of the Deposit Guarantee Fund to provide recovery of guaranteed deposits based on claims of depositors starting from the 20th working day following the date the recovery case occurs, instead of the 30th working day under the previous version of the law.

This measure aims at promoting deposits by reducing the period needed to launch recovery of guaranteed deposits. It brings down the risks of limited access of depositors to their funds, when they may urgently need the funds kept in their deposits.

BM.13.3. Ensuring guarantee of deposits belonging to the same depositor in case of mergers and take-overs in the banking system. Regulatory documents adopted to ensure implementation of the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals.*

Status: met.

Recent amendments to the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals*, which came into force on 1 March 2016, provide for treating deposits belonging to the same depositor, in case of mergers and take-overs in the banking system, as different deposits until they expire.

This measure aims at limiting deposit outflow from banks that can be involved in bank mergers and take-overs. In view of the CBA's requirements on raising the amount of the minimum bank capital, one can expect that banks would merge to become larger. If implemented, this measure would help avoid erosion of the deposit base of such banks.

PI.13.4. Increase thresholds for guaranteed deposit amounts. Regulatory documents adopted to ensure implementation of the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals.*

Status: met.

Recent amendments to the RA Law *On Guaranteeing Compensations of Bank Deposits for Individuals*, which came into force on 1 March 2016, provide for increasing the threshold for guaranteed amounts of AMD and foreign exchange deposits correspondingly from AMD 4 million and AMD 2 million to AMD 10 million and MD 5 million.

This measure is aimed at boosting deposits by increasing the insured amount.

The increase of the threshold for guaranteed deposit amounts would strengthen the credibility of the banking system, thus, promoting deposit base expansion.