Evaluation of Compliance with Conditions for the Final Third Tranche under the Reform Programme of the Government and the Central Bank of the Republic of Armenia Supported with the EFSD Financial Credit

(prepared based on the Report of the Ministry of Finance of the Republic of Armenia)

The conditionality for disbursement of the third tranche of the EFSD financial credit to the Republic of Armenia (RA) in the amount of US $100 million includes 27 indicators, of which 14 are benchmarks. As at the date of the report preparation, all the indicators were met. The key results of meeting these indicators include the following:

- **The beginning of the liberalisation of the RA energy sector against the background of strengthening its financial stability.** The adopted by the Government action plan on the sector liberalization\(^1\) envisages separation of the electricity generation and distribution functions and granting large consumers the right to buy electricity in bulk directly from its producers, paying a certain margin for the service to the distributor; expanding the range of electricity suppliers, *inter alia* through attraction of foreign and small renewable energy producers to the market, creating and developing the institute of wholesale traders and the power market operator to regulate the activity of all its participants;

- **Reduction of the debt burden on the state budget and improving efficiency of public finance management.** A gradual reduction of the state budget deficit began; competition and transparency in the process of public procurement enhanced, *inter alia* owing to elimination of the conflict of interest of the parties; 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; the legislative framework was harmonised with the requirements of the new Tax Code to implement all its provisions starting from 2018;

- **Improvement of the investment climate.** Amendments in legislative acts submitted for the Parliament’s consideration, aim at strengthening investor protection guarantees; creating conditions for the more active engagement of business representatives in drafting regulatory and legislative acts and bringing the legislation in compliance with the EAEU provisions and best international practices; the procedures of doing business were

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\(^1\) Approved by the Government on 27 July, 2017.
simplified; electronic access to the system of getting permits and filing tax reports provided; the conditions for better awareness of the population of regulatory procedures established; access of the private sector to credit resources owing to establishment of the registry of moveable assets expanded;

- Strengthening of the financial system. Measures to improve flexibility of the exchange rate, reduce dollarization of the financial sector, and increase credibility of the financial system were implemented.

In view of the satisfactory performance under all the conditions, the Manager recommends disbursing the third tranche of US $100 million to the Republic of Armenia.

**Current Macroeconomic Situation in Armenia**

Exports remained the key driver of Armenia’s economic growth in the first half of 2017, while domestic demand that began the recovery also contributed to the growth acceleration. The GDP growth was 6.8% in the first half of 2017, compared to 3.5% in the same period of 2016 due to continued high export growth rates (+ 20.5% compared to 19.2% in the first half of 2016). The major exporters were the mining and food industries, export growth of which was positively influenced by Armenia’s membership in the EAEU and economic recovery in Russia and the European Union, combined with the real effective exchange rate depreciation by 7% since 2016. The rate of GDP growth also accelerated largely owing to recovery of the households’ consumption and investments. Domestic demand increased by 6.8%, compared to its drop by 1.6% in the first half of 2016. The households’ consumption was supported by a rapid increase in the inflow of cash remittances since Q4 2016. During last three quarters (since October 2016 to July 2017), consumption grew by 5.4%, cash remittances - by 6.5% on a cumulative basis. Investments grew, largely due to increase in stocks, by 2.5% compared to a drop by 5.1% in the same period of 2016. At the end of nine months of 2017, acceleration of industrial and domestic trade growth was recorded on the background of slowdown in construction, thus evidencing continued export and domestic consumption growth.

The current account (CA) balance improved against the background of growing exports and cash remittances, but the need to repay the external debt of the government and the banking sector resulted in lower gross international reserves (GIR). In the first half of 2017, the CA deficit was 2% of GDP, having declined from 3.7% of GDP registered for the same period of 2016. The key sources of such improvement include decreased outflow of net income (both in terms of payments on FDI of previous years and debt servicing), recovery of labour transfers growth, improved terms of trade due to increase of metal prices, and increase of grants to the general government. Despite the favourable international prices and significant export growth, the trade balance deficit expanded in the first half of the year, reaching 11.7% of GDP against 8.8% of GDP because of outpaced growth of goods imports in the environment of rapid domestic demand recovery owing to the inflow of cash remittances and credit growth. Some net foreign exchange outflow, related to declining external liabilities of the government and the banking sector, was registered under the financial account. The balance of payments deficit of the first half of 2017 resulted in the GIR declining both in nominal terms (by 8.5%) and
in months of imports (down to 4.9 months against 5.9 months of imports as at year start). In general, the Central Bank followed laudable foreign exchange policies consistent with its monetary policy objectives. Foreign exchange interventions were used to smooth sharp exchange rate fluctuations and were mainly represented by net foreign exchange purchases that also contributed to reversing the deflation trend, which emerged at the end of 2015.

The fiscal consolidation, initiated in 2017 as the government debt exceeded its security threshold, was achieved through the implementation of restrained current expenditure policies. In 2015 and 2016, in the context of growing capital expenditures financed with external loans, the state budget deficit expanded respectively to 4.8 and 5.5% of GDP against 1.6% of GDP on average in 2012-2014. As a result, the public debt grew, reaching 51.8% of GDP in 2016. As the government debt exceeded the threshold of 50% of GDP, the 2017 budget was formulated in line with the current fiscal rule that limits the budget deficit — not more than 3% of the GDP. The current expenditures were cut by 2.1% of GDP, primarily in the part of transfers and subsidies, as well as expenses on goods and services. That became the key factor contributing to lower consolidated budget deficit, which went down to 2.3% of GDP for 9 months of 2017 against 4.0% of GDP a year earlier. The target of budget deficit, excluding capital expenditures financed with external loans, monitored within the EFSD program, was also met. It made 1% of GDP compared to the deficit of 2.4% of GDP in January–September 2016.

In this context, the level of the government debt was 51.4% of GDP as at end-September 2017 that was slightly below the level of the year start – 51.8% of GDP. In view of the economic recovery and growing international trade flows, the tax revenues increased by 0.3 percentage points for 9 months of 2017, reaching 21.8% of GDP. Most of the tax revenue growth was attributed to the VAT, excise taxes, customs duties, and royalties. Nevertheless, the overall consolidated budget revenues remained at the level of the previous year of 23.7% of GDP due to lower inflows of grants.

The authorities expect to achieve the budget deficit of 3.6% of GDP in 2017 instead of the deficit of 2.8% of GDP envisaged by the law on state budget because of expanding expenditures to finance investment projects. At the same time, a package of the documents of the Government on a new fiscal rule has been proposed for the consideration of the Parliament. In particular, it includes a proposal to bring the government debt ceiling, which triggers the fiscal rule, down from 50 to 40%, and discontinue the practice of setting the budget deficit ceiling as the instrument of the fiscal rule implementation. As an alternative, once the government debt exceeded the threshold of 40% of GDP, the annual capital expenditures for subsequent years should not be lower than the budget deficit. Once the government debt exceeded the threshold of 50% of GDP, a direct adjustment would be triggered to limit the current budget expenditure growth (excluding interest payments) to the average rate of nominal

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2 If the central government’s debt exceeds 50% of GDP, the next year's budget deficit should not exceed 3% of the average value of GDP for the last 3 years.

3 Due to the planned reduction of state subsidies to farmers for the purchase of fertilizers at lower prices and water supply networks by raising tariffs for water use.

4 The condition of the program was that the budget deficit without the financing of foreign-financed investment programs should not exceed 75 billion AMD, in fact, this figure was at the level of 37.6 billion AMD.

5 Excluding VAT refunds.
GDP growth for the previous 10 years adjusted downward by 1.5 percentage points. Once the government debt exceeded the threshold of 60% of GDP, the adjustment factor would increase to 2.5 percentage points, while the total current expenditures should not exceed the amount of tax revenues and state duties reflected in the budget. In addition, as the debt exceeded 50% of GDP, the RA Government would prepare an action plan to bring the government debt down to a secure level, which is to be considered by the Parliament.

The Tax Code taking effect is of primary importance for the debt and fiscal sustainability. The implementation of its provisions is expected to generate an increase of the tax to GDP ratio by 2 percentage points by 2021 owing to higher rates set for some taxes, reduced tax preferences, and improved tax administration.

**Better performance of the interest rate channel of monetary policies has supported improved banking activity.** The RA Central Bank (CB) implements its monetary policies exclusively within its inflation targeting strategy, which also reflects requirements of the EFSD program. For instance, in the context of deflation observed in 2016, the RA CB significantly cut its policy interest rate from 8.75% in early 2016 to 6% in February 2017, reaching what is seen by the Manager and the RA CB as its neutral level. That resulted in lower interest rates for AMD loans — over the last 12 months, for the loans up to one year for households they have dropped by 4.2 percentage points to 17.1%, and for legal entities - by 4.4 percentage points to 9.8%. An important contributor to strengthening the interest rate channel was the package of measures taken to consolidate the banking sector by raising the capital requirement. In view of the emerging trend of convergence of the actual and the forecast inflation, combined with high rates of economic growth and bank lending, the Central Bank has refrained from further cuts of the policy rate since February 2017.

**The deflation observed starting from December 2015 was reversed in early 2017 owing to the monetary policy loosening and domestic demand recovery.** Against the background of declining international prices in 2015, the consumer price deflation in Armenia averaged at 1.4% in 2016. The effects of the monetary policy loosening, achieved through the policy rate cuts, and widening the budget deficit in 2016, appeared in early 2017, when the annual inflation became positive again, making 1.2% in April. The annualised core inflation, an indicator reflecting mainly the effects of monetary factors, was 1.9% as at end-September 2017, thus advancing the CPI growth, which made 1%. According to the RA CB’s surveys, the inflation expectations in the economy have also picked up, being driven by the declining interest rates. In contrast to the results of earlier surveys, financial institutions and households expect the inflation to accelerate to +2.9% over a 12-month horizon. Under its current forecast, the Central Bank of Armenia expects that the inflation rate would reach the floor of the acceptable range of its variation by end-2017, while in the medium-term perspective (until 2020) it would reach its targeted level of 4%.

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6. Since 01.01.17, the requirement for the minimum authorized capital of banks was increased from AMD 5 billion to AMD 30 billion, which led to an increase in the total bank capital by about 30% with a reduction in the number of banks from 22 to 17.

7. Inflation target is 4±1,5%.
There is some improvement in banks’ activity and lower financial dollarization observed. The annualised bank credit growth accelerated to 13.4% in June 2017 against 6.5% on average in 2015-2016. The main factors contributing to this acceleration include loans to industrial and trade enterprises and loans to households. The credit growth was supported by the refinancing rate reduction, as well as the creation of the registry of moveable assets that simplified the mechanism of formalising pledge collateral for loans to the private sector. At the same time, the share of substandard loans\(^8\), which was 9.6% in September 2016, declined to 6.7% as at end-2016 and went down further to 5.2% for the first 7 months of 2017 that was the lowest level among the EFSD member states. Dedollarization at the level of the banking system became prominent in early 2016 against the background of the local currency stabilisation. The share of foreign exchange in the deposit base went down from 71.6% as at end-2014 to 62.4% as at end-September 2017, while the dollarization of loans declined from 66.6% to 62.7% over the same period. The measures taken to establish higher risks for foreign exchange loans and higher rates of provisioning for foreign exchange deposits have improved the soundness of the banking system.

The sustainability of economic growth in the medium and long term will depend both on the impact of external factors and on the solution of the internal structural problems. Out of external factors, the economic situation in Russia, the main source of remittances, the importer of Armenian industrial and agricultural products and one of the main investors in the economy of the republic, can have the strongest effect. The aggravation of the geopolitical situation in the region can also affect the economic situation in Armenia. The main internal structural problem is the presence of barriers that limit competition in the domestic market. The existing monopolization of business and obstacles to the emergence of new enterprises hamper the development of small and medium-sized enterprises and worsen the conditions for doing business. Removing these restrictions will facilitate the transfer of technology and increase investment in fixed assets. In addition, in conditions of low employment of the population, it is important to speed up the implementation of reforms that stimulate the development of small and medium-sized businesses, create new jobs and train qualified specialists in demand on the market.

\(^8\) Loans overdue by 90 days or more.
Status of compliance with conditions for the third tranche of the EFSD financial credit

The conditionality for disbursement of the third tranche includes 27 measures, of which 14 are benchmarks and 13 are performance indicators. All the measures are met.

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

PI 1.1 Reduction of arrears between power market players: No overdue payables to generating companies.

Status: met.

As reported by the Ministry of Energy Infrastructures and Natural Resources (MENR) and the Public Service Regulatory Commission (PSRC), CJSC [closed joint-stock company] Electric Networks of Armenia (hereinafter referred to as ENA CJSC) has got no overdue payables to generating and transmittance companies.

This measure aims at strengthening the financial sustainability of the energy sector, which accounts for about 5% of Armenia’s GDP, and improving the attractiveness of this sector for investors.

The arrears of ENA CJSC to generating companies and other power market participants amounted to US $50 million and were mainly accumulated in 2014-2015 through a substantial positive difference between the actual cost of electricity generation and its forecasted level due to a shift in the power generation structure to more expensive thermal energy. With tariffs fixed at the level calculated based on the forecasted balance, it led to accumulation of arrears. According to the initial conditions fixed in the Framework of Reforms Supported by the EFSD financial credit, the level of arrears was to be reduced to US $30 million by the control date of the third tranche (1 October 2017). However, the arrears were fully repaid as at 1 August 2016.

The accelerated elimination of arrears was facilitated by the changes introduced in April 2015 to the methodology of calculating the tariff margin fixed to cover the services provided by the electric networks in accordance with the conditionality for the second tranche. The new methodology helps eliminate losses or excess profits of ENA CJSC, which accumulate because of the difference between the actual margin and its calculated amount, by relevant revisions of the margin within one year instead of three years as per old methodology. As a result, the tariff margin revision in August 2015, based on the new methodology, helped the distribution company to fully repay its accumulated debt to other power market participants within one year. In its turn, the methodology of preparing the forecasted balance of power generation and consumption, which was upgraded under the first tranche, helped improve the quality of the forecast and made it possible to revise the forecast within the year in case of significant deviations, that allows for smoother adjustment of the tariff policies.

BM 1.2 Liberalisation and promotion of economic competition in the energy sector: Approval of the Action Plan to liberalise the power market.

Status: met.

The key objective of the Action Plan is to create the foundation for the transition of the RA energy sector from a fully regulated power market model to a modern liberalised model that fosters competition and improves the productivity of the electric power system through the introduction of modern trade rules, expansion of the pool of market participants, improvement of the tariff structure, and development of interstate trade.

The current power market model was formed in 2004. It is based on the “single supplier / buyer” principle, according to which the power distribution licensee — currently it is ENA CJSC — retains the exclusive right to buy energy from generating companies in the wholesale market and sell it to consumers. Both the wholesale and the retail segments of the market are fully regulated. The Action Plan provides for the liberalisation of the power market by separating the electricity generation and distribution functions, granting large consumers the right to buy electricity in bulk directly from its producers, expanding the range of electricity suppliers, *inter alia* through attracting foreign and small renewable energy producers to the market, creating and developing the institute of wholesale traders and the power market operator to regulate the functioning of all its participants.

According to the Action Plan, the transition to a new power market model will be carried out in late 2019, upon implementation of the following key activities:

1. amending a number of laws regulating the operation of the energy sector in order to clarify the functions of government bodies and economic agents operating in the sector; introduce provisions on the liberalisation of the energy sector; establish separate licensing procedures for power supply and distribution functions; clarify and expand the powers of system and market operators; expand the legislative and regulatory framework for the functioning of sellers and trade operators; regulate export and import transactions without issuing licenses.

2. creating and developing an operator in the electricity sector, whose main functions include the organisation and development of wholesale and retail markets, registration of participants in these markets, registration and management of applications for the power sales and purchases, accounting for the volumes of energy supplied, and organisation of trade with foreign markets. The functions of the market operator have already been transferred to Settlement Centre CJSC under the RA MENR, with its powers being expanded as the transition to the new model progresses.

3. approving the network rules for the electric power system aimed at expanding the access of energy suppliers to the market, including foreign and small renewable energy producers, *inter alia* by granting them the right to supply electricity directly to industrial and commercial consumers.

4. improving the structure of tariffs in order to more accurately reflect costs in various tariffs (day and night tariffs, tariffs for different voltage levels), and, possibly, revising the current general principle of tariff setting based on the “profit margin regulation”. Under this approach, if the financial resources received are insufficient, the tariffs for end users are to be
revised, which does not create appropriate incentives for generation and distribution companies to improve their operational efficiency.

(5) separating the electricity generation and distribution functions through the introduction of relevant licenses and development of the regulatory environment for each function, which will expand the pool of participants and improve the competition in these markets.

By the time of this Report, there had been already decisions adopted by the RA Government on amending the RA laws on energy, licensing, and state duty (No. 1131-A dated 7 September 2017) and by the RA PSRC on establishing the power market operator and approving the network rules of the electric power system (No. 162-N and 162-N dated 17 May 2017).

The efficient development of the RA electric power sector is important in view of both the share of the power generation sector in the RA GDP (5%) and the relatively high dependence of the RA economy on prices for imported energy resources, whose share in the energy balance reached 35% in 2016.

**BM 1.3 Reduction of the risk of the actual energy balance deviating from the forecasted one: Application of the methodology of preparing the forecasted balance of power generation and consumption in the process of preparing the power generation balance used for tariff calculation.**

*Status: met.*

The methodology of preparing the forecasted balance of power generation (capacity), import, export, and sales in the distribution networks of the electric power system (hereinafter referred to as the Methodology), approved by Order of the RA Minister of Energy and Natural Resources No. 138, dated 5 May 2015, was taken as the basis for the calculation of tariffs introduced from 1 August 2015 and in subsequent tariff years (2016-2017 and 2017-2018).

This measure aims at improving the financial performance of the energy sector by refining the tariff setting mechanisms, specifically by minimising the difference between the planned and actual energy balance.

The tariff calculation is currently based on the forecasted balance of power generation and consumption prepared in accordance with the requirements of the Methodology. In particular, under the new methodology for calculating the tariff margin, the losses or benefits accruing to ENA CJSC as a result of the actual tariff margin deviating from its calculated value\(^9\), as well as interest payments paid / received as penalty, are to be covered within one year instead of three years under the old methodology. This change helps ENA CJSC and energy producers to quickly address the problem of arrears arising during the year by incorporating them in the calculation of the new tariff margin, which is the basis for setting revised tariffs. The methodology provides for an annual indexation of repair costs and other material costs, reflected in the calculation of the tariff margin, to inflation, thus, preventing deterioration of the financial standing of power market participants. This methodology also focuses on optimising the costs of

\(^9\) Due to the difference between the actual structure of the balance of power generation and consumption and the forecasted one, which was used for setting the tariff margin.
ENA CJSC in the medium term through systematic reduction of the level of acceptable technical and commercial losses in the distribution network and the costs reflected in calculating the tariff margin.

II. Measures aimed at improving the public finance management system

BM 2.1. The state budget deficit not exceeding AMD 75 billion for 9 months of 2017, with the aim of achieving the approved budget deficit of no more than AMD 69 billion for 2017 (excluding external loans mobilised to implement targeted programmes).

Status: met.

The budget deficit, excluding capital expenditures related to implementation of targeted programmes supported with external loans, was AMD 37.6 billion or 1% of GDP for 9 months of 2017, against 2.4% of GDP a year earlier. Nevertheless, according to some preliminary data, the RA budget deficit for 2017 will make about 3.6% of GDP (5.5% of GDP in 2016), against the initially approved 2.8% of GDP. The slight expansion of the deficit against its approved level is explained by an upward revision of capital expenditures to support economic activity.

The budget deficit was approved at the level of 2.8% of GDP by the RA Parliament in accordance with the fiscal rule that was in effect at the time of the 2017 budget preparation and approval, providing for a budget deficit ceiling of 3% of the average nominal GDP for the last 3 years, if the public debt exceeds the threshold of 50% of GDP\(^\text{10}\). During 2017, the RA authorities, in cooperation with the IMF, revised this rule with the aim of eliminating the procyclical principle inherent in it, which negatively affected the economic development. A package of amendments to the Laws On Government Debt and On RA Budget System is currently being considered by the Parliament to approve the new version of the fiscal rule. These amendments establish various criteria for limiting the growth of current expenditures, depending on the level of public debt\(^\text{11}\) reached, as well as limiting the use of debt sources only to financing capital expenditures.

This condition aims at alleviating the debt burden of the RA Government by cutting the budget deficit in the context of countercyclical fiscal policy to support economic growth.

In January-September 2017, the overall deficit of the RA state budget went down to 2.3% of GDP (AMD 88.5 billion), against 4.0% of GDP (AMD 141.8 billion) for the same period of 2016. The deficit reduction was achieved owing to the economic recovery in both the RA and EAEU member states, which had a positive effect on the growth of taxes (primarily VAT, excise taxes, customs duties, and royalties) and restrained current expenditure policies.

The tax revenues for 9 months increased by 7.9%, but due to the decline in grant revenues, the total amount of revenues remained at the same level as for 9 months of the previous year (23.7% of GDP). The current expenditures decreased by 2.1% to 24.2% of GDP due to cuts in the financing of almost all items – transfers, expenses on goods and services, and subsidies. The financing of capital expenditures increased by 15.1%, which increased their share

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\(^{10}\) As in 2016 the government debt increased to 51.9% of GDP, the budget deficit, including targeted loans, was limited by legislation at AMD 150 billion for 12 months of 2017 that is estimated to make 2.8% of GDP.

\(^{11}\) The draft amendments provide for various limiting criteria if the debt reaches 40%, 50%, and 60% of GDP.
in GDP to 2.3%, against 2.1% GDP a year earlier. While in previous years, the growth of capital expenditures was associated with an increase in external financing of targeted programs, in the first 9 months of 2017, the domestic capital investment growth was accompanied by declining foreign capital investments. This trend is reflected in the reduction of external sources of budget deficit financing and is in general consistent with the policies followed by the authorities to consolidate the budget and ensure debt sustainability.

The primary budget balance, excluding interest payments, was formed with a slight surplus at 0.1% of GDP, compared to a deficit of 2.0% of GDP a year earlier that is a signal of a significant debt burden for the budget.

The government debt decreased slightly to 51.4% of GDP for 9 months of 2017 against 51.8% of GDP as at the year start. The sources of the government debt growth included both domestic and external borrowings.

The budget consolidation policies will continue in 2018. The draft 2018 budget provides for a deficit of 2.7% of GDP that is a result of a new fiscal rule becoming effective. Under this new fiscal rule, debt sources of financing cannot exceed a volume of capital expenditures.

**BM 2.2 Development of the Tax Code: A Resolution adopted by the RA Prime Minister to approve measures needed to implement the RA Tax Code. Execution of the measures needed to implement the RA Tax Code in line with the schedule established by the RA Prime Minister’s decision.**

*Status: met.*

The RA National Assembly adopted the Tax Code in November 2016. The list of government resolutions, which are necessary to ensure the implementation of the Tax Code, was adopted by the RA Prime Minister's Decision No. 35-A *On Approval of the List of Measures to Ensure Implementation of the RA Tax Code*, dated 19 January 2017. The decision covers 95 legislative and regulatory acts. By the date of the Report, 87 regulatory and legislative acts had already been approved by the Government, 5 resolutions had been declared invalid by a decision of the Government, and the deadline for the adoption of the remaining 3 documents had been extended by the Prime Minister's decision until the end of 2017.

The introduction of an integrated Tax Code is aimed at ensuring long-term growth of tax collections through the systematisation and improvement of the RA tax legislation within the framework of a single document, improved transparency of fiscal policies, creation of a level playing field for taxpayers, and budget revenue growth. The Tax Code is designed to regulate legal relations, associated with taxes and mandatory payments applicable in the Republic of Armenia, establish the principles of the tax system, the range of taxpayers, tax rates, the order and timing of tax calculation, payment and collection of tax liabilities, including tax preferences.

According to the authorities, the entry of the Tax Code into force is expected to improve tax collections in 2017-2021 by 2% of GDP (cumulative).

**BM 3.1. Improving the transparency of public procurement by wider application of the e-procurement system: Amendments introduced to the RA legislation on procurement to:**
a) define the mechanism prohibiting parallel participation of affiliates in one competitive procurement process, except for cases of participation of organisations founded by the state or communities, as well as cases of joint activity (a consortium);
b) define the mechanism of publishing statements of no conflict of interests among members or the secretary of the evaluation committee, as well as statement of withdrawal in case entities affiliated to members or the secretary of the evaluation committee participate in the procurement process.

Status: met.


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

In accordance with the Decision of the Government, procurement process participants are required to include in their bids a statement of no parallel participation of their affiliates in the procurement process. The accuracy of this information is checked by the RA State Commission for Protection of Economic Competition, as well as by all stakeholders owing to disclosure of information about bidders in the e-procurement system ARMEPS at https://www.armeps.am/epps/home.do and online at www.procurement.am. To do this, relevant changes have been introduced to the e-procurement system software with the result that bids submitted by bidders are automatically published on the website after their opening. In addition, minutes of evaluation committee meetings and announcements on signed contracts, which contain information about all the participants who submitted their bids, are published online at www.procurement.am. Thus, all stakeholders, including other procurement process participants, representatives of the civil society, as well as relevant government agencies are able to identify cases of parallel participation of affiliates in the procurement process.

The legislation provides that if a participant presents incorrect data, the participant shall be “blacklisted” and barred from participation in procurement processes for a period of 1-2 years. If the discrepancy is found out after a contract is signed with the participant, the contract shall be terminated and the participant shall be “blacklisted” and barred from participation in procurement processes for a period of 2 years. Moreover, in this case, the customer bears no risk for damage or loss of expected gain of the other party to the contract due to the unilateral termination of the contract, and, following the procedure established by the RA legislation, the participant is obliged to compensate the damage caused to the customer in the amount, caused by the latter as a result of termination of the contract.

The legislation also regulates the issues of the conflict of interest between procurement process participants and civil servants, who are members of the evaluation committee. If a certain link between a member and / or the secretary of the evaluation committee (hereinafter referred to as a member of the evaluation committee) and a bidder, as provided for in the
legislation,\textsuperscript{12} is discovered in a bid opening meeting, the member of the evaluation committee shall announce his withdrawal from that procurement process. Otherwise, all members of the committee shall sign a statement of no conflict of interest and publish it online at www.procurement.am.

\textbf{PI 3.1. At least 92\% of funds allocated for procurement to cover the needs of public administration authorities is used to carry out procurement processes through the e-procurement system.}

\textit{Status: met.}

As at 9 October 2017, procurement carried out through the e-procurement system using tender procedures accounted for 95.2\% (against 91.4\% a year earlier and 83.2\% in 2015) of procurement to cover the needs of public administration authorities of Armenia, not related to state or official secrets (except for transactions related to copyright and related rights, and special or exclusive rights).

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

The new edition of the Law \textit{On Procurement}, adopted in December 2016, contributes to the organisation of procurement processes on a more competitive and transparent basis, \textit{inter alia} by identifying the electronic auction as a separate procurement method, as well as by introducing a provision requiring procurement through an e-tender (except for the two-staged tender, involving several rounds of negotiations).

\textbf{BM 3.2. Introduction of a public sector accounting system: An accounting system aligned with the new accounting rules (including the new chart of accounts) is implemented at no less than 38 public sector organisations.}

\textit{Status: met.}

As at the evaluation date, the new public sector accounting system was introduced at 41 ministries and agencies\textsuperscript{13}.

This measure aims at increasing the transparency of budgetary operations and aligning the reports produced by budget institutions with the requirements of the Government Finance Statistics 2001.


\textsuperscript{12} The conflict of interest, in particular, covers the following cases: the range of tender participants includes (a) an organisation founded by a member or the secretary of the evaluation committee; (b) an organisation, in which a member / the secretary of the committee has an interest; (c) a person, who is a close relative or has in-law relationship with a member / the secretary of the committee, or (d) an organisation founded by a member / the secretary of the committee.

\textsuperscript{13} The full list of ministries and agencies, which have introduced the new accounting rules, is presented in the report of the RA Ministry of Finance on compliance with the conditions for the third tranche of the EFSD financial credit.
At the moment, the new accounting and reporting system is implemented at 593 public institutions, including subordinated institutions. According to the schedule, 21 organisations will additionally switch to the new system from 1 January 2018. Full transition of all public sector organisations to the new standards, planned for 2020, will be the basis for the preparation of consolidated public sector financial statements and creation of a unified system of regulatory acts for reporting purposes. It is also planned that the methodology of data collection by the statistical agency will be adjusted in accordance with the new system.

BM 3.3. Proportion of the length of roads, maintained fully according to standards on a regular basis, is at least 55%. The Road Network Financing Strategy is developed. The strategy implementation has been launched. A budget request is developed based on the adopted strategy.

*Status: met.*

As at 1 October 2017, the average weighted share of the length of roads, maintained fully according to standards on a regular basis, reached 57.5%.

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

The State Road Network Strategy and the Guidelines on Calculation of Ministry Expenditures Based on Programme Budgeting Principles were approved in September of 2017 by Order of the RA Minister of Transport, Communication, and Information Technologies No. 990-A to improve the quality of strategic planning in the road sector.

The budget request for road construction financing in FY2018, which provides for allocation of AMD 15.1 billion for these purposes that is 47.8% above the actual level of 2016, was prepared in line with the Medium-Term Government Expenditure Framework for 2018-2020.

The importance of this measure stems from the size of budget allocations for road construction, which reaches 0.5% of GDP.

BM 3.4. Establishing a database on the condition of the road surface to serve as an input for decision-making in the process of budgeting road sector expenditures. The relevant database contains technical parameters of the surface condition of at least 1,200 km of inter-state roads.

*Status: met.*

By the control date for evaluation of compliance with the conditions for the third tranche, Armenian Roads Directorate SNPO [state non-profit organisation] had undertaken a study of the condition of the surface of 1,231.5 km of inter-state roads.

This measure aims at improving the quality of information on the condition of road surface to ensure more efficient use of the limited financial resources available for road repair.

The condition of road surface is studied to determine the operational integrity and physical condition of roads. The collected data will contribute to improving the efficiency of budget resource distribution in the sector by improving the quality of forecasting the operational...
integrity of road surface, the need for road maintenance and rehabilitation, and prioritisation of road surface maintenance and rehabilitation.

**BM 4.1. The legislative framework put in place for payment of pensions, benefits, and other allowances, financed from the state budget, by one government agency. 20 multifunction centres established and operate. The construction of at least 2 multifunction centres launched.**

*Status: met.*

All social benefits (pensions, unemployment, disability, and social protection benefits) are paid through a single agency – the State Social Security Service. Previously, several agencies used to be involved in the payment process, including the social protection, employment, pension services, and the occupational medicine expert commission.

As at the date of preparation of this report, there were 20 regional multifunction social service centres in the RA, of which 18 were launched under the first tranche of the financial credit, while the certificates of operational acceptance for the two additional centres (in the cities of Talin and Vanadzor) were signed in October 2017. In addition, there are currently 4 more centres under construction; tenders for the construction of 2 centres have reached the evaluation stage; the procedure of land allocation for 5 centres is underway.

This measure aims at improving the quality of social services by simplifying and accelerating the procedures of filing applications and formalising benefits at multifunction centres operating based on the “one stop-shop” principle, and strengthening the targeting of social protection due to the accumulation of comprehensive information on applicants at the site of application that enables more precise identification of the type of social assistance needed for each user of social services.

Operating the centres based on the “one stop-shop” principle facilitates acceleration of the process of providing social services to the population and improves their quality. The centres are currently operating based on the registration principle: the centres service only residents of respective areas, whereas residents of other areas have to go to several isolated social services to get their benefits. At the same time, citizens can apply for the appointment of their pensions and benefits, recalculation or recovery of their pension at any regional directorate of the State Social Security Service, irrespective of the place of their registration.

In the process of reforming the social protection system and improving the quality of services provided, government functions were streamlined through elimination of duplicate functions, reorganisation of the structure of agencies involved, and there are also plans to optimise employment by up to 25%.

**PI 4.2. Improving the access of the population to social services and the quality of social services by expanding online technologies: Launch of the online system of filing application**

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14 Centres in Amasia, Hrazdan, Malatia-Sebastia, and Shengavit.
15 Centres in Akhuryan and Tashir.
16 Centres in Arabkir, Erebuni, Kentron, Kanaker-Zeytun, and Nor-Nork.
for first and second child birth lump-sum benefits. At least 10% of applications for first and second child birth lump-sum benefits have been filed electronically.

Status: met.

The option to file applications for first and second child birth lump-sum benefits electronically starting from January 2017 was provided for in Resolution of the RA Government No. 976 On Making Amendments and Addenda to Resolution of the RA Government No. 275, dated 6 March 2014, on Assigning Child Birth Lump-Sum Benefits, on Approving the Procedure of Assigning and Paying Child Birth Lump-Sum Benefits, dated 10 August 2017. In January-August 2017, about 60% of such applications were filed using the online system.

This measure aims at improving the quality of social services provided through the implementation of modern technologies.

Judging by the data taken from the pension accounting information system, about 60% of such applications were filed using the online system, of which 8,300 (about 60%) were filed electronically. Implementation of the online system resulted in cutting the time needed for filing applications by the factor of 8-12, i.e. from 35-40 to 3-5 minutes. The Government also plans to enable filing applications for benefits related to the birth of a third and every subsequent child electronically starting from 2018.

III. Measures aimed at improving the business environment

BM 5.1. Improving engagement of businesses in drafting legislative and regulatory acts: Submission of the draft Law On RA Legislative and Regulatory Acts to the National Assembly.

Status: met.

The draft Law On RA Legislative and Regulatory Acts was approved by Decision of the RA Government dated 28 September 2017 and, following the relevant procedure, was submitted to the RA National Assembly. The draft law includes a binding requirement to hold public consultations on draft laws and to reflect the results of public consultations in the summary list, which accompanies a draft law presented to the legislature to ensure transparency of public consultations.

Implementation of this measure aims at expanding the engagement of businesses and the public in the process of drafting legislative and regulatory acts by including binding provisions in the legislation on holding public consultations on all draft legislative and regulatory acts to discover the position of the public concerning the issues offered for discussion, get information on alternative options, potential costs, benefits, and possible risks associated with the proposed provisions.

It should be noted that the practice of holding public consultations on legislative and regulatory acts was launched back in 2010, when the Government issues a decision approving the Procedure of Organising and Holding Public Consultations on Draft Legislative and Regulatory Acts17 (hereinafter referred to as the Procedure of Public Consultations), but it was expanded in 2016, following the creation of an online platform for public consultations.

In accordance with the amendments and addenda to the Procedure of Public Consultations introduced by the Decision of the RA Government dated 2 September 2016, a draft legislative and regulatory act is to be published by the body that developed it on the official website (www.e-draft.am), which is operated and coordinated by the RA Ministry of Justice. Following their preliminary registration at the single website, private individuals and legal entities can share their comments, proposals, and critical remarks on draft legislative and regulatory acts online.

Each proposal and comment received during public consultations, as well as their summary can be used by the body that drafted the legislative and regulatory act to improve the draft. Comments can be rejected if they are shared in a foreign language, are not related to the draft legislative and regulatory act, or include expressions degrading or discrediting a person and citizen. A list of proposals and comments, prepared following the procedure established by the RA legislation, and an improved version of the draft document are to be posted on the single website within a 15-day period following the completion of public consultations.

Since the time the single portal for draft legislative and regulatory acts was launched in early 2017, 415 draft documents have been posted there, 31 draft documents are currently under active discussion. All in all, 3,097 users have been registered at the portal, and 8,466 hits were generated by these users during the first week of October.

BM 5.2. Strengthening the country’s investment attractiveness through improvement of the legislation: Submission of draft Laws On Foreign Investment and On Free Trade Areas to the National Assembly.

Status: met.


The key objective of this measure is to amend the legislation to expand the rights of investors and strengthen the protection of their interests.

Amendments to the Law On Free Trade Areas (hereinafter referred to as FTAs) are aimed at harmonising the national legislation on FTAs18 and the customs legislation19 with the EAEU requirements, as well as at clarifying the rights and obligations of the parties, based on the lessons learned from implementing two pilot FTA projects in the RA. In particular, amendments cover requirements to developing the facilities along the FTA perimeter and conditions sufficient to start operation of an FTA, improved procedures of evaluation of potential

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18 Implementation of agreements fixed in the EAEU Treaty on FTAs; FTAs are included into the country’s customs area; improved mechanisms of monitoring FTAs’ performance are introduced; new mechanisms are established for penalising FTA residents that breach the terms of participating in FTAs etc.
19 Transition to the territorial principle of customs regulation instead of the procedural one; establishment of the legislative framework for customs procedures, in addition to export and import procedures, within FTAs etc.
FTA residents’ applications, introduction of a framework to monitor compliance with the FTA residents’ obligations, and clarified terms of reference of the parties.

The draft Law *On Foreign Investments* focuses on improving the conditions for mobilisation and protection of foreign investments, as well as implementing the best international practice in the field of investment protection.20 Amendments to the Law *On Investment* specifically align the definition of foreign investments with the international practice, expand the exclusive rights of foreign investors to protection against any changes in the legislation worsening their position, introduce the option for foreign investors to directly apply to the international arbitral tribunal before the judicial proceedings are completed within the framework of the national court system; fully introduce the preferential treatment and national regimes, and introduce the minimum investment protection standards.

According to the MEDA, this measure, if implemented, would help eliminate the key barrier to greater foreign investment inflows to Armenia – the low level of confidence in investment integrity.

**PI 7.3. Simplification of the system of filing applications for construction permits: The electronic system of issuing construction permits fully operational.**

*Status: met.*

The electronic system of issuing construction permits through the website [www.e-permits.am](http://www.e-permits.am) is fully operational. A link to the website is also posted on the official website of the State Committee of Urban Planning.

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

The website [www.e-permis.am](http://www.e-permis.am) offers access to an instrument ([www.cpms.e-permits.am](http://www.cpms.e-permits.am)), which enables registration, creating an account, filling in an application to get the relevant permit, and attaching all the documents needed to get a permit. To do that, users must have an e-signature. The website offers a step-by-step instruction and links to relevant legislative acts.

Under Decision of the RA Government No. 596-N, dated 19 March 2015, which regulates the procedure of issuing electronic urban planning permits, the system is operated and maintained by the State Committee of Urban Planning under the RA Government.

All in all, by the evaluation date of the third tranche, the Mayor’s Office of Yerevan had received 19 electronic requests and applications21 for urban planning documents and evaluation certificates since 2016. Based on consideration of the documents received, 9 permits for design, 3 construction permits were issued to developers, 1 working design was cleared with a related construction permit issued, 5 evaluation certificates were issued, and 1 request was rejected.

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20 It includes: a clarified definition of the concept of “foreign investments”; expansion of the exclusive right of foreign investors to protection against any changes in the investment legislation worsening their position to cover the tax legislation; introduction of the option for foreign investors to directly apply to the international arbitral tribunal before the judicial proceedings are completed within the framework of the national court system; introduction of the preferential treatment and national regimes, etc.

21 One application could include requests related to several urban planning projects.
BM 8.1. Registration of rights to moveable assets: Amendments to the RA Law *On Registration of Secured Rights to Moveable Assets*, which provide for expanded access of citizens to registration services, submitted to the National Assembly.

*Status: met.*

The draft Law *On Making Amendments and Addenda to the RA Law On Registration of Secured Rights to Moveable Assets*, which provides for expanded access of citizens to registration services, was approved by Decision of the RA Government No. 1171-A, dated 28 September 2017, and submitted to the RA National Assembly on 4 October 2017.

The measure aims at simplifying the process of getting loans, *inter alia* for small and medium businesses, through implementation of a system of secured transactions offering borrowers the option of using moveable assets as collateral, and at reducing the cost of loans owing to lower risk premia.

The draft law provides for expanded access of citizens to registration services by assigning this function to local offices of the Agency of State Registry of Legal Entities under the RA Ministry of Justice. At present, the rights are registered by notaries public, at commercial banks’ offices (if the latter are pledge holders), or by pledgers themselves in the publicly available electronic system.

In addition, Order of the RA Ministry of Justice No. 506-A *On Realisation of Functions Assigned to the Agency of State Registry of Legal Entities under the Agreement between the Republic of Armenia and the Eurasian Development Bank*, dated 27 September 2017, local offices of the Agency of State Registry of Legal Entities are already engaged in organising consultations on secured rights to moveable assets, issuing statements of secured rights to moveable assets, and creating the conditions for private individuals to study relevant legislative acts.

According to the RA Ministry of Justice, by the evaluation date for the third tranche, 14,000 registrations have been performed in the system of the registry of moveable assets, of which 3,000 – since the start of 2017.

PI 9.1. The terms of reference prepared for programming the tasks of accepting electronic reports and applications, including changed one or those resulting from adoption of the RA Tax Code. Work done to programme the tasks of accepting electronic reports and applications. The share of documents accepted electronically to increase from 95% to 99%.

*Status: met.*

As at 1 October 2017, the share of tax documents filed by taxpayers electronically was 99%. According to the RA State Revenue Committee (hereinafter referred to as the SRC), only reports on the environmental tax are currently filed in hard copy. Their electronic format has already been cleared with the Ministry of Justice and will be implemented starting from around 10 November 2017. The “Pre-filing system” software has been developed, it enables automatic formation of electronic reports based on the new / changed parameters.

This measure aims at reducing the burden on economic agents related to meeting their tax liabilities and mitigating corruption risks by narrowing direct contacts of taxpayers with government bodies.
Under the programme of tax administration modernisation implemented by the RA SRC in cooperation with the World Bank, significant progress has been achieved in implementing an automated system of government revenue management. This system reflects all the requirements of the Tax Code, which will come into force in January 2018. In the framework of the system, the tax payments of each taxpayer will go to the Treasury Single Account, which is currently being established (with the taxpayer’s identification details maintained within his individual account), while electronic payment copies are to go to the RA SRC. The taxpayer individual account includes information on his tax liabilities, while the system design does not allow payments in excess of liabilities, including advance payments. In case of a surplus payment under certain taxes and no tax arrears of the payer, the surplus payment would automatically be transferred to the “purse” of the counterpart (taxpayer) until new liabilities arise. This and other measures implemented by the RA authorities to improve the tax administration (see BM 9.2) should result in reducing the tax and administrative burden on economic agents and strengthening their payment discipline.

BM 9.2. The list of tax audits of economic agents prepared based on the revised risk assessment criteria is published.

Status: met.

The list of economic agents to be covered by tax audits in 2017-2018 is prepared based on the revised risk assessment criteria and posted on the website of the State Revenue Committee under the RA Government (www.petekamutner.am). The number of organisations to be audited has declined compared to the previous list by 10-15%.

This measure is aimed at improving the business environment and boosting economic activity by reducing the excess administrative burden created by government bodies for economic agents, inter alia in the process of their audit activities.

In early 2017, the RA SRC revised the risk assessment criteria of the system used to select taxpayers to be audited and made relevant changes in the computer-aided risk assessment programme used for generating lists of economic agents to be covered by tax audits. These efforts were focused on updating the risk assessment criteria for certain taxes, whereby 76 criteria were fixed to replace 72 criteria, which were used under the old methodology; weights and their maximum risk scores were revised practically for all criteria; the formulas for calculating 10 criteria were revised, and fixed risk scores were replaced with risk ranges for 5 criteria.

Under the amended programme, risks were scored for all taxpayers and the list of economic agents to be covered by tax audits was prepared.

The results of this activity are reflected in Decision of the RA Government No. 570-N, dated 25 May 2017, On Approving the Methodology of Comprehensive Tax Audits within the Framework of Tax Authorities’ Functioning and the General Description of Risk Assessment Criteria.
PI 10.1. Simplification and enabling equal access to data on subsoil exploitation. Digitalisation and public disclosure of information on subsoil exploration and exploitation completed. At least 90% of geologic fund materials digitised.

Status: met.

As at the evaluation date for the third tranche, 91% of materials of the Geological Fund were digitalised (against 51.3% a year earlier). As at the date of this report preparation, 100% of such materials were digitalised. The information is posted on the following website: www.geo-fund.am.

This measure aims at enhancing the transparency and competition in the mining sector to ensure equal rights of access to subsoil exploration.

As a result of the work done by the RA Government in cooperation with the USAID, the digitalisation of all the information of the Geological Fund of Armenia — over 12.5 thousand documents — was completed within a short period of time (slightly more than a year) and the information was publicly disclosed online. The increase in the traffic on the website, where the materials are posted, from 200 hits in January 2017 to 900 hits in September and the growth in the number of the website users, who represent major investors in the mining industry (Russia, USA, etc.) point at the fact that it is gaining popularity with professional investors in the RA mining industry.

Further efforts in information digitalisation and posting it on the website will be undertaken by the Ministry of Energy Infrastructures and Natural Resources, which supervises the Geological Fund. This ministry has received the relevant equipment and technologies.

The importance of this measure stems from the significant capacity of the processing industry in generating the RA GDP — the added value of this sector accounted for 2.6% of GDP in 2016, against 2.1% in 2014, while its growth rates in real terms reached almost 30% per annum in the last 2 years. Disclosure of the information of the Geological Fund can become one of the drivers of growth of foreign investments in the RA mining industry.

BM 10.2. Enabling equal rights of access to subsoil exploration: Regulatory documents adopted to ensure implementation of the Law On Subsoil.

Status: met.

The Government of the Republic of Armenia has adopted the following Decisions:
- No. 1199-N, dated 28 September 2017, On Approving the Procedure of Functioning of the Tender Committee on Granting the Right to Subsoil Management for Geological Exploration of Radioactive Raw Materials;
This measure aims at ensuring a fair and predictable environment for investors in the field of geological exploration.

The Law On Amending RA Law On Subsoil, which provides for establishing the rights of ownership to subsoil to explore radioactive raw materials on a competitive basis, was adopted by the RA National Assembly on 20 October 2016.

The above Decisions of the Government are aimed at implementing this provision of the Law through clarification of liabilities of the parties, definition of functioning of the tender committee on granting the right to subsoil management for geological exploration of radioactive raw materials, establishment of the procedure of filing bids, deadlines, requirements to the qualification, financial and technical capacity of bidders, as well as definition of the procedure of tender package preparation.

The importance of this measure, among other things, stems from the fact that, according to the data for 2016, about one third of electricity in the RA is generated at NPPs using fuel, which is currently imported. With investments mobilised to develop excavation of radioactive raw materials, the import intensity of generating this type of energy could be significantly reduced.

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

PI 11.1. Implementation of monetary policies within the framework of the inflation targeting strategy. Actions on the foreign exchange market aimed exclusively at smoothing sharp variations of the exchange rate.

*Status: met.*

During the whole period of the EFSD Programme implementation, the RA CB engaged in foreign exchange interventions exclusively for the purposes of smoothing sharp variations of the local currency exchange rate, *inter alia* caused by the seasonality of transactions under the balance of payments.

This measure aims at improving the exchange rate flexibility that would strengthen the economy’s resilience to external shocks and maintain the GIR growth.

In 2017, the RA CB performed interventions to sell foreign exchange only in January, while buying foreign exchange in the market for the rest of the year. Net purchases of foreign exchange reached US $95.6 million in January-September 2017, against US $6.6 million for 9 months of 2016. For the first nine months of 2015, net sales of foreign exchange reached US $206.5 million — except for a couple of months, the RA CB was a net seller of foreign exchange in 2015. Thus, while in 2015 the RA CB was actively supporting its local currency exchange rate, in 2016 its long-term impact on the exchange rate was most likely neutral, and in 2017, owing to the foreign exchange market stabilisation, the National Bank managed to replenish its reserves relying on domestic sources.

The IMF characterises the RA exchange rate regime as a floating exchange rate. Although over the last 12 months, the GIR grew by 14.8% in the US $ equivalent (or by US $271 million), in terms of months of imports they declined from 5 to 4.9 months owing to the high rate of recovery of demand for imports against the background of economic growth and growing
remittances from Russia. The key sources of reserve growth included the second tranche of the EFSD’s financial credit and the RA CB’s purchases of foreign exchange in the domestic market.

PI. 12.1. The level of dollarization of banks’ loan portfolio is 62.5%. The dollarization is reduced from 67.5% to 62.5%.

Status: met.

As at end-September 2017, the level of dollarization of banks’ loan portfolio was 62.7%.

This measure aims at reducing the dollarization of the RA banking system and, thus, improving its resilience to external shocks.

Under the programme, the RA CB management supported and implemented measures to reduce the dollarization of loans and deposits (measures 12.2-12.4 of the Framework). Owing to these measures, accompanied by the AMD exchange rate stabilisation, the dollarization of loans was consistently going down in 2016-2017. Over the last 12 months, it has gone down from 65.6% to 62.7%. Certain sluggishness of the dollarization reduction is a result of expansion of export-oriented production, where lending is often provided in foreign exchange, as well as demand for loans from non-residents. The dollarization of loans, net of loans to non-residents, dropped from 66% to 62.3% in the period under consideration.

PI 12.2. For estimation of the credit risk, to be factored into the calculation of the capital adequacy ratio, 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 percentage points higher than for assets in AMD. Continuous monitoring and adjustments, when appropriate.

Status: met.

Decision of the RA CB Board No. 6-N, dated 21 January 2015, established the same risk weights for foreign exchange assets provided to borrowers, who are exporters complying with certain requirements (are legal entities; generate cash inflows through exports; and have cash inflows, net of loans, in excess of cash outflows), as to similar assets in AMD. As to other foreign exchange assets, the weight risks should be 50% higher than for assets in AMD.

Over the period evaluated for the third tranche, the risk weights established for assets in foreign exchange were at least 50% higher than those for assets in local currency. For a number of risks related to mortgage lending, the weights of foreign exchange risks were 100% higher than the risks in AMD.

This measure aims at ensuring access of exporters to foreign exchange loans that should bring down the costs of dedollarization measures for enterprises generating export proceeds, while reducing lending in foreign exchange to borrowers not generating foreign exchange.

The implementation of this measure facilitated a reduction of dollarization of loans in 2016-2017. At the same time, the Manager notes that loosening of the RA CB’s monetary policies and AMD exchange rate stabilisation also contributed to lower dollarization of loans.

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22 Data as at end-September 2017.
PI 12.3. 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, amending regulatory documents of the RA CB.

Status: met.

Under Decision of the Board of the Central Bank of the Republic of Armenia No. 147-N, dated 29 June 2010, the rate of provisioning for potential losses on assets in foreign currency exceeds that for assets in the local currency by 20%.

This measure aims at creating incentives for banks to lend in local currency, which should facilitate the dedollarization of assets.

As noted above, the dollarization of loans was reduced, *inter alia* owing to this measure.

PI 12.4. Maintaining higher reserve requirements for funds mobilised in foreign exchange. Monitoring and amending regulatory acts of the RA CB, as needed. The reserve requirement set at 2% for AMD funds mobilised and at 18% for funds mobilised in foreign exchange. Monitoring and amending regulatory acts of the RA CB, as needed.

Status: met.

This measure came into force from February 2007.23 Under Decisions of the RA CB Board No. 299-N, dated 24 December 2013, and No. 146-N, dated 20 September 2016, the reserve requirement for funds mobilised in AMD was left at 2%, while for foreign exchange it was set at a level of 18%. In the past, the reserve requirement for funds mobilised in foreign exchange varied, averaging at 12%, while the reserve requirement for funds mobilised in AMD was 2% during the whole period.

This measure aims at reducing the dollarization of deposits and is related to PI 12.3 of the Policy Matrix. As at end-September 2017, the dollarization of deposits was 62.4%, having dropped from 66.8% a year earlier. The decline in deposit dollarization is explained by both the measures taken by the RA CB and the depreciation expectations subsiding against the background of the stable local currency exchange rate.

PI 13.1 Growth rate of deposits at a constant exchange rate: at least 5% per annum.

Status: met.

As at 1 October 2017, the deposit base made AMD 2,483.1 billion (at the programme exchange rate as at 1 October 2015), having grown by 16.7% over 12 months.

This condition aims at strengthening the monetisation of the economy through expansion of the deposit base and at expanding the investment possibilities for banks to reverse the consistent trend of declining fixed capital investments observed in the RA in recent years.

The deposit base growth was generated owing to both the strengthened confidence in the banking system and improvements in the banking legislation on depositors’ rights through measures implemented under the second tranche in the framework of the EFSD Programme: raising the threshold of guaranteed deposit amount, acceleration of the process of deposit

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23 Decision of the RA CB Board on approving Regulations 2 *Regulation of Banks’ Activity, Key Prudential Regulations for Banks* (No. 39-N, dated 9 February 2007).
recovery, extension of the period allowed for filing an application for guaranteed deposit recovery. From the macroeconomic point of view, the key factors included the growth of remittances from Russia and economic recovery.


Status: met.

On 14 September 2017, the RA National Assembly passed the draft Law of the Republic of Armenia On Making Amendments and Addenda to the Law of the Republic of Armenia “On Banks and Banking” in the first reading. This law sets the legislative framework for introducing a range of prudential controls, such as: the economic countercyclical buffer, the leverage ratio, the claim/collateral and client debt/income thresholds, and the algorithm of identifying systemically important banks.

This measure aims at strengthening the resilience of the banking system in line with the international prudential supervision standards reflected in Basel III.

The Manager expects that after the Law is adopted, implementation of these measures would help improve the quality of prudential supervision in the RA.