

## SUMMARY REPORT

### On Implementation of RA Government Anti-crisis Action Plan

#### **Introduction**

1. The Republic of Armenia was able to withstand the first tide of the global financial and economic crisis firstly thanks to efficacious financial control leading to historically high financial system stability indicators and, secondly due to the lack of “hot” money in Armenia’s financial sector. Besides, domestic financial markets did not maintain too strong ties with global sub-prime markets. In particular, unlike developed economies, Armenia’s banking and financial institutions escaped panic with relatively low demand for liquidity. While GDP growth was below target in 2008, there was a 6.8% growth recorded in the same period against a 5% average for the CIS countries. Note that Armenia is ahead of Russia (5.6%) and Ukraine (2.1%) as for economic performance indicators.
  
2. Nevertheless, like many other countries, Armenia was not spared by the crisis, with the bulk of its impact coming down on the real sector which experienced some downward tendency. This was chiefly conditioned by the following factors:
  - Reduced remittances from abroad
  - Lower raw material and mineral ore prices on the global markets
  - Lower demand for Armenian commodity and service exports due to curbed global demand
  - Shrinking influx of investment into Armenia due to the lack of liquidity in the global economy.
  
3. Falling real estate prices on the global markets led to diminished interest for domestic immovable assets. This, coupled with (or conditioned by) reduced investment, ended by freezing the main driving force of Armenia’s economics – the building sector. Inferior household income and altered consumer behavior, on the one hand and reduced foreign demand on domestic goods and services, on the other hand, resulted in less activity in number of economic branches in Armenia. 9.7% fall in growth was recorded as early as in the first four months of 2009.
  
4. Armenia’s pricing framework was the lowest among the CIS countries due to which our country managed to maintain its overall economic stability. Inflation was only 5.2% against the average 14.8% across the CIS countries by the end-of-year. Low inflation was partly due to the

government's policy aimed at having a strong and stable national currency. This put a check on the prices of a number of strategic imports (chiefly fuel and food) which had already soared considerably worldwide. Inflation was up 3.2% and 1.6% in April and May, 2009 respectively, as compared to the previous month, resulting in an aggregate of 3.4% 12-month inflation rate by the end of May, situated at the bottom of the target corridor. Drastic dram devaluation-caused fluctuation in commodity prices in early March, as well as increased utility fees as of last April may have accounted for some rise in prices over the period under review.

5. 2008 was unprecedented in terms of improved revenue collection and tax administration with a 0.9 percentage point higher revenue-GDP ratio leading to a total increase of 17.0%. This was made possible due to radical reform carried out in the system of tax administration which helped sharply increase budget receipts to open up exceptional possibilities for addressing welfare issues in Armenia.

6. Precautious public debt management policy was pursued with the foreign debt-GDP ratio standing at 13.4% in the period under review against the average 33.4% across the CIS economies. Note that the low level of public debt at this stage of the global crisis allows sufficient room for fiscal maneuvering, namely it is possible to contract extra debt without putting at risk the public debt sustainability indicators. This is why, in order to offset the impact of the global financial and economic crisis on Armenia, the Government was in active talks with international donors and partners with a view to attracting additional resources on preferential terms. As result of sustained efforts with the International Monetary Fund, the World Bank, the Asian Development Bank and the Government of the Russian Federation, Armenia will receive over 1.6 billion US dollars to cope with those adverse consequences of the global financial and economic crisis coming from abroad, including the maintenance of the country's overall trade balance, the fostering of business activity and the development of welfare-related and physical infrastructures. Note that this has been an unprecedented achievement for independent Armenia, in particular, and for the international record of individual country-donor organizations relationships, in general, standing as a testimony for high level of confidence in our government's economic policy on the part of international financial institutions and partner States.

7. As of early March, 2009, Armenia resumed the policy of floating rate. Note that this was preceded by savings flight- and dram deposit conversion-related pressures in the banking system caused by expectations of the upcoming national currency devaluation. This gave rise to threats

associated with banking system liquidity and capital adequacy. To address them, as early as from the very start of the financial year, the Central bank of the Republic of Armenia had been stepping up intervention into the foreign exchange market allowing domestic banks to restructure the balance taking the opportunity offered by the temporary stability of exchange rate. At the beginning of March as Armenia's financial system was sufficiently capitalized, had enough liquidity to withstand the crisis-related challenges ahead, the Central Bank gave up the policy of active foreign exchange market interventions and returned to the policy of floating rate with a basic goal to build up a solid groundwork for defying efficiently imminent pressures coming from exchange rate liberalization. This policy of "instant exchange rate liberalization" proved successful in the aftermath. Step-by-step liberalization would have increased the level of uncertainty within society and among the business circles triggering out in turn a non-justified rise in the rate of exchange. The latter was sure to impair the structure of the economy as a whole giving rise to serious threats for doing business in Armenia. Besides, some speculative practices might turn up to alter the existing market balance. This policy of the Armenian authorities was welcomed on the part of such reputed financial institutions as the International Monetary Fund and the World Bank which pointed out that it was just the only right course to meet the challenges posed by the global crisis. Moreover, Bloomberg declared that any country facing similar threats should follow Armenia's example. It is noteworthy that these measures failed to impair Armenia's investment rating: according to Fitch, a world-reputed rating organization, Armenia managed to keep afloat on the BB level – with a maximum of BB+ scenario – which speaks for our country's healthy position and sustained level of attractiveness for would-be investors. It should be further noted that weaker national currency will foster exports which suffered during the past few years due to appreciating dram. All this speaks for the Government's wise and balanced policy which made it possible to achieve macroeconomic stability amidst a complex situation.

### **The Principles of Anti-crisis Policy**

8. Account taken of the impact of the global crisis on Armenia's economy, the Government's anti-crisis policy response is chiefly aimed at boosting economic activity rather than strengthening financial institutions and providing additional guarantees against eventual risks.

The main principles of the anti-crisis action are stated below:

- Achieving macroeconomic stability through financial sustainability
- Efficient exchange rate policy pursuit

- Ensuring effective feedback with society and businesses
- Implementation of expansive monetary and fiscal policy
- Realization of large-scale infrastructure-related programs
- Business environment improvement and temporary support for entrepreneurship
- Priority given to socially-targeted programs.

### **Macroeconomic Policy**

9. At this point, the Government and the Central Bank of Armenia are implementing anti-cyclic fiscal and monetary policy implying that overall demand is boosted to counteract economic downturn which, in turn is supposed to revive the business environment. Proper coordination first of all is prioritized in this process, which seems to have been the case so far. In particular, with a view to strengthening the banks' financial position and injecting extra liquidity into the economy, which in turn can lead to reduced interest rates, the Central Bank took the refinancing rate 1.0 percentage point down to 6.25% at the end of May, with deposit and pawn credit rates standing at 3.25% and 9.25% respectively. On the other hand, the Central Bank diversified the toolkit applied to injected funds, inclusive of:

Long-term repo functionality implying:

- 91-day maturity
- monthly basis
- fixed rate (refinancing rate + margin rate)
- no limits (long-term repo transactions must allow for the key repo transaction to rise to 20 billion drams and above)

Purchase of government bonds on the following conditions:

- maturities can vary, nevertheless transactions are best carried out in such bonds as have higher rate of return
- frequency – irregular
- interest rate – fluctuating (negotiated)
- amount - the long-term repo facility should be considered as the key tool for injection of resources. At the same time, bonds should be purchased to such an amount as will not reduce the level of key repo transaction below the mark of AMD 20 billion

Guidelines for the swap of foreign exchange:

- maturity – up to 7 days
- frequency – irregular
- interest rate – fixed (the rate of swap should be equal to that of long-term repo transaction)
- amount – irregular

Application of systemic tools:

- subordinated credits of 5-year maturity shall be available to banks should their paid-in capital be replenished
- availability of 3-year maturity credits to the rate of 30% of paid-in capital in case of bank merger

10. Fiscal policy sought to extend the scope of gross demand in the first quarter of 2009. The index of fiscal impact was 5.8% in the period under review, with the restrictive income impact standing at 8.2% and the expansive spending impact rising to 14% respectively. The income impact-caused restraint was basically conditioned by sustained mandatory social insurance payments and the high level of non-tax revenue collection. In particular, mandatory social insurance payments rose to 4.6% of GDP in the first 3 months of 2009 instead of 3.1% as stated in the budget law. Actual receipts under non-tax revenue items constituted AMD 9 billion, 3 times as much as the target set for the first quarter. The expansive spending impact is caused by the fact that notwithstanding a 6.1% economic fall, expenditure items – welfare spending and salaries in particular – were honored in full providing for a higher level against GDP. As per the figures of the first quarter, total expenditures rose to 35.4% of GDP while the expenditure-GDP target set in the budget law was only 22.7%.

### **Tax and Customs Reform**

11. The Republic of Armenia Tax Administration Strategy Program for 2008-1011 provided a framework for those reforms underway in the fiscal sector with its watchword of “facing the taxpayer.” The following key emergency measures have been carried out to date:

12. Tax rules have been simplified considerably for the business circles inclusive of small and medium-size enterprises, in particular. Simplified rules envisage:

- Higher VAT threshold - AMD 58.3 million against the currently applicable AMD 3 million, as well as a simplified tax returning procedure for small and medium-size enterprises

implying that entities with a turnover up to AMD 100 million will be subject to taxing regulations instead of having to apply the international standards.

- Taxpayers with turnovers up to AMD 58.35 million are required to submit a simplified statement for profit tax and income tax once a year.
- Quarterly reporting (instead of monthly statements) is required from those employers having 5 or less employees.
- Acceptance of expenditure justifications on the basis of cash-register tickets and short invoices to a yearly amount of AMD 36 million against the applicable AMD 1 million.
- Simplified tax returning procedures: elimination of control commissions and introduction of mechanisms for the receipt of tax returns by plain mail or through special boxes available close by local inspectorates. Starting October, 2009, tax returns can be submitted in electronic version. All this is supposed to minimize the possibility of physical contact between individual taxpayers and tax inspectors minimizing thereby corruption risks.
- Canceling of monthly VAT return submittal requirement for entities with less than AMD 100 million worth of turnover, against the threshold of AMD 60 million applied so far. The above measures will save entrepreneurs valuable time and will reduce the cost of entity-tax authorities contact.
- The launching of an accounting service center to help implement unified policy for each category of taxpayers, as well as to provide them with standardized, high-quality and affordable services.
- VAT and profit tax holiday for manmade carpet industry to both improve their financial performance and help preserve this important tradition for Armenian nationals.
- 3-year-long VAT waiver for those products specified in Article 6 of Republic of Armenia Law on Value Added Tax, should the total amount payable exceed 300 million drams. This rule shall be applied to such products out of this group as may be specified in government-approved investment programs with a total budget of AMD 300 million and above.
- In accordance with the RA Law on Licensing Fees, such fees will be applicable to 11 activities (mostly done by the self-employed) which sets new gaming rules in private-public sector relationships allowing the self-employed to feel more at ease and protected in the context of tax administration.
- Simplification of taxation rules for non-brand hotels by establishing flat rates for such entities according to different zones. This is supposed to build a network of relatively affordable hotel services which in turn will strongly boost traveling and tourism in the country.

- To develop tourism and enhance Armenia's attractiveness in the eyes of would-be visitors, the amount of State duty has been taken down from 15 thousand to 3 thousand drams for short stays (21 days).
- The Government of Armenia has decreed to refund about AMD 15 billion in VAT arrears in the second quarter of 2009. This will considerably increase the resource base of our businessmen providing a strong incentive for continued activity.
- The requirement for compulsory 1% advance payment of profit tax on turnover has been lifted in the jewelry sector to free additional resources for future activities.
- The RA Government has taken an unprecedented step in the area of inspections and checkups: in the period from June 1, 2009 to January 1, 2011, no inspections and checkups will be held with such economic entities (except the ones carried out on the part of the State Revenue Committee) which will display a turnover less than AMD 70 million for 2008 (except as specified in the penal Code of the Republic of Armenia concerning the protection of human rights, citizens' health and life, national defense and security purposes, with RA Prime Minister's written agreement, based on written applications received from small and medium-size enterprise chief executives, when dissolving a small and medium-size enterprise).

13. The following reforms were carried out within the customs administration:

- Customs broker's offices and self-declaration desks are operational with customs houses and warehouses. They are supplied with electronic links to the TWM customs clearance-servicing computer software, applied at customs houses and warehouses. As a result, less time is spent for clearance purposes. Physical contact between importers and customs officers is minimized to avoid much of corruption risks.
- Many procedures have been simplified by adding such clauses as call for customs declarations to be corrected instead of canceling them in case of irregularities detected during post-clearance controls. This is meant to save importers a lot of time and efforts.
- Risk assessment criteria have been revised in the TWM customs-clearance servicing computer software to enhance control efficiency. As a result, the software has become more targeted and resource-saving.
- The number of documents to be submitted by importers and exporters when crossing the border has been decreased to only 3 pieces, reducing thus the time needed for customs clearance purposes.

- The range of imported products subject to mandatory certification has been reduced from 65 to 16.
- It is no longer needed to fill in a duty receipt form as duties are currently paid through the banking system, which is supposed to considerably reduce corruption risks among customs officers.

### **Improved business environment**

14. In an effort to win for Armenia an image of “the best country for doing business in the region” and promote its rating in the Doing Business Report, in the year 2008 the Government of the Republic of Armenia adopted a concept note on “Center of Excellence” nationwide project for Armenia’s business and investment environment, backed by the Business Environment Improvement Action Plan. A number of improvements have been implemented (in addition to tax and customs administration reforms), including:

15. Draft Republic of Armenia laws on immovable property tax, tax on transport means, income tax have been developed which provide for a single tax payable for land and immovable assets and a consolidated contribution instead of the currently applied income and welfare taxes. This will cause taxpayers to produce unified returns for each of the above categories.

16. The process of creating a legal person has been simplified:

- The requirement of having a seal has been lifted
- Legal persons will no longer have to file a request with competent authorities should they wish to have a seal
- No threshold will be put on the amount of statutory capital, and applicants will no longer have to state its size at the time of registration
- The contents of corporate by-laws will not be checked at the time of registration. Instead, they will only be registered and put on record.

17. A business support center will be established by the State Registry of Legal Persons to provide the whole range of services needed for company registration purposes according to the “one stop shop” principle, including trade mark registration and taxpayer’s account current provision.



18. The following measures have been implemented as to the granting of construction authorizations:

- A “one stop shop”-based package of laws is being developed to facilitate the receipt of technical requisites for utility access on the part of corporate and individual developers.

19. The following measures have been implemented as to the receipt of loans and credits for construction purposes:

- The RA law on circulation of borrower’s information and lending organizations activities has been enacted to streamline the process of collecting and circulating borrower’s information. Lending banks’ risk exposure will thereby be reduced to enhance their operational efficiency.

20. The following measures have been implemented in the area of property registration:

- A computer-operated program has been developed to facilitate immovable property cadastre running in the Republic of Armenia, supposed to save customers a lot of time and efforts, which in turn will help increase system work efficiency, as a whole.

### **Infrastructures**

21. The Asian Development Bank has agreed to extend a credit to the amount of USD48mn for rural road rehabilitation purposes. Construction work started as early as in October, 2008, and will be completed in 2009-2010.

22. About AMD 5.3 billion-worth of building activities have been carried out under the Millenium Challenge Account-Armenia program, including a 24.5 km-long road section on Armavir-Isahakyan-Gyumri highway with a total cost of 1.5 billion drams.

23. In October 2008, an arrangement was reached with the Georgian side on reconstruction of Yerevan-Batumi motorway. 30% shorter than the existing one, the new highway is expected to boost commodity turnover between the two countries and help promote tourism in Armenia.

24. Efforts have been made in search of alternative communications of strategic relevance to Armenia, including the Iran-Armenia railroad construction. Talks have been held with potential investors resulting in 3 different project scenarios developed for the project.

25. Steps have been taken towards the building of a new nuclear reactor based on domestic uranium deposit development and processing projects, which are of paramount importance to our country as seen from the geopolitical perspective:
- The tender announced to select a managing entity is complete, and Warley Parsons, a company with deep knowledge and long experience in this field, has been chosen to manage the project. It will render an all-out and comprehensive assistance to the Government of the Republic of Armenia, including the identification of strategic investors.
  - A concept note referred to as “Geological survey in 2009-2010” has been developed to streamline uranium exploration activities in Armenia for the period under review. According to this document, field work for uranium development will start in early 2009.
26. The following activities have been carried out in the power engineering-energy sector:
- Building and assembly work is underway under those projects supported by the Japanese Bank for International Cooperation, including the construction of a gas and steam operated combine-cycle unit at the Yerevan flame station and design work for 110 kW substations and SCADA communication system modules under the power transmission and distribution project. Once upgraded, the thermal plant will help increase significantly the output of electricity and reduce its cost-price.
  - Refurbishment is carried out at Unit 5 of the Hrazdan TPP on the part of HayRusgasard CJSC.
  - On January 30, 2009, a lending and project funding agreement was signed between the Republic of Armenia Ministry of Finance and Armenian High-Voltage Electricity Transmission Lines CJSC, on the one hand, and the German KfW Bank, on the other, under which a total of 14.6 million euro coming from the State budget and the financial market will be made available for reconstruction of Gyumri-2 high-voltage line.
27. The following activities have been carried out in the field of renewable energy and energy saving:
- The European Bank for Reconstruction and Development has agreed to provide a USD 1.5 million grant for two selected geothermal projects in Armenia. Exploration work will start as soon as positive geological and geophysical expert findings are available concerning these projects.

- The German KfW Bank has been supporting with success minor hydro-power plant projects in Armenia. The German-Armenian Foundation has so far financed the construction of 11 such hydro-power plants. 23 other minor HPPs were realized with the support of the World Bank mediating the Renewable Energy and Energy Saving Fund.
  - Under a program of joint study of the Araxes River hydropower potential as signed between the Government of the Republic of Armenia and the Government of the Islamic Republic of Iran, a package of mutually agreed instruments on simplified border crossing procedures have been sent to the National Assembly of the Republic of Armenia for ratification. Talks are underway with the Iranian side with a view to finalizing the financing scheme for the Meghri HPP.
28. The Government of Armenia is negotiating with the Iranian side on construction of Iran-Armenia (Tebriz-Yeraskh) oil pipeline due to start this year. Having a 450-500.000 annual output capacity, the pipeline is meant to meet Armenia's home demand. This project is crucial to our country as it will provide an alternative path for energy supplies to bring down hydrocarbon prices and keep the home market safe from the negative impact of external turbulences.

### **Construction**

29. The problems of disaster-hit and vulnerable households are given a special focus on the part of the Government. Under a housing program designed for the earthquake zone, at least 2300 apartments and service facilities have been built in Ani and Mush-2 residential districts of Gyumri town, 182 apartments and service facilities – in Akhurian village of Shirak marz, a minimum of 226 individual homes - in 10 rural communities of Shirak marz, at last 354 apartments and service facilities – in Spitak town of Lori marz (in the District of Craftsmen). Tenders are out for at least 1821 individual homes to be built in 24 rural communities of Lori marz.
30. In December 2008, bids were invited for the design of primary development schemes on the site of a redundant airport in Jermuk town of Vayotz Dzor marz of Armenia. Follow-up activities are underway which will help get a municipal development scheme and its by-laws.

31. Kumayri program for rehabilitation and refurbishment of historical and cultural monuments in Gyumri town is being worked out now. The program seeks to restore the architectural and cultural dimensions of Gyumri town's past image by preserving the historical downtown, as well as to promote the traditional trades and crafts among the population, boost small and medium-size enterprise in the town, develop traveling and tourism infrastructures, generate a business-friendly environment and several new jobs.
32. Under the National Competitiveness Council's terms of reference, a comprehensive program is out for the reconstruction of Tatev monastic complex, meant to foster tourism in the region by giving it enhanced attractiveness. Total project cost is USD 20 million, financed by businessmen and entrepreneurs from the Armenian Diaspora. An unprecedented cableway is scheduled for construction which as per expert estimates will be one of highest and longest ones in the world.
33. The Government has embarked upon an ambitious program addressing construction, aimed at reviving the building sector considering its impact on the GDP. To this end, State guarantees are being provided to those developers who own unfinished multi-storey apartment houses with 50% and more completion status. The Government has likewise started drafting a bill which provides for over 1 billion dram-worth of subsidies available under new public work program for the period 2009-2011. The bill stipulates that the whole amount of VAT and welfare contributions paid to the treasury during the implementation stage will be refunded to the developers upon program completion.
34. To boost the building sector and address the population's welfare problems, the Government is going to launch a mortgage fund based on the public-private sector cooperation scheme. The State is expected to invest 20 million US dollars planning a follow-up attraction of 200-300 million dollars for mortgage lending purposes.

### **Real sector support**

35. With a view to providing direct support to the real sector, an Operative Staff is operational processing business programs received from private sector representatives. The Operative Staff has so far received about 300 applications, with 24 projects endorsed for support to a total budget of AMD 14.1 billion.

36. To date, AMD 50 million worth of support has been provided by the SME DSC in the form of a stake held in the statutory capital of companies. AMD 12 million and USD 110 thousand were disbursed under loans. In addition to these projects, after discussions held in the working group, 16 business projects were forwarded to the SME DSC for consideration.
37. A special investment/lending organization has been set up by the SME DSC, which shall use the Russian stabilization credit of USD 500 million (about 15 billion drams) to provide lending both for implementation of development-oriented major business projects and purchase of stakes in corporate capital. With the ever increasing cost of borrowed funds, this initiative will provide a strong incentive for the development of small and medium-size enterprise and the economy, as whole.
38. A stabilization fund is due to be created by means of the funds borrowed from Russia to keep the national economy safe from possible disruptions caused by the global crisis.
39. Resources coming from international financial institutions, too, are used to finance small and medium-size enterprise in Armenia. Namely, USD 50 million out of USD 85 million worth of World Bank loan proceeds have already been injected into local small and medium-size enterprises with the balance having to be spent on road building activities.
40. The Government of Armenia is currently negotiating with the Russian ALROSA company over a USD 100 million credit, meant for the development of domestic diamond processing industries. If available, the credit will make it possible to rehabilitate and further expand this traditional for Armenia branch of industry which has been experiencing problems of objective character recently.
41. The National Assembly of the Republic of Armenia has adopted a law on the Pan-Armenian Bank providing a legal and institutional framework for its functionality. The Pan-Armenian Bank is supposed to become a strategic stronghold which will bring together efforts and resources from the Armenians all over the world.

### **Welfare Programs**

42. The Government has announced the start-up of a targeted State-administered program under the motto of “Affordable housing for youth,” which will provide assistance to

vulnerable households in the country. State support will be made available under the program in an effort to help young families get housing by means of mortgage lending. Assistance will go in two ways:

- Extension of interest-free loans of 10-15 years' maturity by the State to cover 30% of the amount of advance payment required under mortgage lending. In case of underage children in young families, extra 10 % subsidy will be offered for each such child.
- Partial subsidy given by the State in compensation of mortgage loan interest. In case of underage children in young families, extra 10 % subsidy will be offered for each such child until the age of majority.

### **Foreign Economic Policy**

43. Armenia's adherence to the GSP+ system is crucial in terms of strengthening economic ties with the European Union. This will allow access to preferential terms of export for domestic exporters while intervening into the European marketplace which in turn will bring down the cost of Armenian exports to ensure enhanced competitiveness for Armenian products.

### **Education and Science**

44. Well aware of the instrumentality of scientific research as to economic stability and the formation of progressive society, the Government of the Republic of Armenia has recently passed two important decisions. The first one relates to the establishment of an international research center on the basis of CANDLE synchrotron light source project, which is supposed to provide a breakthrough for the development of fundamental research and applied sciences in Armenia. The second decision bears on the production of isotopes by means of "Cyclotron" system in the Yerevan Physics Institute. A specialized medical center will be operational by the isotope plant to deal with the early detection and accurate diagnosis of malignant tumors.

## **Conclusion**

45. The aforementioned anti-crisis and strategic development programs will be carried out in line with Armenia's best public fund management traditions. All relevant investment programs involving public means will be reflected in the financial statements of the State (in the State budget) to provide for stringent accountability and a high-level of transparency. Those non-traditional measures of State support targeting the private sector will be limited in size and timing. Advanced public investment monitoring and assessment systems will be introduced to that effect. The Government will be abiding by its focus of liberal economic policy and will honor the obligations assumed before the WTO and other international agents. The need in making some policy corrections due to the economic crisis will never cause the Government to deviate from its policy of economic liberalization.