Letter of Development Policy
Republic of Armenia

Mr. David Malpass
President of the World Bank
Washington DC, USA

Honorable Mr. Malpass:

On behalf of the Republic of Armenia, allow me to express the assurance of my highest consideration.

We would like to share an overview of economic developments in the Republic of Armenia and expected trends of current reforms.

The Government Program

Despite the risks, which arose due to political changes in 2018, as well as negative signals coming from the external world and slowdown in economic growth of partner countries, prudent macroeconomic policies allowed overcoming them and achieving macroeconomic stability. Current economic developments attest to the fact that macroeconomic and financial stability have been achieved and sufficient conditions have been created for attaining higher economic outcomes in the near future.

Government activities in the upcoming five years will be aimed at building a competitive and inclusive export-led economy, which meets high technological, industrial and environmental standards.

The tasks of the Government for the upcoming five years are as follows:

✓ Expanding opportunities for economic activity;
✓ Increasing efficiency of public administration;
✓ Developing human capital;
✓ Developing reliable infrastructure and expanding accessibility.
Fundamental milestones of the Government’s economic policy will include:

- **Economic policy and citizen welfare:** promoting inclusive economic growth will be a key feature of the Government’s upcoming economic policy. The economy has to grow at high rates with average GDP growth rate of at least 5 percent in the program period. Meanwhile, a significantly higher number of citizens have to participate in economic development and the economic product created as a result of their work has to be distributed more evenly.

- **Competitive and participatory economy:** Increase in global competitiveness by widening the competitive advantages of Armenia’s economy, creation of a modern and green, knowledge- and innovation -based economic system, providing opportunities for decent work to Armenian citizens, and improvement in the quality of life of the population are the cornerstone of the Government’s policy. The economic policy will be based on an investment policy aimed at export, employment expansion, and encouragement of work. As a result, the economy’s structure has to undergo major changes; the high-tech industry has to become the locomotive of the economy.

- **Business climate, freedom in domestic markets, fair competition:** Guaranteeing of fair competition has to be articulated and generally perceived as an indisputable pillar of economic development. Economic competition and ruling out of artificial monopolies are critical guarantees for achieving substantial economic growth.

- **Exports as a key driver of economic growth:** a significant increase in the exports of goods and services should be the main driver of Armenia’s economic progress. By the end of the program period it is planned to achieve export of goods and services-to-GDP ratio of 43-45 percent by increasing significantly the role of technology-intensive goods in the composition of exports in the meantime.

- **Investment growth - a prerequisite for competitiveness and sustainable growth:** in future mechanisms encouraging increased savings will be developed and alternative opportunities for their investment created. Special attention will be given to developing mechanisms for protecting foreign investment and supporting investment projects in sectors with high export potential. As a result of implementing these policies gross capital formation as a percentage of GDP has been targeted at 23-25 percent by the end of program implementation.

**The Government’s poverty reduction and social protection policy** will aim to improve the living standards and social conditions for citizens based on equal opportunities for exercising the social rights fully and effectively and the principle of encouragement of work. Work and creation of real opportunities for work is the primary tool for poverty reduction. The Government targets the eradication of extreme poverty and a significant reduction in poverty by 2023. To achieve this objective encouraging education and work among the poor population and implementing projects to promote doing business are of key importance.

**Macroeconomic Situation and Prospects**

The risks associated with the political changes in 2018 were overcome and macroeconomic stability achieved as a result of prudent macroeconomic policy posting an annual growth of 5.2 percent, which despite slowing down compared to the previous year, was still among the highest in the region.

Growth was 6.8 percent year-over-year between January and June of 2019, and economic activity rates remained strong from January to August. Growth in services, manufacturing and trade has been the main contributor to increased economic activity. Economic growth in the first six months was accompanied by an increase in domestic demand, specifically private consumption and improvement in net exports.

The current account deficit widened markedly in 2018 compared to the year before: it accounted for 9.4 percent of GDP and diverged from its long-run equilibrium. The widening of the current account deficit was due to deterioration in the negative balance of goods and services. Remittance inflows into the economy fell by 2.8 percent in 2018, mainly due to depreciation of the Russian ruble. Both exports and imports continued to grow in 2018 (by 7.8 and 21.4 percent, respectively), while the trade balance showed a
downward trend due to progressively strong growth in imports of goods mainly contributed by manufactured and investment goods.

In the first half of 2019, the goods trade balance started to improve, however, the weakening in the services and income accounts kept the current account deficit high. Encouragingly, exports (after contracting in early 2019) continued to grow with the growth rate in the eight months of the current year reaching 4.6 mainly supported by the export of manufacturing products (precious stones and metals and finished food products). Imports increased slightly (0.7 percent) in the first eight months of the current year amid increasing domestic demand.

As the economy rebounded in 2018 a contractionary fiscal policy was targeted and implemented to maintain fiscal and debt sustainability. The fiscal deficit was in 2018 1.8 percent of GDP below the budget target of 2.7 percent of GDP. Under these circumstances the Government’s debt-to-GDP ratio decreased by 2.4 percentage points and reached 51.3 percent.

The fiscal policy direction of 2018 was maintained in the first half of 2019. Measures to reduce the grey economy and improve tax administration taken by the Government of Armenia in 2019 resulted in high tax collection rates leading to over-performance in tax revenue. On the expenditure side, there are savings due to expenditure efficiency-enhancing measures by the Government of Armenia.

The 12-month inflation in July 2019 remained at low level recorded in the beginning of the year and accounted for 1.7 percent (average inflation at 1.9 %). In the months of January and September of the current year the CBA in response to economic developments has carried out expansionary monetary policy and reduced the policy rate by 0.25 percentage points (5.75 and 5.5 percent, respectively). Under these conditions strong growth in loans and deposits continued. Thus, in July of the current year loans increased by 13.5 percent and deposits by 16.8 percent year-over-year. The average interest rate on short-term dram-denominated deposits remained almost unchanged in the period between January and July while the interest on loans decreased by 0.7 percentage points.

Macroeconomic and Fiscal Framework

Based on the Medium-Term Expenditure Framework (MTEF) projections, On the demand side, growth will be supported by stronger domestic consumption benefiting from credit growth and job creation, higher investment demand, and recovery of exports.

Faster exports growth (compared to imports) over the medium-term horizon is expected to lead to continued improvement in the current account deficit. In 2019 the current account deficit will amount to 7 percent of GDP, while in 2020-2022 it will average 5.6 percent closer to its longer-term sustainable level.

The 2019 year-end inflation is projected to be within the lower-end of the permissible band (4+/-1.5) and in the medium term it will stabilize around the target.

As a result, we have been able to reverse the trend in the increase in debt to GDP ratio. Our efforts have been recognized by markets, our credit rating was recently upgraded while our USD500 million Eurobond (to be used to refinance the bond maturing in 2020) was issued at much improved terms compared to earlier issues and was heavily over-subscribed.

Until recently, Government debt had significantly increased due to our response to external shocks by counter-cyclical fiscal policy as well as the high dollarization of our debt. From 2017 the Government of Armenia has been implementing a fiscal consolidation policy focusing on debt sustainability and in parallel aiming to contribute to achieving economic growth and macroeconomic stability.

The recently updated fiscal rule strengthens the institutional base for achieving medium-term and long-term debt sustainability. Unlike the previous rules which operated through rigid limitations and relied on short-term targets, the new rules expand the policy horizon by setting medium-term debt targets and linking debt to generation of public assets thus targeting long-term debt sustainability. Contrary to the previous system of rules, which used to limit the fiscal deficit, the current system of rules are expenditure-based; they emphasize the role of fiscal policy in stabilizing economic cycles and boosting long-term growth.
The new rules were operationalized for the first time in the MTEF for 2019-2021, which also includes the Government’s debt reduction plan for 2019-2023 which envisages to decrease the Government debt-to-GDP ratio below 50 percent by 2023. The update of the debt reduction plan for 2019-2023 was drafted in the medium-term expenditure framework for 2020-2022 which maintained the target for the Government debt-to-GDP ratio below 50 percent in 2023 but with higher fiscal deficit (2.2-2.3 percent of GDP). In line with the new fiscal rules, in the projected medium-term horizon, given the need to create sustainable fiscal and debt environment, the impact of fiscal policy on aggregate demand in 2020 will be characterized by expansionary impact, while in 2021-2022 – it will be neutral. The Government regularly evaluates debt sustainability to correct the course of policy as necessary. Based on the findings of assessments carried out by the methodology widely used internationally (MAC DSA – Debt sustainability analysis of market-access countries), the government debt under various shocks remains within a sustainable range and is characterized as manageable and low-risk.

However, we also understand that the reduction in the debt burden in recent years came at the expense of under-investing in critical sectors. Hence, going forward, the government remains committed to anchoring fiscal policy in the fiscal rule framework and intend to keep modest deficit levels that will ensure public debt continues to decline while allowing us to increase capital spending as percent of GDP to close to 5 percent of GDP. Equally important, we are committed to improve the efficiency of government spending. For example, we intend to focus on improvement of the quality of capital spending through the deployment of a strong public investment management framework supported by this operation. We also plan to rationalize current spending to the extent possible, for example by better targeting of social spending, generating savings in spending on goods and services through an improved procurement system, and a more efficient performance based civil service. This will allow us to keep current spending contained while improving access and quality of public services and better remunerating out civil servants. On the deficit financing part also, the Government’s Debt Strategy for 2020-2022 envisages reduction in the share of external financing of the deficit from 64 percent in 2018 to below 50 percent in 2021, with the intention of reducing the share of external debt in total Government debt from 78.2 percent at the end of 2018 to below 75 percent by 2021.

**Regulatory Impact Assessment (RIA)**

The latest reforms served as a basis for showing a well-targeted and systematic approach to implementing evidence-based policy in Armenia. In 2018 with the passage of the Law on Normative Legal Acts clear formal processes were introduced. Recently, the actions taken were aimed at operationalizing the RIA system. Namely:

Annex to Government of Armenia Decree No. 65-A on RoA Government Program of February 8, 2019 provided for number of actions aimed at increasing the efficiency of public administration including the approach to subject to regulatory impact assessment by the Government high impact decisions for citizens or the business environment that would allow an understanding of the medium-term and long-term impact of such decisions on the overall economy and its individual directions.

A Regulatory Impact Assessment Department was created in the office of the Prime Minister of Armenia pursuant to the Decree of the RoA Prime Minister No. 667-L of June 1, 2019.

A Concept Note on Introducing a Decentralized Regulatory Impact Assessment System was drafted by the Office of the RoA Prime Minister based on the best international practice.

This action also supports climate change adaptation and mitigation, by enabling the government to systematically identify and assess the impacts of new laws and regulations on climate change mitigation and adaptation efforts of the country, in addition to impacts on other important dimensions (see below).

Following establishment of the RIA department, the government intends over the next two years with World Bank technical support -to continue strengthening the department capacity as a regulatory oversight body and the capacity of line ministries and other relevant agencies to carry out RIAs, as described in the RIA Methodological Concept Note (approved by the Prime Minister) that follows good international
practices. Regulations subject to RIA will be selected on the basis of a checklist screening ("light RIA") of their expected impact on five priority dimensions (economic and competition, fiscal, health, social, environmental impact). Regulations expected to have significant impact will be subject to a more detailed impact assessment ("in-depth RIA"). Draft regulations and impact assessments will also be subject to timely public consultations allowing stakeholder feedback to inform the final RIA and draft regulation before a policy decision is made. The RIA Department also plans to use ICT to improve data access and integrate online public consultation in the RIA processes. The strengthening of evidence-based, streamlined strategic planning and M&E is an important priority of the government program, of which RIA is a key foundation.

**Customs Reforms**

The State Revenue Committee has developed an ambitious customs administration agenda based on reforms in customs administration aiming to deliver higher quality services, expand risk management and alleviate the administrative burden of cross-border trade. In particular, the amendment to the RA Government Decree N236, dated March 24, 2011 “On Establishment of methodology for Implementation of Customs Control” allows risk-based management of truck scanning at border crossings. The development of key performance indicators and improvement of the quality of trainings will gradually result in replacing the control approach by trade facilitation in customs administration. The State Revenue Committee is planning to enhance the National Single Window for Foreign Trade platform currently functioning as one single window for customs purposes and for three other Government agencies. It is also planned to include other Government agencies in the single window platform by December of 2020. This is a critical reform which will reduce significantly the time spent on customs formalities at the border.

Risk based selectivity of trucks allow more targeted scanning thereby focusing scarce resources at the border to a potential trucks and consignments that are more likely to be in contravention. It opens the possibility for faster clearance and reduced waiting time. While scanning and inspection can be independent activities, inspection capabilities are enhanced by scanning. As the risk management capability improves, customs will reduce the levels of intervention. Training of inspectors will take place over the coming year, while the establishment of KPIs will help monitoring the progress towards more efficient custom management. In addition to the National Single Window, facilitating trade will be supported by improvement in infrastructure and logistics.

**Tax reforms**

The RA State Revenue Committee has introduced new automated inspection system including the process of carrying out the selection of audit inspectors in an automated (software) manner. The State Revenue Committee has also drafted the Government of Armenia Decree on Approving the Strategy for the Development of the State Revenue Committee of the Republic of Armenia and Enhancement of Administration for 2020-2024 with objectives and actions targeted at improved tax compliance, taxpayer service and capacity building for SRC. Within the framework of this program, the SRC has established 5 strategic development goals for the upcoming 5-years period, which are further segregated into 9 sub-goals with 54 costed measures (actions) for their achievement.

(i) to improve the quality of public services with the view to enhancing management systems, which will result in having infrastructures that comply with the planned criteria and ensure high level of sustainability, full-pledged distance servicing of the SRC network and efficient operation of tax and customs information databases.

(ii) to increase the efficiency of tax and customs control through new solutions that are in line with international best practices, increase of revenues and shadow reduction, which will ensure the practical application of targeted risk management mechanisms, identification of taxpayers with a high

---

1 This will be supported by technical assistance provided by World Bank, with EU funding.
level of risk, Implementation of less administration towards compliant taxpayers, and effective control with the help of automated systems.

(iii) to upgrade existing infrastructures as well as to build new modern ones, as a result of which tax and customs procedures will be automated in almost all (core) processes, an effective mechanism for the exchange of information and cooperation within the framework of the EEU, as well as faster, transparent and more effective control processes of the border crossing process for entrepreneurs will be introduced.

(iv) to form a healthy dialogue atmosphere with the public, as well as to improve the relationship between tax and customs administration participants, for which it is necessary to expand the dynamic feedback with the civil society, ensuring an effective platform for taxpayers and SRC cooperation.

(v) to improve the human resources management system. As a result of achieving this goal, an effective staffing policy will be implemented, which will meet and contribute to the implementation of defined functional outcomes. A revision of the internal regulations will be carried out, a new system of appraisals and staff assessments, a new system of assessment and decent compensation of the working units and employees will be put into operation that will encourage professional development and work efficiency.

State Aid

Introducing an oversight mechanism for state aid is important for creating a level playing field for the private sector to enter the market, increasing the market competitiveness and preventing non-reported state aid. The commitment to maintain a register of state aid is enshrined in the Comprehensive and Enhanced Partnership Agreement (CEPA) signed between the Republic of Armenia and European Union, and will serve as a tool for the authorities to rationalize support for the private sector in the interests of enhancing market competition.

To this end, amendments and supplements to the Law on Protection of Economic Competition have been approved by the Government of Armenia. In order to avoid potential restrictions of economic competition across all economic sectors and insure transparency of granted state aids, the concept, types, modalities of state aid, the obligations of state bodies granting state aid to submit information on provided state aids, the requirement to maintain a register of state aid, the powers of the State Commission for Protection of Economic Competition (SCPEC) in this regard have been made clear and revised. A unified information database will be introduced to include information on all granted state aid and to be granted by the state, their nature, focus, sizes, and other data. Once available, the SCPEC will review, assess state aid features in Armenia and, in case of necessity, new regulations for state aid control will be designed. This database will be made publicly available by August 2021.

Public Investment Management

Public investment has an impact on the population’s choice of where to live and work, and may be an incentive, if well managed, for crowding in private investment. With efficient and high quality management public investment contributes to sustainable, long-term and inclusive growth and improvement in the quality of life. On the other hand, poorly managed public capital spending can lead to a loss of public resources and economic and social losses.

Among the critical challenges in the area of public investment management are the absence of a single assessment system and methodology for the impact and priority of public investment, limited public resources as well as an insufficient level of capacity and statistics required for project evaluation and development. Public investment priorities have to stem from sectoral strategies and be based on the country’s long-term fiscal constraints.

The Government aims to improve the public investment management system, as well as ensure that favorable conditions are in place for attracting private sector capacities. To this end, the Public Investment Policy Department has been created, aiming to define a single methodology for the assessment and
prioritization of public investment projects as well as ensuring that unified requirements are set for PPP projects. The law on Public-Private Partnership was adopted in July 2019 with the objective of defining clear operating rules for the public and private sectors.

The Government plans to draft and define methodological guidelines for appraisal of public investment and an appraisal system, continuously improve the statistics related to public investment and develop institutional capacity. It is expected that a PIM framework will be deployed over the coming 2 years, starting with a simplified screening and appraisal methodology for key projects, and gradually expanding the framework to the full stages of project cycle.

**Fight Against Corruption**

The Government is convinced that corruption is a phenomenon with the most destructive impact on the society and the state and thus, fight against corruption is one of the main priorities. Armenia’s velvet revolution of spring 2018 embodied the political will to overcome Armenia’s development constraints through a strong commitment to fight corruption, to ensure rule of law and fair competition. Special importance is attached to carrying out actions aimed at identification and elimination of root causes of corruption as outlined in the Anti-corruption Strategy and its accompanying 2019-2022 Action Plan. The Strategy seeks to reduce fragmentation of policies and strengthen the institutional foundations for a more effective prevention, detection of and enforcement against corruption.

In the short and medium-term the Government will focus on strategically fighting corruption by drafting and consistently implementing an Anticorruption Strategy and an Action Plan for achieving these goals. Furthermore, the anti-corruption reforms will be carried out in two directions: first, to create effective institutional basis for preventing corruption, detecting and investigating corruption cases; second, to set effective anticorruption mechanisms, including improvements to the asset, income and conflict of interest disclosure system, the unified electronic whistleblowers platform, the implementation of corruption-risk assessments, and disclosure of beneficial ownership of legal persons participating in public affairs, which are aimed at increasing the transparency and accountability in the public service.

The RA Strategy and Action Plan on Anti-Corruption Reforms for the period of 2019-2022 was approved by the RA Government on 3 October 2019.

**Justice sector reforms**

The RA Government approved the RA 2019-2023 Strategy and respective Action Plans for Judicial and Legal Reforms for the period of 2019-2023 aimed at, among others, ensuring equal access to justice, improving the provision of fair and more efficient judicial service. In particular, it focuses on creating an independent, power-balancing justice system enjoying public trust by considering mandates, functions, roles and responsibilities of judicial institutions that are in line with the government program and bringing justice closer to citizens and businesses, including through streamlined procedures for small claims management enabling quick and inexpensive resolutions of legal disputes with a small value. This allows for greater access to justice, helps to reduce the current backlog of court cases in the medium- to long-term, and enables judges to devote more time to complex cases.

The Strategy is accompanied by three Action Plans – one for the short-term 2019-2020, one for the medium-term 2021-2023, and a specialized one for e-justice - translating the Ministry’s and Government’s strategic goals of transparency and accountability in the justice sector into action items for tangible change and impact on the ground.

**Civil Service Reform**

Reduction in the number of ministries is one of the significant public sector reforms in 2019. The number was reduced from 17 to 12. In parallel, the horizontal scope of civil service was expanded by
incorporating other types of services in it. The activities of drafting preparatory, and legal amendments for harmonizing types of public services and introducing performance management system in them, have been completed within the set timelines. Packages of amendments to relevant laws have been sent to the National Assembly. A strategy on creating a Senior Executive Service has been developed to improve the effectiveness of public service, which will guarantee the unhampered fulfilment of state goals, stability in the administration system and top-quality leaders in relevant sectors.

**Climate Change and Environmental Protection**

The Government of Armenia aims to overcome its main environmental challenges and actively pursue climate adaptation and mitigation policy and institutional reforms, including mobilizing more resources and strengthening monitoring. Important steps to address these challenges have been taken, such as redefining national environmental policies, goals, and priorities, as acknowledged by the Government Program. In addition, the government seeks to mainstream climate change adaptation and mitigation into its sector policies. This is the case for example for the Regulatory Impact Assessment Reform, with a methodology which proposes to assess the environmental and climate change impact of laws, regulations and policies. This is also the case for public investment management, with an appraisal methodology of projects which will assess the environmental and climate change impact of public investment projects.

Highlighting the significant contribution of the World Bank to the socio-economic environment, public administration system, business environment improvement, fight against corruption, modernization of tax system of the Republic of Armenia, the RA Government is looking forward to the World Bank support to promote the implementation of the priority measures envisaged by the government reform program through the Development policy operation, as follows:

1. The Borrower, through the Prime Minister’s office, has (a) established and staffed a RIA department; and (b) adopted a concept note outlining the RIA broad principles including methodology, scope, and institutional mandate consistent with international good practices;

2. The Borrower, through the State Revenue Committee, has: (a) amended the Government Decree No. 236 “On Adoption of the Methodology for Implementation of Customs Control”, dated March 24, 2001, to allow risk-based management of truck scanning at border crossings; (b) required advanced declaration submissions; and (c) mandated the extension of the National Single Window System;

3. The Borrower, through its Cabinet, has approved a draft bill of law to be submitted to the National Assembly, for approval thereof, to amend the Law on Protection of Economic Competition, to support the implementation of state aid including, *inter alia*, (a) the definition of state aid; and (b) the establishment of reporting requirements for government agencies to submit information on state aid schemes and granted aid to a designated body in line with good international practice;

4. The Borrower, through the State Revenue Committee, has started the implementation of the Tax Audit Case Management System, including full functionality for digitalized audit planning and random inspector assignment and replacing the State Revenue Committee’s current audit system;

5. The Borrower, through its Ministry of Economy and Ministry of Finance, has established, staffed and budgeted for a Public Investment and PPP department to improve the efficiency and effectiveness of public investment and PPP schemes;
6. The Borrower: (a) through its Cabinet, has approved the Borrower’s anti-corruption strategy and action plan, which sets up the institutional architecture and mechanisms for strengthening the fight against corruption; and (b) has launched an electronic platform for anonymous whistleblower accessible to public servants and the public;

7. The Borrower: (a) through its Cabinet, has approved the Borrower’s judicial strategy and action plan, which sets up the institutional architecture and mechanisms for judicial reforms and (b) has established a fast-track-procedure for small claims;

8. The Borrower, through its Cabinet, has approved draft amendments to be submitted to the National Assembly, for approval thereof, to modify a Package of Laws to merge different civil service regimes and extend the performance management system to a larger part of the civil service.

**Program Monitoring and Evaluation**

Armenia’s Ministry of Finance is the main counterpart for implementation of the Development Policy Operation.

Sincerely Yours,

[Signature]

Atom Janjughazyan