

ACTION FICHE FOR ARMENIA AAP 2011 PART II

1. IDENTIFICATION

Title/Number	Support to the Government of Armenia for the implementation of the ENP Action Plan and preparations for the future Association Agreement – Phase II (CRIS: ENPI/2011/23094)		
Total cost	EU Contribution €24 million		
Aid method / Management mode	Sector budget support (€22 million) Direct centralised management Complementary action / Technical Assistance (€2 million) Direct centralised management		
DAC-code	43010	Sector	Multi-sector aid

2. RATIONALE AND COUNTRY CONTEXT

The Eastern Partnership envisages the prospect for concluding an EU-Armenia Association Agreement (AA) including the establishment of a Deep and Comprehensive Free Trade Area (DCFTA) once the relevant conditions are met. The future AA will deepen political association and foster economic integration by, inter alia, promoting further convergence towards EU legislation and standards. This will require considerable strengthening of the core institutions in Armenia involved in this process and the implementation of comprehensive economic, legislative and administrative reforms.

The European Commission approved in 2010 a Sector Budget Support operation for “Support to the Government of Armenia for the implementation of the European Neighbourhood Policy (ENP) Action Plan and preparations for the future Association Agreement” (hereafter Support Programme I), hence establishing a platform for dialogue with Armenia towards implementation of the EU-Armenia ENP Action Plan and on preparations for negotiations, negotiations and implementation of the future EU-Armenia- Association Agreement including a DCFTA once the necessary conditions have been met..

The proposed Support Programme phase II is to complement the first phase with a view to (i) enlarge the scope of the Commission support to the implementation of the ENP Action Plan and AA/DCFTA processes, in particular through inclusion of customs reforms and public sector modernisation (e-Governance), and (ii) deepen support to public financial management, public sector transparency and trade areas reforms. Phase I and II should thus be viewed as part of an integrated package of EU assistance to Armenia.

The areas covered by the proposed action correspond to Focal sectors 1 "Democratic structures and good governance" (sub-sectors PFM, Public Sector Reform) and 2 "Trade and Investment Regulatory Alignment and Reform" (sub-sectors Trade related regulatory convergence, International movement of persons) of the National Indicative Programme (NIP) 2011-2013 for Armenia.

2.1. Country Context and National Policy and Strategy

2.1.1. Economic and social situation, poverty incidence

The global economic crisis seriously threatened the economic growth and poverty reduction achieved in Armenia over recent years. Data on 2009 indicate that the crisis has had a serious impact on poverty incidence.

According to the December 2010 IMF Country Report, GDP per capita rose from USD 1,982 in 2006 to USD 3,606 in 2008, but fell to USD 2,615 in 2009. The estimated GDP per capita in 2010 is USD 2,548. GDP per capita (in PPP terms) has fallen from USD 5,800 in 2008 to USD 5,200 in 2009¹.

In the years of economic growth the registered unemployment experienced similar trends. Steady growth contributed to the decrease of unemployment from 9.6% in 2004 to 6.3% in 2008. In 2009 and 2010, however, the registered unemployment rate had risen to 7%.

2.1.2. National Development/ Cooperation Policy and Strategy

The EU-Armenia ENP Action Plan was signed in November 2006 to encourage and support Armenia's objective of further integration into European economic and social structures. The ENP Action Plan helps to devise and implement policies and measures to promote economic growth and social cohesion, to reduce poverty and to protect the environment. In May 2009, the President approved a "List of measures for 2009-2011 to ensure the implementation of the EU-Armenia Action Plan"², which is subject to regular monitoring.

(1) National Policy and Strategy:

The Sustainable Development Programme (SDP) 2008-2021, approved in October 2008³, presents the national strategy for economic and social development. The document starts with an assessment of the hitherto completed PRSP and a review of the national strategy for growth.

Sector policies included in the strategy are (1) Employment and labour; (2) Rural development and agriculture – this component includes the Sanitary and Phyto-sanitary (SPS) issues that are being supported by the Support Programme Phase I and with further support envisaged under the proposed second phase; (3) Infrastructure development; (4) Regional development; (5) Reforms in public management and judiciary system – this component includes the introduction of e-Governance covered by Support Programme II; (6) Social protection; (7) Human development and poverty reduction.

(2) National budget and medium term financial perspectives:

The Armenian budget rests on the Constitution and its operational details are articulated in the Law on Budget System. The budget has a 3-dimensional structure. It includes an administrative breakdown of the units of the state, a line-item economic classification system based on the IMF GFS 2001 guidelines, and a functional classification consistent with the UN COFOG and GFS 2001 requirements. Estimates of revenue are consolidated in the budget which allows deficit financing to be planned according to the overall budget constraints.

¹ Source: Index Mundi, <http://www.indexmundi.com/>

² Approved on 06 May 2009 by Presidential Decree No. NK68A

³ Government of Armenia Decree N 1207 of 30/10/2008

In April 2003 multi annual planning was introduced as a provision in the Law on Budget System and the first comprehensive and functional Medium-Term Expenditure Framework (MTEF) was prepared. The MTEF for 2011-2013 fiscal years was produced in line with the new economic and fiscal circumstances.

(3) Performance Measurement:

The measurement of achievement of reform objectives will be carried out using the following frameworks and data sources:

- The monitoring and evaluation framework of the SDP.
- “List of measures for 2009-2011 to ensure the implementation of the EU-Armenia Action Plan” is subject to regular monitoring. The government has demonstrated commitment in achieving the goals agreed with the Commission. The majority of actions in the Presidential Decree are derived from or linked with the SDP.
- Annual assessment of the implementation of the ENP Action Plan by the Commission through its regular Progress Reports.
- Each of the sector strategies mentioned in section 2.3 below includes an action plan and a regular monitoring of progress in implementation, including performance indicators.

Also, the government has formally endorsed the Public Expenditure and Financial Accountability (PEFA) framework as a performance measurement tool for the Armenian Public Financial Management (PFM) system. Following the PEFA 2008 report, the government is at present in process of discussion with the WB on the next PEFA assessment in Armenia.

Finally, the National Statistical Service of Armenia is a reliable source of information on which performance measurement can be based. It regularly publishes statistics on, among other things, socio-economic situation, poverty and household survey, macroeconomic, agriculture, and trade⁴.

2.2. Eligibility for budget support

Armenia continues to meet all three eligibility criteria for budget support, which will become general conditions for disbursement of budget support and will be monitored and assessed regularly during the course of the implementation of the Programme.

2.2.1. National Development or Cooperation Policy and Strategy

The SDP integrates the ENP Action Plan and puts priority to policy that would accelerate approximation to EU standards. It is evident that the government sees the continuous deepening of relations with the EU as a matter of top priority. EU-Armenian relations are expected to be further enhanced within the framework of the Eastern Partnership, and its objective to conclude and implement the Association Agreement, including the establishment of a DCFTA once the necessary conditions have been met. These commitments will arguably define the Armenian development strategy in the years to come.

In addition, there are several sector strategies that are directly relevant to the proposed Programme, as detailed in section 2.3 below.

⁴ See <http://www.armstat.am/en/>.

2.2.2. Macroeconomic situation

The Armenian economy suffered a major setback during the global crisis but recent macroeconomic developments are encouraging, despite some inflationary pressures, which are largely supply driven. Fiscal consolidation is moving forward, while the monetary policy remains focused on price stability. In spite of fiscal consolidation the Ministry of Finance has succeeded to implement countercyclical budget policy which has contributed to the recovery efforts. In its latest Country Report (December 2010), the IMF states that Armenia is on the right trajectory as it exits the crisis.

The IMF Executive Board approved a three-year programme in June 2010 for USD 395 million under the Extended Fund (EFF) and Extended Credit facilities (ECF). Following a positive assessment, the Board concluded the first programme review in December 2010, enabling disbursement of about USD 54 million.

Overall macroeconomic situation:

After experiencing among the highest growth rates in the world with real GDP growth of 12 % per year on average during 2000–2007, Armenia was hit hard by the economic crisis in 2009. The sharp contraction in exports, remittances, and foreign direct investments, and an overvalued effective exchange rate in 2009 led to a crisis of confidence and an enormous drop in output. The assessment by the IMF of the GDP contraction in 2009 was as high as 14.2% as opposed to 6.8% growth in 2008⁵.

The prospects of Armenia for recovery now look better. The government shifted focus to medium-term challenges including stimulating growth from new sources and reducing poverty. The policy measures undertaken helped ease the impact of the crisis. One of the most critical issues of the aftermath of the crisis is that public debt increased substantially. Post-crisis policies will therefore include fiscal consolidation, increased exchange rate flexibility, continued commitment to price stability, strengthening the banking sector, and stepping up structural reforms. The IMF concluded that the real GDP growth in 2010 was 2.1% and the projection for 2011 is 4.6%.

Fiscal performance has improved in 2010, with a projected tax collection increase of 16.8%, reflecting the rebound of activity and progress in tax administration reforms. The government remains committed to reducing the deficit. The estimated current account deficit in 2010 is around 15% of GDP. It will gradually narrow further as exports and remittances pick up in line with the global recovery.

In the IMF Staff's view, Armenia should be considered at low level of debt distress on the basis of its public debt burden indicators. Nevertheless, the government has stepped up efforts to modernise debt management supported by the IMF and the Commission – debt management is a focal point of the Support Programme I and the recently agreed DG ECFIN Macro-Financial Assistance. Additional complementary action in the form of technical assistance to the Public Debt Management Department is also envisaged.

2.2.3. Public Financial Management

Armenia has made strides in PFM since the collapse of the Soviet Union. In the late 1990s the challenge to rationalise systems and processes and achieve aggregate fiscal discipline was addressed successfully. Modern challenges rest on achieving a consistent framework for

⁵ Source: IMF Staff Report for the 2010 Article IV Consultation Discussions, Government of Armenia projections

public sector financial management, enhancing accountability and increasing the effectiveness of public spending.

The 2008 PEFA report captures many of these challenges. The report shows a solid PFM foundation and highlights the areas that require improvement. Following the PEFA report GoA has adopted a PFM reform strategy developed with the guidance of the WB, which identifies reform targets and sequencing and includes action plan for its implementation.

The Support Programme Phase I covers extensively PFM and supports reforms in a number of areas including debt management, development of the Public Internal Financial Control system, improvement in public procurement, and formulation of public sector accounting standards. The proposed Phase II will complement the reforms under way.

2.3. Sector Policies

In addition to the SDP, the overarching national strategy, there are several sector strategies that are directly relevant to the proposed programme:

- The Customs Administration Strategy 2008-2012 of December 2008. The Strategy is supported by a “Strategic Action Plan” that includes performance indicators, target dates and required resources. Both the Strategy and Action Plan derive from a process of using international good practice, including EU Customs Blueprints, as benchmarks for assessing gaps in a wide range of Customs functions. The Government intends to update the Customs Strategy and incorporate requirements related to the future DCFTA with the EU.
- The Strategy on Reforms of Quality Infrastructure in Armenia⁶. The document envisages reforms necessary for gradual legislative and institutional approximation to the EU and international laws and standards in this area.
- The Armenian authorities, supported by donor assistance, in particular the EU Advisory Group, are currently drafting the Republic of Armenia's Strategy and Action Plan for Food Safety System Development (Food Safety Strategy and Action Plan) with a view to finalise the documents and approve them during 2011. The draft Strategy and Action Plan clearly identify approximation to the EU laws and standards as a priority. They also stress the need to strengthen the institutional framework for food safety notably through reinforcement of the newly established Food Safety Service, and to develop a risk assessment approach for food safety, veterinary and phyto-sanitary issues – core theme of support already under the Support Programme I.
- The Concept Paper 2010-2012 for the formation of e-Society in the Republic of Armenia⁷. The document identifies e-Governance as one of its four components. A detailed time-bound action plan foresees several priority actions, including the enhancement and broadening of e-governance systems, the development of a legislative framework for protection of information and personal data, and the introduction of biometric passports. Responsibility for implementation is assigned to an inter-ministerial council chaired by the Prime Minister.
- In addition to the above mentioned e-Society strategy, a Presidential Order of 15 March 2008⁸ endorsed a “Concept Paper for the Republic of Armenia’s migration system and for the introduction of a system of electronic passports and identification

⁶ Adopted by the Government degree N1693, dated 16.12.2010.

⁷ Approved by Government Decree No. 7A on 25 February 2010

⁸ Presidential Order No NK 53A of 15 March 2008

cards with biometric parameters in the Republic of Armenia” and assigned the Government to implement this strategy.

2.4. Lessons learnt

Armenia has a history of successful implementation of Commission budget support programmes since 1997. During the 1997-2006 decade, the Commission provided budget support under the Food Security Thematic Programme (FSTP). It is noteworthy that Armenia has been the only country among the former Soviet Union countries beneficiaries of the FSTP that was able to execute all programmes with a 100% disbursement record as documented by the final Evaluation. Since 2006, the Commission has provided assistance in the form of sector budget support programmes in the areas of Vocational Education and Training, and more recently, Justice.

Setting realistic objectives and feasible reform conditions in the budget support programme can be achieved only through extensive and meaningful discussions of reforms with relevant ministries and agencies of the government of Armenia. The process of discussions and agreement of reform conditions with the parties who will be directly responsible for the implementation of reforms is the important phase in building cooperation and ownership for the programme by the beneficiary. Also, sustained capacity in the Armenian administration remains a concern, and it is important to ensure that the Government makes available adequate resources for the relevant institutions.

In line with the recommendations of the Special Report 13/2010 by the European Court of Auditors concerning the results of the ENPI in the Southern Caucasus, the choice of budget support has been carefully considered, keeping in mind a balanced deployment of the different tools, including timely and well targeted complementary technical assistance.

2.5. Complementary actions

Complementary actions in form of technical assistance will be mobilised taking into consideration the technical support already envisaged by other Commission interventions under the Support Programme I complementary action, the EU Advisory Group, SIGMA programme and support provided by DG Budget. In addition, Part I of the Annual Action Programme 2011 for Armenia (€19.1 million) makes available complementary technical assistance and Twinning, including the Comprehensive Institution Building (CIB).

Institutional capacity has improved considerably since independence, along with successful civil service reforms. However, the ambitious objectives set by the ENP AP and the AA/DCFTA processes will require important modern skill development and capacity building programmes.

2.6. Donor coordination

There is a systematic donor coordination framework co-chaired by the WB, IMF, UNDP and the Commission in which all donors and bilateral agencies are invited to contribute. The meetings are organised in thematic groups covering, among other things, economic development, governance, rule of law, health, education and environment. The government counterpart to the donor coordination framework is the Ministry of Economy and its EU National Coordination Unit (NCU). The Minister of Economy is the National Coordinator of EU assistance.

The conceptual framework and the specific areas and themes of intervention of the proposed programme have been discussed with relevant donors and organisations and coordination will

be ensured during the implementation phase. In the PFM area, the intervention will continue to benefit from synergies and collaboration with the IMF and the WB. As concerns the area of Customs, coordination is particularly foreseen with the WB and the UNDP.

3. DESCRIPTION

3.1. Objectives

The **overall objective** of this Programme is to assist the Government of Armenia in the implementation of its national and sector strategies related to selected key areas of the ENP Action Plan, while assisting the government to prepare for the negotiations of the DCFTA part of the future AA and improving overall economic performance within a framework of continuous improvement in governance and accountability.

The **specific objectives** of the Programme are to: (1) further improve Public Finance Management (PFM) systems; (2) contribute to the improvement of public sector transparency and performance, including e-governance; and (3) assist regulatory convergence with the EU and international laws and standards in the areas of trade, in particular in Customs, Technical Barriers to Trade (TBT), and Sanitary & Phyto-Sanitary (SPS) matters.

3.2. Expected results and thematic areas:

Each specific objective of the Programme corresponds to the **expected results and main thematic areas** listed below (subject to formulation and final agreement of Government on conditions):

Expected Results	Thematic Areas
Public Finance Management	
1. Implementation of the Public Internal Financial Control (PIFC) framework.	<ul style="list-style-type: none"> - Strengthening the Central Harmonisation Unit (CHU) of the Ministry of Finance; - Assistance in the implementation of the PIFC Strategy, adopted by the Government (protocol number 44) in November 2010.
Public Sector Transparency & Performance	
2. Improvement in Public procurement in line with the new Public Procurement Law adopted on 22 December 2010, effective as of 1 January 2011.	<ul style="list-style-type: none"> - Strengthening of the Procurement Support Centre (formerly the State Procurement Agency); - Creation of a system for certification of public procurement specialists across all Armenian institutions covered by the Public Procurement Law.
3. Improved data protection and privacy in line with European standards.	<ul style="list-style-type: none"> - Improvement of the legal framework on data protection in line with European standards; - Establishment of an independent supervisory authority to ensure compliance with the national data protection legislation.
4. Enhancement and broadening of e-governance systems	<ul style="list-style-type: none"> - Initiation of the process of digitization of civil registers; - Initiation of the process to ensure inter-operability of public databases.
5. Introduction of biometric passports to increase the level of travel document security.	<ul style="list-style-type: none"> - Initiation of the process of issuing biometric passports to citizens

Trade, DCFTA	
6. Improvement in Customs legislation, policy and administration in line with the EU Acquis.	<ul style="list-style-type: none"> - Revision of Customs legislative and policy framework with a view to ensure their approximation with the EU and international standards, particularly in relation to preparations for the negotiations, negotiations and subsequent implementation of the future DCFTA;; - Development and implementation of effective customs systems for post-clearance audit, risk management, valuation control, and enforcement of intellectual property rights.
7. Progress in regulatory approximation with the EU and international laws and standards in Technical Barriers to Trade areas (technical regulations, standardisation, accreditation, certification, conformity assessment, metrology and market surveillance), including through institutional capacity building.	<ul style="list-style-type: none"> - Progress in legislative approximation with the EU and international standards in TBT areas, in particular the fields of technical regulation and standardisation. - Progress in the establishment of domestic institutional system in TBT areas.
8. Progress in regulatory approximation with the EU and international laws and standards concerning Sanitary and Phyto-Sanitary measures including through institutional capacity building.	<ul style="list-style-type: none"> - Drafting, adoption and starting of the implementation of the Strategy and Action Plan for Food Safety System Development; - Strengthening the capacity and ensuring the independence of the newly established Food Safety Service.

3.3. Stakeholders

The main stakeholders for the proposed programme are the Prime Minister's Administration (Specific objective 2/Public Sector Transparency/e-Governance), the Ministry of Economy (Specific objective 2/Public Sector Transparency/e-Governance; specific objective 3/TBT), the Ministry of Finance (Specific objective 1/PFM), the State Revenue Committee (Specific objective 3/Customs), the Police (Specific objective 2/ Public Sector Transparency/e-Governance), the Ministry of Agriculture and the Food Safety Service (Specific objective 3/SPS).

Given the budget support nature of the programme, the Ministry of Finance will have an increased responsibility in line with its role as the central fiscal authority for the Republic of Armenia.

3.4. Risks and assumptions

The basic assumptions underlying this Programme are as follows:

- Prevalence of political and social stability in Armenia.
- Sustained government commitment to the EU-Armenia Partnership and Cooperation Agreement, to the EU European Neighbourhood Policy and to the Eastern Partnership.
- High level ENP dialogue is complemented by specific and consistent dialogue on the areas and themes of intervention.
- Sustained commitment to institutional and organisational capacity building across the government institutions.

The risks underlying the proposed Programme are set out in the table below:

Risks	Level⁹	Risk Mitigation Measures
Exacerbation of the impact on Armenia of the global financial and economic crisis.	M	Successful implementation of the IMF Stand-by Agreement. Prudence in fiscal and monetary policy.
Under-financing of programmes and activities related to the Support Programme Phase I and II reform agenda.	M	Proper planning assumptions made and costing techniques used to ensure fiscal realism.
Delays in the disbursement of instalments under the Support Programme Phases I and II.	L	General and specific conditions of the programme are formulated in a realistic, measurable and achievable manner. Review of the programme is performed within the foreseen time schedule.
Entrenched corruption and resistance to increasing public transparency.	L	Linking disbursement conditions to results in improving public transparency.
Delays of envisaged complementary action under the Support Programme Phases I and II.	L	Timely programming of complementary action and appropriately designed capacity building activities ensured by the Commission

3.5. Crosscutting issues

This Programme contributes to good governance and accountability, transparency and equality in the planning, design, implementation, and monitoring of policies and programmes.

Since this Programme targets the efficiency and transparency with which the government's resources are utilised, it helps to address issues related to poverty and access to basic needs. At the same time, a more transparent and accountable PFM system can help to support democratic aspirations.

4. IMPLEMENTATION ISSUES

4.1. Method of implementation

The proposed operating modality is direct centralised management. This will apply to both the budget support and complementary action / technical assistance components of the Programme.

4.2. Procurement and grant award procedures

1) Contracts

All contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

⁹ Risks are broadly divided in low (L), medium (M) and high (H).

Participation in the award of contracts for the present action shall be open to all natural and legal persons covered by the ENPI. Further extensions of this participation to other natural or legal persons by the concerned authorising officer shall be subject to the conditions provided for in article 21(7) of the ENPI.

2) Specific rules for grants

The essential selection and award criteria for the award of grants are laid down in the Practical Guide to contract procedures for EU external actions. They are established in accordance with the principles set out in Title VI 'Grants' of the Financial Regulation applicable to the General Budget. When derogations to these principles are applied, they shall be justified, in particular in the following cases:

- Financing in full (derogation to the principle of co-financing): The maximum possible rate of co-financing for grants is 80%. Full financing may only be applied in the cases provided for in Article 253 of the Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of the Financial Regulation applicable to the general budget
- Derogation to the principle of non-retroactivity: a grant may be awarded for an action which has already begun only if the applicant can demonstrate the need to start the action before the grant is awarded, in accordance with Article 112 of the Financial Regulation applicable to the general budget.

4.3. Budget and calendar

The **proposed financing modality is direct and untargeted budget support**. The overall amount for budget support will be €22 million with an additional €2 million for complementary support measures. The budget support funds are broken into fixed and variable instalments. There will be a fixed tranche upon signature of the Financing Agreement, provided that the general conditions (eligibility criteria) are met, to be followed with two annual variable tranches. The fixed and variable instalments will be disbursed upon fulfilment of the general and specific conditions attached to each particular instalment.

Indicative Disbursement Timetable (*budget support only*)

Amount	€8 million (fixed tranche)	€7 million (variable tranche)	€7 million (variable tranche)
Indicative Timetable	2012	2013	2014

The indicative implementation period is 48 months from the entry into force of the Financing Agreement for the budget support, and 48 months after the signature of the contracts for the complementary support measures.

4.4. Performance monitoring and criteria for disbursement

The monitoring of the programme will be carried out by a Steering Committee chaired by the Minister of Economy (National Coordinator) and whose members will include representatives of all ministries and institutions involved in the implementation of the Support Programme Phases I and II and of representatives of the European Commission.

The performance of the Programme will be assessed against general and specific conditions defined for fixed and variable tranches. General conditions will require the implementation of national strategy, macroeconomic and fiscal stability and progress in public financial management. Specific conditions will be set for the areas of public finance management, public sector transparency and performance and trade.

Review missions will be mobilised to advise the European Commission on the progress in fulfilling the agreed conditions to determine disbursement of tranches under the Programme.

4.5. Evaluation and audit

The Programme may be subject to an evaluation in order to assess the relevance, efficiency, effectiveness, impact and sustainability of the achievements of the Programme. Independent evaluators may be contracted by the European Commission in accordance with its internal procedures.

All budget support disbursements can be subject to audit by the Court of Auditors of the EU. In addition, the European Commission may mobilise ad hoc audit missions if deemed necessary.

4.6. Communication and visibility

EuropeAid visibility guidelines will be followed throughout the implementation of the Programme, and the best possible visibility will be sought through visibility actions to be organised in cooperation with all relevant stakeholders.