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ANNEX 1: ACTION FICHE ARMENIA

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. Ref: 2010/ENPI/22039		
Total cost	<i>EU Contribution</i> : €21 million (76% of IP)		
Aid method / Management mode	Multi-sector budget support (€20 million) – Direct centralised management Complementary action (€1 million) – Direct centralised management		
DAC-code	43010	Sector	Multi Sector budget support

2. RATIONALE AND COUNTRY CONTEXT

The Eastern Partnership envisages a prospect for concluding an EU-Armenia Association Agreement including the establishment of a Deep and Comprehensive Free Trade Area (DCFTA) once the relevant conditions are met. The future Agreement 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 overall objective of the EU assistance in a number of selected key areas of the ENP Action Plan (AP), as reflected in the National Indicative Programme 2007-2010, will be well addressed within the comprehensive framework offered by a Multi-sector Budget Support aid modality. The Government of Armenia's (GoA) solid track record and experience in implementing EU assistance in the form of budget support mitigates the risks of such an approach. Indeed, apart from the more recent sector budget support programmes which are confined to specific ministries Armenia benefited for a decade from a multi sector budget support programme, the Food Security Programme (FSP). The FSP included public financial management, national statistics development, agriculture and land reform, and social protection reform. The FSP in Armenia was considered as one of the most successful in the former Soviet Union countries as documented by the annual reviews and the final evaluation.

This Programme will consolidate a comprehensive and sustained dialogue in core areas of the Eastern Partnership and European Neighbourhood Policy (ENP), and Armenia's own reform agenda. It will also support the Armenian preparations for the future EU-Armenia Association Agreement.

2.1. Country Context and National Policy and Strategy

2.1.1. Economic and social situation and poverty analysis

Armenia is a resource-poor country that is relatively isolated from key neighbouring countries. Its educated and entrepreneurial labour force and potential support from the Diaspora are usually seen as Armenia's main competitive advantages.

Armenia's economic performance has been remarkable during the past decade, with an average of nearly 10% annual growth between 2001 and 2008. This favoured a reduction of the poorest by half; but at the outburst of the global crisis in 2008 still 25% of the population lived below the poverty line with nearly 4% living in conditions of extreme poverty. The country was very badly hit by the world crisis, registering a sharp fall in real GDP that, according to WB estimates, resulted in an overall increase of poverty incidence by five points. This poverty increase has followed the trend of the existing map of regional disparities.

Poverty incidence in rural areas, where approximately 38% of the population lives, is linked to isolation, subsistence agriculture and lack of basic infrastructure that would allow to benefit from improved social services as well as to commercialise production. Climate change is also a potential disruptive factor that may hamper poverty reduction efforts particularly concerning food security.

In urban areas, particularly the provincial small and medium size ones, the crisis is characterised by lack of new investment and restricted employment opportunities. Unemployment in the country follows very strong age, gender and regional patterns. The upgrading of labour force, the diversification and creation of innovative sources of employment, the deficiencies of the business environment, the difficulties in attracting financial capital, and fight against corruption, constitute typical areas for action if Armenia is to increase competitiveness and experience structural change.

2.1.2. National Development/ Cooperation Policy and Strategy

(1) National Policy and Strategy:

ENP Action Plan's agreed priorities between the EU and the Government of Armenia are the basis for the internal reform agenda and they are focused on democratic structures and the rule of law; human rights and fundamental freedoms as well as economic development, improvement of the investment climate, poverty reduction and social cohesion. The agenda for reforms is embedded in the convergence of economic legislation and administrative practices which include also an energy strategy and the decommissioning of Medzamor Nuclear Power Plant. A peaceful solution of the Nagorno-Karabakh conflict is part of the regional political agenda. The government has enhanced these priorities through the preparation of negotiations for an Association Agreement which were adopted by the EU in May 2010. In the framework of the future Association Agreement, negotiations on a Deep and Comprehensive Free Trade Area (DCFTA) could start once the necessary conditions have been met.

The Armenian Social Development Plan (SDP) 2008-21 is an important policy effort. Although it has been under revision as a result of the economic and financial crisis, the measures outlined in the SDP are nonetheless intended to be fully consistent with the commitments stipulated in the Mid Term Expenditures Framework 2011-13. The plan includes the strategy for economic development, sets out the poverty reduction objectives and establishes several policies ranging from employment and labour, rural development and

agriculture, regional development, infrastructure development to governance and judiciary sector reforms.

Armenia made progress in several areas of the ENP Action Plan: the launching of a regular human rights dialogue with the EU; and taking positive steps to address the internal political crisis following the aftermath of the presidential elections in February 2008. However limited progress was noted on key reforms recommended by the EU and endorsed by the Armenian authorities after a fact-finding mission in the context of preparations for the DCFTA negotiations. With substantial additional efforts on its side, Armenia would become prepared for the start of the DCFTA negotiations.

Armenia widely aligned itself with CFSP declarations and is generally very active in cooperating on CFSP-related issues. The Armenian authorities are aware of the need for further efforts to ensure follow-up of the parliamentary ad hoc inquiry committee about the event of March 2008, the need to improve electoral standards and strengthen media freedom along with the reforms in the judicial system and the need to keep momentum in the establishment of diplomatic relations with Turkey. Enhanced dialogue between the ruling political forces and the opposition would contribute to the democratic development of the country.

(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 government has had a disciplined track record with timely submissions of the budget to the Assembly, as required by the constitution. Similarly, the readings of the budget by the Assembly have always been completed within the time frame foreseen by the constitution. This has not been disrupted in spite of the economic crisis and its impact on the fiscal stance of Armenia.

The structure of the Armenian budget is 3-dimensional with (1) administrative breakdown by agencies and judicial units, (2) line item economic classification based on the International Monetary Fund's Government Finance Statistics (GFS) manual 2001 and (3) on functional classification consistent with UN Classification of the Functions of Government (COFOG) and GFS 2001 requirements for reporting on the broad functions of Government spending. Estimates of revenue are consolidated into the budget which allow deficit financing to be planned according to the overall budget constraints.

Multi annual planning started since April 2003 as foreseen by the law on budget system and the first comprehensive and functional Medium-Term Expenditure Framework (MTEF) was prepared for the period 2004-2006. In 2009 the Ministry of Finance was forced to suspend the 2009-2011 MTEF due to the economic crisis and the new reality that made the multi-annual fiscal projections in the MTEF irrelevant. However a new MTEF 2011-13 which includes a medium-term debt strategy has been drafted and is expected to be approved in August 2010.

(3) Performance Measurement:

The Technical and Administrative Provisions of this programme will be annexed to the Financing Agreement for this action to be signed by both parties. These provisions will contain a conditionality matrix providing the performance indicators against which a disbursement decision is made by the Commission.

There are a number of specific sources for measuring performance in the areas covered by this programme from which result indicators will be derived. The first is the monitoring and evaluation framework of the SDP. In this context a process for updating the document to serve as the basis for macroeconomic policy aimed at achieving prosperity through sustained growth has started. The measures outlined in the updated SDP will be fully consistent with the commitments stipulated in the present MTEF.

Secondly, the government of Armenia has also articulated its own performance and progress framework for the implementation of the ENP Action Plan. In May 2009 Presidential Order 68 was issued listing the activities and indicators for the implementation of the ENP Action Plan. Furthermore, the majority of actions in the Presidential Decree are derived from or linked with the SDP. The Commission is assessing annually the implementation of the ENP Action Plan through its regular Progress Reports.

With regards to the DCFTA component of this programme, performance indicators will derive from the list of the "key recommendations" for Armenia to become ready for the DCFTA negotiating process. Fulfilment of such performance indicators will not mean that the key recommendations are met per se; rather they will tend towards achieving substantial progress in the key areas. These "key recommendations" prepared by DG Trade are areas where Armenia needs to show sufficient progress to enable the Commission to conclude that Armenia is sufficiently advanced in its preparations for the DCFTA negotiating process, and that negotiations can be launched and carried out effectively. These recommendations focus on Armenia's need to create transparent and efficient institutional structures for the purpose of the possible future DCFTA negotiations; to strengthen the administrative capacity of the institutions to be involved in the preparation phase and the negotiating process as such. The recommendations also stipulate that Armenia needs to achieve progress on regulatory issues in terms of adopting and starting to implement essential legal acts and improving the institutional framework, in accordance with the EU and international requirements, in the areas of technical regulations and sanitary and phytosanitary measures. Finally, the recommendations advocate that Armenia also has to achieve tangible progress in effective implementation and enforcement of the existing legislation on intellectual property rights, in particular as regards fight against piracy and counterfeiting.

Finally, as regards the Public Finance Management component, the PEFA 2008 report will be the prime source of clear performance indicators. The fact that the government conducted this PEFA as a self-assessment is a clear indication that the government will be monitoring performance of its systems along the lines of the 28 internationally endorsed standardised indicators of PEFA.

Moreover the publication of statistics on the socio-economic situation, poverty reduction and, macro-economy, agriculture and trade by the National Statistics Service is quite regular and a good source of information.

2.2. Eligibility for budget support

In spite of adverse circumstances in 2009, the Government of Armenia continues to be compliant with the three eligibility criteria as per the ENPI Regulation:

- *A defined policy and strategy which is under implementation:* the EU-Armenia Action Plan with mutually agreed priorities and the upgrading of contractual relations in the form of an Association Agreement demonstrate the commitment of the government.

The adaptation of the SDP 2008-21 after the crisis and the preparation of the Medium Term Expenditures Framework are additional demonstrations of the commitment to plan in the long term for poverty reduction.

- *A stable macroeconomic policy:* Although the effects of the economic and financial crisis were dealt with excessive borrowing, the government has rapidly realized the importance of managing its debt, by rapidly reducing its expenditures in spite of increasing revenues in an improving economy. The draft MTEF 2011-13, which includes medium-term debt strategy, is encouraging. In this context the IMF board has also approved the extended fund facility and the extended credit facility.
- *A credible program for improving Public Finance Management:* The PEFA report 2008 is the basis of the reforms in areas which require improvement, under the guidance of the WB.

Furthermore, the Armenian Budget has been one of the most transparent among the former Soviet Union countries adopting, at the time of independence, the IMF GFS1986 standards. The Armenian Budget has three dimensions: an administrative, a functional and an economic. The latter is the system for budget accounting and budgetary control and it consists of a very detailed range of budget line-items which are all very transparently disclosed in the appropriated annual Budget Law.

More recently, Armenia has been making attempts to introduce a more programmatic structure for its budget aimed at improving the effectiveness of budget spending. It has also introduced the GFS2001 system that allows it to introduce elements of accrual accounting in the near future. The Armenian budget formulation and planning, and budget execution is considered adequate for the implementation of the budget support instrument. This is documented in the 2008 PEFA assessment conducted with the assistance of the World Bank (this document is accessible in the PEFA Secretariat website).

In addition, the good standing of the Armenian fiscal and budget management systems are adequately documented in the IMF Article IV consultations of recent years.

2.2.1. National Development or Cooperation Policy and Strategy

This programme directly supports the implementation of the ENP Action Plan in core priority but crosscutting areas, and supports preparations for the future EU-Armenia Association Agreement:

- Priority Area 3 of the ENP Action Plan encourages further economic development, enhancement of poverty reduction and social cohesion efforts, as well as action contributing to the long term objective of sustainable development, including the protection of the environment. Specific action under this priority area requires the maintenance of macroeconomic stability by implementing prudent monetary and fiscal policies in co-operation with international financial institutions (IFIs). This issue will form part of the general conditions for budget support and will be addressed in more detail by including the debt management and sustainability as a core theme of the Programme.
- The ENP Action Plan Objective 4.4 entitled “Trade-related issues, market and regulatory reform” will require extensive reform and regulatory approximation to the EU and

international trade related laws and standards, covering a wide range of issues. The programme will also support the preparation for the EU-Armenia Agreement, notably its DCFTA part, by:

- a) Supporting the creation of relevant institutional structures and increase in administrative capacity of the new structures;
 - b) Supporting reforms in trade related regulatory areas, in particular Technical Barriers to Trade (TBT), Sanitary and Phyto-Sanitary (SPS) issues, Intellectual Property Rights (IPR) protection, and public procurement.
 - c) Support to public procurement reform, notably regulatory approximation of Armenia's legislation and procedures in this area with the EU and international laws and standards, foreseen under the following sub-objective, falls at the same time also within the scope of the DCFTA preparations.
 - d) As part of the implementation of the ENP AP and preparations for the DCFTA and with a specific view to integrating efforts under the MoE, the programme may also support the reform of Armenian Customs, in particular by supporting further improvement of post-clearance controls and application of customs valuation rules.
- Sub-objective 4.4.5 of the ENP Action Plan “Other key areas” encompasses the Public Internal Financial Control (PIFC) issues such as the need for implementation of public sector accounting reform process and the introduction of independent internal audit. The need to strengthen the Chamber of Control, another core theme of the programme, is also included in this section. Public procurement reform also features in this section. Specific actions require the implementation of the public procurement law, compliance of the procurement system with EU procurement legislation and principles, review of existing procedures and improve the administrative capacity of the State Procurement Agency, and implementation of the “Strategy for introduction of an electronic procurement system in Armenia”.

2.2.2. Macroeconomic situation

The eligibility criterion on macro-economic stability is met, as Armenia has reaffirmed its commitment to pursue a stability-oriented macroeconomic policy by having reached an agreement with the IMF on a new programme, approved by the IMF board on 28-6-2010. This programme covers a three-year arrangement under the Extended Fund Facility (EFF) (US\$197.4 million), and a three-year arrangement under the Extended Credit Facility (ECF) (US\$197.4 million) for the Republic of Armenia. Access under the arrangements totals an amount equivalent to US\$394.8 million for the period through June 27, 2013. The programme replaces the previous Stand-by Arrangement. Armenia's performance under the Stand-By Arrangement has been strong and the total amount disbursed so far amounts to US\$ 532 million. Under the new programme Armenia will have access to the Fund's concessional lending window, thereby facilitating future debt repayment of Armenia.

Overall macroeconomic situation:

According to IMF, while conditions remain difficult, the Armenian economy is gradually recovering. The latest data confirm the upward trend of GDP which rose by 5.5% in the first quarter of 2010 (cumulatively as of 1/1/2010). The sectors leading the recovery are services and industry, the latter benefitting from rising metals prices and the government support

measures. Revenues have been increasing to 22% in the first 5 months of the year as compared to last year. The Government has not increased spending opting for reducing fiscal deficit.

Inflation, which reached a worrisome level in the first quarter of 2010 (8.8% in March year-on-year) is now at 6.3 %. The Central Bank kept raising refinancing rate from 5% (September 2009) to 7.25% in May 2010. However, movements in the refinancing rate have only a limited impact, as the domestic money market is not sufficiently developed and the dollarization rate is high (around 70%).

The situation in the external sector improved in the first quarter of 2010 with export increasing by 160% (compared with Q1/2009) while import value increased to a lesser extent by 123%. Remittances in Q1/2010 have been stabilised at the same levels as Q1/2009. Despite these positive trends pressures in the balance of payments will remain as the current account deficit for 2010 is projected to reach around 13% of GDP.

The Armenian authorities have committed to a number of macro-economic policies which should allow Armenia to meet its medium term challenges, helping to sustain the economic recovery, strengthen the balance of payments and lead to continue progress in poverty reduction:

- Fiscal policy will continue to support economic activity, but budget deficits will gradually fall to a sustainable level (4.8% of GDP foreseen in 2010);
- The tax basis will be widened through an improvement in tax administration with an increase of 1.7% of GDP foreseen in 2010-13;
- The efficiency of spending will be improved while ensuring adequate allocations for social and capital spending with further steps to be taken to protect the poor and social safety networks;
- Low inflation will be the priority of the monetary policy;
- Structural reforms on taxes administration and boosting taxpayers' rights will contribute to improve the business environment.

2.2.3. Public Financial Management

The Armenian PFM system has made considerable progress in the last decade. Progress however has been uneven with some areas advancing faster than others. The Budget legislative framework and formulation process have been among the strongest in the Region and budget planning has also improved considerably but still requires considerable capacity development at line ministry level to develop skills for policy development, costing and ultimately planning expenditure with fiscal realism.

The Treasury system of Armenia is also very robust and guarantees solid cash management based on the Law on Treasury. The Armenian PFM system is highly centralised with the Ministry of Finance (and Treasury) as central fiscal authority controlling expenditure at a very detailed level.

It is recognised that the Government of Armenia needs to acquire proper financial management skills, including modern financial control and internal audit systems, before central controls can be relaxed.

In this respect, this Budget Support operation is focusing on the development of appropriate public sector accounting standards. These standards are expected to observe international requirements under GFS 2001 and follow the events that are currently unfolding regarding the International Public Sector Accounting Standards (IPSAS) developed by the International Federation of Accountants (IFAC).

The revenue side of the PFM system is also reasonably well organised. The Ministry of Finance had traditionally over-performed its revenue targets in the budget until the economic crisis erupted. The sharp decline in revenues due to this crisis led to an increased need for borrowing and the consequent doubling of the stock of debt. Therefore this programme also deals with the issue of debt management and sustainability as a matter of priority. Moreover, the World Bank is involved in efforts to rationalise revenue policy and administration seen within the wider competitiveness and economic development strategy of the country.

The weakest element of the Armenian PFM system is the internal and external audit function. These areas involve sophisticated concepts and systems and are linked to the wider governance issues in the country. The majority of countries in transition have had difficulties in making progress with such reforms.

The Armenian supreme audit institution in charge of public external audit, is the Chamber of Control (CoC). The CoC has existed for several years but the institution was made effectively independent as required by INTOSAI standards and the Armenian Constitution only in December 2006, when the Law on CoC was enacted. The Armenian CoC is based on the collegiate model which is prevalent in Germany and the Netherlands. Public external audit is a crucial element in the wider chain of accountability and the CoC needs support in order to play its Constitutional role. Hence the CoC is a core institution under this programme.

2.3. Sector Policies

Certain sectors' policy reforms relevant to the programme, as listed below, have been carried out. Other are still under discussion and formulation, while some set backs have also been noticed:

- Government's adoption of a procedure for organising and holding public consultations on Draft Normative Acts on 25 March 2010. Adoption in first reading also of a Law for transparency of income of the public employees.
- The drafting of the Civil Service Reform Programme (CSRP) by aligning it to EU best practices in the field of civil service reform as foreseen in the ENP Action Plan for Armenia.
- Adoption of procurement system strategy upon recommendations of the December 2008 SIGMA report.
- Adoption of debt sustainability and debt strategy, which will be included in the MTEF 2011-2013.
- Approval (first reading) of the Law on internal audit. However the recent mission of DG budget has pointed out the risk that certain articles of the law can be interpreted as inspection rather than a tool and advice addressed to the managers.

- Accomplishment of a first draft of a comprehensive strategy on reform of Armenia's quality infrastructure system (final version to be adopted by a governmental decree) and establishment of 5 specific working groups in the MoE to draft new laws on standardisation, technical regulation and conformity assessment, accreditation, metrology and market surveillance approximated with the EU and international laws and standards.
- Ongoing drafting by an inter-ministerial working group of a new comprehensive strategy including an action plan (final version to be adopted by a governmental decree) in the area of sanitary and phyto-sanitary issues (SPS).
- After the adoption of the Anti-corruption Action Plan in 2009, the establishment of the envisaged Anti-corruption's Secretariat and the allocation of adequate resources continue to be crucial for the implementation and monitoring of the plan. Some parts of the strategy plan require also adaptation to EU best practices.

2.4. Lessons learnt

Armenia has had a track record spanning over a decade of implementing substantive reforms in very important areas within the framework of EU sector budget support interventions. There are two ongoing Sector Budget Support programmes in justice and covering vocational education and training. In both programmes, sector reforms are considered the main achievements.

Progress in the implementation of reforms in the justice sector under the sector budget support programme 2008 is being assessed in late 2010 as part of the conditionality matrix review mission for the disbursement of the first variable tranche. Nonetheless amongst the major achievements being considered is the involvement of justice stakeholders in the reform, which resulted in a Presidential Ordinance approving a "Program of strategic measures of judiciary reforms 2009-11", and an action plan. Important steps have already been taken in approving legislation which increase people's participation in the debate of laws and in approximating the code of conduct to EU standards including anticorruption measures.

The 2006 and 2007 VET Sector Policy Support Programme provided by the EU has played a vital role in improving the physical conditions for the delivery of VET and strengthening the governance of the system, through pilot measures implemented at colleges' level. However, the Programme has privileged the up-grading of equipment to the refurbishment works with the result that the pilot actions implemented have only allowed the start of the process of modernisation of the infrastructures which need to be completed.

Social partners' organisations and other public institutions have actively participated in the implementation of all activities of the budget support programmes for VET. All of them provide a positive assessment of the programme, which is considered a "milestone" in the process of reform of the VET system in order to make it more attractive and relevant to labour market needs.

The 2007 budget support operation in support of VET reform was completed in April 2010, with the final disbursement effectuated in July 2010.

The successive review missions have demonstrated that reforms have indeed been successfully implemented but that further work was necessary to ensure the sustainability of the VET system by improving accessibility of VET across the country and linking VET curricula with specific labour market needs. This overall positive review coupled with the

desire of the Armenian authorities to pursue reforms has prompted the Commission to provide additional support through the 2009 Action Programme for the continued reform of the VET sector.

These budget support operations focused on a key sector falling under the responsibility of one particular authority within the Government of Armenia. In the case of the ENP Action Plan, that includes several core priorities which are multi-sectoral (such as trade-related issues), a multi-sector budget support modality is seen as more appropriate to address both macroeconomic objectives (such as debt sustainability) and objectives in specific areas of the ENP Action Plan covering a number of sectors in a coherent manner. Nevertheless, this approach retains the essential function of bringing about definite and measurable outcomes and results through a conditionality matrix designed in the same way as a single sector approach.

Budget support can increase efficiency, reduce transaction costs for both the European Commission and the government, and contribute to a more focused and improved dialogue under the European Neighbourhood Policy and the Eastern Partnership.

In the case of Armenia, bearing in mind its present stage of development, the use of budget support enables a more systematic engagement and dialogue, and an opportunity to positively influence strategic decisions in public financial and the determination of the country's trade relations with the EU. In addition, the proposed Multi sector Budget Support Programme will engage systematically the supreme audit institution of Armenia and tackle the question of improving public external accountability.

This Budget Support Programme is one of the many development instruments to be deployed in the EU assistance to Armenia. Other instruments (including policy advice and technical assistance) are used to maximise the impact of such Budget Support operation. Although the institutional context of Armenia is not yet optimal, there have been clear and consistent improvements over the years which are documented in IMF, World Bank as well Commission documents.

The benefits that accrue from a budget support instrument are measured in terms of "results" i.e. specific outputs or outcomes to be achieved through the implementation of Government reforms or systems' change. The Commission intends to further the intended reforms envisaged by the Multi Sector Budget Support Programme through the achievement of specific conditionality articulated in the Technical and Administrative Provisions (TAPs), and in particular the Policy Matrix of the Programme.

2.5. Complementary actions

On 30 November 2009 the Council adopted a Macro-Financial Assistance (MFA) programme for Armenia. The programme was designed in a way to cover Armenia's financing needs in 2010 and early 2011 as identified by the IMF in the context of the Fund's financing arrangement with Armenia. The negotiations on the economic conditions for this operation (i.e. structural conditionality) should be completed before the end of 2010. The current timetable would still not prevent the implementation of the programme according to the planning decided at the beginning of 2010, i.e. the disbursement of the first tranche still before the end of 2010 and of the second tranche in the first half of 2011.

The MFA and the proposed Budget support operation, while they complement each other in the sense that they both participate to covering Armenia's financing needs, pursue different

primary goals. As opposed to this programme, MFA is a crisis-related operation designed in the context of an IMF arrangement and its main objective is indeed to help the beneficiary country meet its external financing needs. The conditionality in MFA is designed to strengthen the macro-economic management (conditions in the areas of financial policies, including clearly public finances).

The MFA conditions relating to Public Finance Management precede and complement the expected results of this budget support operation. With regards to debt management, the MFA condition stipulates that the Ministry of Finance needs to include a debt section in the Medium Term Expenditure Framework (MTEF) and acquires a new debt recording system. Regarding Public Internal Financial Control (PIFC), the conditions of the MFA refer to the adoption of the PIFC strategy and a time-bound action plan based on the gap assessment of SIGMA in 2009, and that the Ministry of Finance establish a Central Harmonisation Unit responsible for the methodological development and monitoring of financial management, control and internal audit across the government. Finally, with regards to the external audit function, the MFA states that the Chamber of Control (CoC) adopts its Action Plan for improving its working practice in line with INTOSAI standards.

The development of the internal audit system has been, and still is, a focal point of assistance of the WB. There has also been considerable assistance by USAID. In the Public Finance Management (PFM) area the EU intervention will benefit from synergies and collaboration with the IMF and WB.

The EU is also supporting the Government of Armenia with its reform agenda necessary to conclude an Association Agreement with the EU and other relevant international commitments assumed by Armenia through the provision of high level advice by the EU Advisory Group to the presidency, the legislative, executive, and judiciary powers..

Finally, the Comprehensive Institution Building (CIB) of the Eastern Partnership earmarked for the period 2011-2013 is set to respond to the need to strengthen the capacity of core institutions involved in the process of negotiating and implementing future EU-Armenia Agreements. This includes: (i) support to the process toward the Association Agreement, including the establishment of a DCFTA once the relevant conditions are met; (ii) assistance in making progress towards visa liberalisation as a long term goal as well as meeting the related commitments. Notably in the area of trade, the actions under the CIB can effectively complement the present programme.

2.6. Donor coordination

There is a systematic donor coordination framework co-chaired by the WB, USAID, UNDP and the EU 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's counterpart to the donor coordination framework is the Ministry of Economy. In 2008 the newly founded MoE took over the donor coordination role which was previously assigned to the unified Ministry of Finance & Economy. The EU National Coordination Unit (NCU) became a unit within the MoE. The Minister of Economy is the National Coordinator of EU assistance.

There is an agreement with the IMF to collaborate on the issue of debt management¹. Similarly, there will be coordination and complementary action with the WB on the areas of public sector accounting and the development of public external audit and the Chamber of Control (CoC), as well as issues concerning the improvement of the regulatory and administrative framework for public procurement.

3. DESCRIPTION

3.1. Objectives

The **overall objective** of this Programme is to assist the government in the implementation of a number of selected key areas of the ENP Action Plan as well as assisting it to prepare for the negotiations of the future Association Agreement in the area of Deep and Comprehensive Free Trade Area; and improving overall economic performance within a framework of continuous improvement in governance and accountability. The **purpose/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; and (3) assist in the regulatory approximation with the EU and international requirements in trade-related areas.

3.2. Expected results and main activities

Each specific objective of the Programme may include the below listed **expected results and main activities** (subject to formulation and final agreement of Government on conditionalities):

(1) Improvement in PFM

Expected results:

- Supreme Audit institution is strengthened and external audit functions improved – PEFA indicator PI-26;
- Public accounting standards developed and financial reporting systems improved - PEFA indicator PI-25 (quality and timeliness of annual financial statements);
- Debt management improved.

Activities:

- Implementation of new legislation on Public external audit and Chamber of Control (Supreme Audit Institution);
- Strengthening of Chamber of Control institutional role in the chain of public accountability;
- Preparation of an inventory of the existing legislative and sub-legislative documents defining and regulating accounting policies and procedures for recognition, valuation and registration of assets and liabilities, revenues and expenses in the public sector. The inventory should be followed by an analysis of gaps and contradictions in the legislation and regulations and final product should be formally endorsed by the Ministry of Finance.

¹ See paragraph 20 of the IMF Letter of Intent and Stand-by Agreement review, 14 October 2009; <http://www.imf.org/External/NP/LOI/2009/arm/101409.pdf>

- Primary legislation drafted strengthening the mandate and accountability of the Debt Management Unit;
- Internal organisation of the Public Debt Management Department revised along functional lines;
- Enhanced debt and cash management practices, in particular in relation to reporting and to the issuance policy;
- Medium Term Debt Strategy based on Debt Sustainability Analysis (DSA) and risk management tools.

(2) Public sector transparency and performance focused on improving the public procurement system and anticorruption

Expected results:

- Efficiency, effectiveness and economy in the public procurement process enhanced;
- Convergence of public procurement legislation to EU and international laws and standards;
- The government anti-corruption strategy is implemented.

Activities:

- Revision of the public procurement system and the approximation of legislation and procedures to the EU and international laws and standards;
- Introduction of an e-procurement system, which is already foreseen in the current law on procurement. In January 2006 a strategy on introducing of e-procurement was adopted by the Government;
- Revision and implementation of anti-corruption strategy.

(3) Regulatory approximation, including institutional and administrative capacity building, in trade related areas, notably in the field of Technical Barriers to Trade (TBT), Intellectual Property Rights (IPR) and Sanitary and Phyto-Sanitary (SPS) matters, and also Public Procurement.

The programme will support the implementation of the relevant provisions of the EU-Armenia Partnership and Cooperation Agreement and ENP Action Plan as well as assist the government in its preparations for the negotiation and for the implementation of a future DCFTA with the EU. The programme will complement other EU technical assistance provided to Armenia in this area, notably action undertaken by the EU AG and the CIB.

Expected results:

- Institutional structures and administrative capacity building for the purposes of DCFTA negotiations and implementation – Progress in restructuring of the institutions involved in DCFTA-related matters and their administrative capacity building with a view of Armenia's becoming ready to negotiate a DCFTA with the EU and subsequently implement the commitments undertaken in a sustainable manner;
- SPS – Adoption of a comprehensive governmental strategy for the establishment of a solid and efficient food safety system aligned with the EU and international laws and standards;

- SPS – Progress in modernisation of key technical and quality infrastructures necessary for effective implementation and enforcement of the SPS legislation approximated with the EU and international laws;
- IPR – raised awareness on importance of IPR issues among key stakeholders and general public;
- TBT – Adoption and launch of the implementation of a comprehensive governmental strategy for reform of Armenia's quality infrastructure system in line with the EU and international laws and standards;
- TBT - Adoption and implementation of a governmental programme for approximation of legislation to the EU Acquis in the area of technical regulations and standards for priority industrial products;
- TBT – Progress in modernisation of key technical and quality infrastructures necessary for effective implementation and enforcement of the TBT legislation approximated with the EU and international laws;
- Public Procurement – see the parts related to public procurement under the "Expected results" of section (2) Public sector transparency and performance focused on improving the public procurement system and anticorruption.

Activities:

Institutional structures and administrative capacity building for the purposes of DCFTA negotiations and implementation

- Develop an institutional audit of all Ministries and other governmental bodies involved in DCFTA-related matters to assess the level of reorganisation necessary for Armenia to become ready to negotiate a DCFTA and subsequently effectively implement obligations undertaken;
- Appoint the key positions in the team/task force carrying out preparations for DCFTA negotiations and designed to be in charge of future negotiations as such (members of the core technical coordination team at the Ministry of Economy, etc.);
- Ensure coordination with CIB in the development and implementation of a comprehensive training programme on DCFTA-related matters for this team and define an agenda for its delivery, with the aim of ensuring that the team members will gradually acquire sufficient knowledge of the EU and international trade-related legislation and standards, good understanding of the EU's practices and requirements related to DCFTA negotiations, as well as upgrade of language skills. Start to implement this training programme.

SPS

- Draft and adopt a comprehensive governmental strategy for the establishment of a solid and efficient food safety system in line with the EU and international laws and standards. This will address the urgent need for measures to increase consumer protection in Armenia and improve quality and safety certification of products;
- Ensure appropriate budgeting of necessary resources for the implementation of the above strategy;

- Upgrade essential technical equipment/infrastructures necessary for effective implementation and enforcement of the SPS legislation approximated with the EU and international laws.

IPR

- Intensify efforts towards establishing an effective dialogue with right holders;
- Take specific steps to raise awareness of IPR issues among general public.

TBT

- Finalise and adopt a comprehensive governmental strategy for the reform of the quality infrastructure system aligned with the EU and international laws and standards;
- Draft and adopt the relevant legislative basis for reorganisation of the core quality infrastructure institutions in the areas of standardisation, metrology and accreditation as foreseen in the above-mentioned quality infrastructure strategy;
- Draft and adopt a governmental programme for approximation of Armenia's legislation to the EU Acquis in the area of technical regulations and standards for priority industrial products;
- Ensure appropriate budgeting of necessary resources for the implementation of the above strategy and programme;
- Upgrade essential technical equipment/infrastructures necessary for effective implementation and enforcement of the TBT legislation approximated with the EU and international laws.

Public Procurement – see the parts related to public procurement under the "Activities" of section (2) Public sector transparency and performance focused on improving the public procurement system and anticorruption.

Complementary action

In order for the programme to achieve maximum effectiveness, complementary action in addition those describe above under 2.5 is needed in the form of technical assistance.

The objectives and expected results of technical assistance and capacity building actions will be embedded in the intervention logic and thus contribute to the successful implementation of the Programme. Complementary action is proposed to the amount of €1 million which will include short and long term advisory and technical assistance projects, audit, evaluation and review of the Programme implementation and other relevant activities.

With the PCA and the AA as the framework for EU-Armenia relations, the technical assistance to be provided within this Budget support operation will have a complementary relation with the assistance being provided by the EU AG and the CIB. The EU AG provides advice for the reforms required under the core chapters of the above mentioned agreement. The CIB will provide, with the government budget contribution, comprehensive capacity building to the cluster institutions responsible for reforms which are in the process of being identified by the government. As a consequence, although the technical assistance to be provided to the government will monitor the implementation of the conditionalities of this Multi-sector budget support operation, the three instruments will concur towards the same aim of the EU-Armenia's Agreements.

3.3. Stakeholders

The Government of Armenia confirmed its willingness to use performance criteria and indicators for disbursements in the areas discussed above and to take the lead on donor coordination.

The MoF plays a strong central role in PFM reforms and is responsible for public expenditure management, including budget preparation, management of the budget expenditure process, budget monitoring, cash management and treasury functions, debt management, internal controls, etc. Thus, it is one of the main stakeholders of this programme along with its many different departments such as the Treasury Department, the Debt Management Department, Procurement Processes and Budget Implementation Methodology Department, Budget Management, Expenditure Financing and Expenditure Planning Departments.

Other important stakeholders include Chamber of Control and State Procurement Agency, Ministry of Economy, Ministry of Health and Ministry of Agriculture, Armenian exporters, foreign investors, Armenian consumers and general public.

3.4. Risks and assumptions

The basic assumptions underlying the Programme are as follows:

- Prevalence of political and social stability in Armenia.
- Sustained Government's commitment to the European Neighbourhood Policy and to the Eastern Partnership, including the negotiation of a new Association Agreement with the EU.
- Sustained government's commitment and political will to conduct reforms in the DCFTA area.
- High level ENP dialogue is complemented by specific and consistent dialogue on the areas and themes of the Programme.
- Sustained commitment to institutional and organisational capacity building across the government institutions.

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

Risks	Level ²	Risk Mitigation Measures
Exacerbation of the impact on Armenia of the global financial and economic crisis.	M	Successful implementation of the IMF supported economic program. EU's macro-financial assistance provided in response to the crisis. Prudence in fiscal and monetary policy.
Under-financing of programmes and activities related to the reform agenda.	M	Proper planning assumptions made and costing techniques used to ensure fiscal realism.
Delays in the disbursement of instalments under the Programme.	L	General and specific conditions of the Programme are formulated in a realistic, measurable and achievable manner. Progress in reforms is monitored on a regular basis through

² Risks are broadly divided in low (L), medium (M) and high (H).

Risks	Level ²	Risk Mitigation Measures
		existing ENP mechanisms. Review of the Programme is performed within the foreseen time schedule. Administrative burdens to the disbursement of instalments are avoided.

3.5. Crosscutting issues

This Programme contributes to improved good governance and accountability. Many of the proposed areas will tie directly to accountability (external and internal audit), transparency (debt management strategy), and anticorruption (external audit, internal control).

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

4. IMPLEMENTATION ISSUES

4.1. Budget and calendar

The **proposed financing modality is direct and untargeted budget support**. The overall amount for budget support will be €20 million with an additional €1 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)	€6 million (variable tranche)	€6 million (variable tranche)

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, if applicable, for the complementary support measures.

4.2. Budget support modalities

The **proposed operating modality is direct centralised management**. This will apply to both the budget support and complementary action components of the Programme. There will be one Financing Agreement with the Government governing operational and financial issues, including the use of complementary action.

4.3. Procurement and grants award procedures

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.

4.4. Performance monitoring and criteria for disbursement

The basis for performance measurement is the monitoring and evaluation framework of Social development Plan (SDP), activities and indicators of ENP AP implementation, key Commission recommendations in trade-related regulatory and institutional reforms (in which Armenia will need to achieve sufficient progress before negotiations on the DCFTA part of the EU-Armenia Association Agreement may begin), as well as formal endorsement by the Government of the PEFA framework as a performance measurement tool for the Armenian PFM.

4.5. Evaluation and audit

The project will be subject of a mid-term review, a final review and a final ex-post evaluation. In addition to the above-mentioned evaluations, the Commission may send specific missions at any time to assess project progress. The mid-term and final review will compare the design and implementation of Programme through an analysis of the relevance, efficiency, effectiveness, impact and sustainability of the project. Independent evaluators will be contracted by the Commission services in accordance with its internal procedures.

4.6. Communication and visibility

The Programme will be implemented in such a way that the best visibility is given, at all times, to the support of the European Union for the programme, the achievements of its objectives and results obtained. Communication and visibility will be organised in conjunction with the MoF and other relevant Ministries, in accordance with the EuropeAid visibility guidelines so as to ensure the best visibility to the co-operation between EU and Armenia.