

Republic of Armenia: 2001 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; and Public Information Notice, Press Release and News Brief on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2001 Article IV consultation with the Republic of Armenia and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **January 29, 2001**, with the officials of the Republic of Armenia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 27, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **May 21, 2001** updating information on recent economic developments.
- a Public Information Notice (PIN), a Press Release and a News Brief, **summarizing the views of the Executive Board as expressed during its May 21, 2001, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

The documents listed below have been or will be separately released.

Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper
Letter of Intent sent to the IMF by the authorities of the Republic of Armenia*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

**Staff Report for the 2001 Article IV Consultation and Request for a Three-Year
Arrangement Under the Poverty Reduction and Growth Facility**

Prepared by European II and Policy Development and Review Departments
(In consultation with other departments)

Approved by Gérard Bélanger and Martin Fetherston

April 27, 2001

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Executive Summary

- Economic activity fell in early 1999 due to the August 1998 Russian currency crisis. Following the political assassinations in October 1999, the economic situation deteriorated significantly in late 1999 and early 2000. In the second quarter of 2000, economic growth resumed while inflation remained moderate.
- Fiscal policy was characterized by a very substantial run-up in budgetary expenditure arrears in late 1999 and the first three quarters of 2000, reflecting shortfalls in tax revenues and delays in disbursements of external budgetary financing related to policy slippages. In the second half of 2000, the authorities increased revenue collections and cut expenditures, thereby stabilizing the stock of arrears.
- Monetary policy during 1999 and 2000 was consistent with price stability, despite the challenges posed by the aftermath of the Russian crisis in early 1999 and some pressures to monetize the fiscal deficit in late 1999 and early 2000. While monetary aggregates increased sharply during the last half of 2000 due to budgetary spending from the Special Privatization Account on capital expenditures, and to clear socially relevant arrears, reserve money was brought down significantly in the first quarter of 2001.
- Discussions focused on policies that would enable Armenia to reduce its remaining external and fiscal vulnerabilities and ensure a sustained resumption of economic growth as the cornerstone for its efforts to reduce poverty. The envisaged policies are consistent with the Interim Poverty Reduction Strategy Paper, which sets out the main elements of the authorities' broader program aimed at achieving sustained, rapid growth and poverty reduction.
- The authorities recognize the need to reduce Armenia's high external debt ratios and the stock of budgetary arrears through a strengthening of public finances and by creating a more favorable climate for private investment and growth, including by pursuing a monetary policy consistent with continued price stability.
- The program also includes selected reforms in the structural and governance areas which will be essential to ensure macroeconomic stability, establish an improved environment for private investment and growth, and reduce poverty. In particular, the authorities intend to improve tax administration and expenditure control, progressively eliminate financing gaps in the quasi-fiscal sectors, further improve regulation of the banking sector, and improve governance via increasing transparency and reducing corruption.
- Access under the new arrangement, as proposed in this paper, would be SDR 69 million (75 percent of quota), to be disbursed in semiannual installments over three years.

I. INTRODUCTION

1. Discussions for the 2001 Article IV consultation and a new program that could be supported by an arrangement under the Poverty Reduction and Growth Facility (PRGF) were held in Yerevan during November 7-21, 2000 and January 16-29, 2001. Earlier missions to conduct PRGF discussions took place in March, May, and September 2000.¹ The staff representatives met with President Kocharian, Prime Minister Margaryan, Minister of Finance and Economy Khachatryan, Central Bank of Armenia (CBA) Chairman Sargsyan, and other senior government officials and members of parliament.

2. The 1999 Article IV Consultation was concluded on October 8, 1999, when the mid-term review under the third annual arrangement under the Enhanced Structural Adjustment Facility (ESAF) was also completed (EBS/99/181 and SM/99/246). On that occasion, Directors noted Armenia's resilience to external shocks, but were concerned about the loss of momentum in the implementation of structural reforms and setbacks in the carrying out of the financial rehabilitation plan for the energy sector. On fiscal policy, Directors emphasized the importance of enhancing expenditure control to avoid arrears buildup, and also called on the authorities to address forcefully the issue of tax arrears. Directors supported the tight stance of monetary policy, but encouraged the authorities to strengthen prudential oversight over the banking system. Directors also stressed the importance of developing a comprehensive external debt strategy for the medium term.

3. In the last few years, Armenia has received extensive financial and technical assistance from multilateral institutions, including the Fund, World Bank, and EBRD.² The World Bank staff has informed the Fund staff that it is prepared to recommend approval to its Executive Board of a new SAC IV loan in an amount equivalent to SDR 38.4 million (\$50 million), including a disbursement of \$15 million on Board approval of the SAC IV which is expected in the second quarter of 2001.

4. The Armenian authorities report to the Fund on a regular basis the minimum core data used for surveillance (Appendix IV). The statistics currently produced in Armenia generally meet, and in many cases exceed, the recommendations of the General Data Dissemination

¹ The staff teams consisted of Messrs. Wolf (head), Wakeman-Linn (March, May), Semblat (March), Shiells (May, September, November, January), Kumah (November, January), Ms. Li (EP; March, May), Ms. Nickel (EP; September, November, January), Ms. Alvis (Assistant; March), (all EU2), Mr. Nielsen (PDR), and Ms. Dieterich (FAD). Mr. Iradian, the resident representative, and Mr. Anayiotos, the former resident representative, contributed to the work of the missions.

² Armenia's relations with the Fund, the World Bank Group, and the EBRD are summarized in Appendices I-III.

Standard (GDDS) with respect to periodicity and timeliness of dissemination. However, with respect to other aspects of data quality and their policy value, further improvements are needed, especially in the national accounts and balance of payments, and socio-demographic indicators, as discussed in the forthcoming Report on Standards and Codes (ROSC) data module for Armenia.

II. PERFORMANCE UNDER THE ESAF

5. Following the collapse in output in the early 1990s, significant progress was made on macroeconomic stability and restoration of growth under the government's economic reform program during 1996-99, supported by arrangements under the ESAF and by considerable World Bank assistance. Period average CPI inflation declined from 175 percent in 1995, prior to the start of the ESAF, to 0.7 percent in 1999. Real growth, driven by construction and services, averaged around 5 percent over the program period, despite the effects of a drought and the impact of the Russian economic crisis.³ At the same time, however, despite the economic growth performance during this period, there has been very little progress in reducing poverty and income inequality, as reflected in the Interim Poverty Reduction Strategy Paper (IPRSP).⁴

6. Non-inflationary monetary and fiscal policies contributed to this strong macroeconomic performance. The non-inflationary fiscal stance was facilitated by abundant official external financing. Inflation remained low in 1998-99, even though indicative targets for broad money growth under the program were exceeded in almost every quarter, as money demand continued to respond more strongly than anticipated to the stabilization policies pursued (Table 2). Nevertheless, and despite the fact that external debt at end-1999 was actually below what had been projected at the beginning of the ESAF, there was a worrisome lack of progress in increasing exports, which contributed to the very rapid growth in external debt ratios (the external debt/export ratio increased from 127 percent at end-1995 to 223 percent at end-1999). In addition, real interest rates remained high, and there were frequent budgetary revenue shortfalls and problems with expenditure control, the latter leading to the nonobservance of the 1998-99 performance criteria on budgetary revenues and arrears.

7. Substantial progress was made in structural reforms during the period of the ESAF arrangements, albeit somewhat less than was targeted. Progress was achieved on banking

³ Despite this performance, there were slippages relative to inflation and growth targets at times. In particular, in 1997 inflation was more than double the program target (22 percent versus 10 percent), while growth was half the target (3 percent versus 6 percent).

⁴ The Joint Staff Assessment (JSA) of the IPRSP describes the timetable for completion of the full PRSP, and the main tasks that lie ahead.

system reform, establishment of a treasury, strengthening of the social safety net, and revising tax laws. Reforms were also carried out in the quasi-fiscal sectors (including the energy, irrigation, and drinking water and sewage sectors)—improving collections and production efficiency, beginning the process of eliminating the culture of non-payment, improving the transparency of and budgeting for quasi-fiscal energy subsidies, and initiating the privatization of the sector, although not all targets under the program were met in this area, and progress was greater in some sectors than others. Privatization continued, despite a major slowdown in late 1998 and early 1999 due to the Russian crisis.

III. RECENT DEVELOPMENTS

A. Political Developments

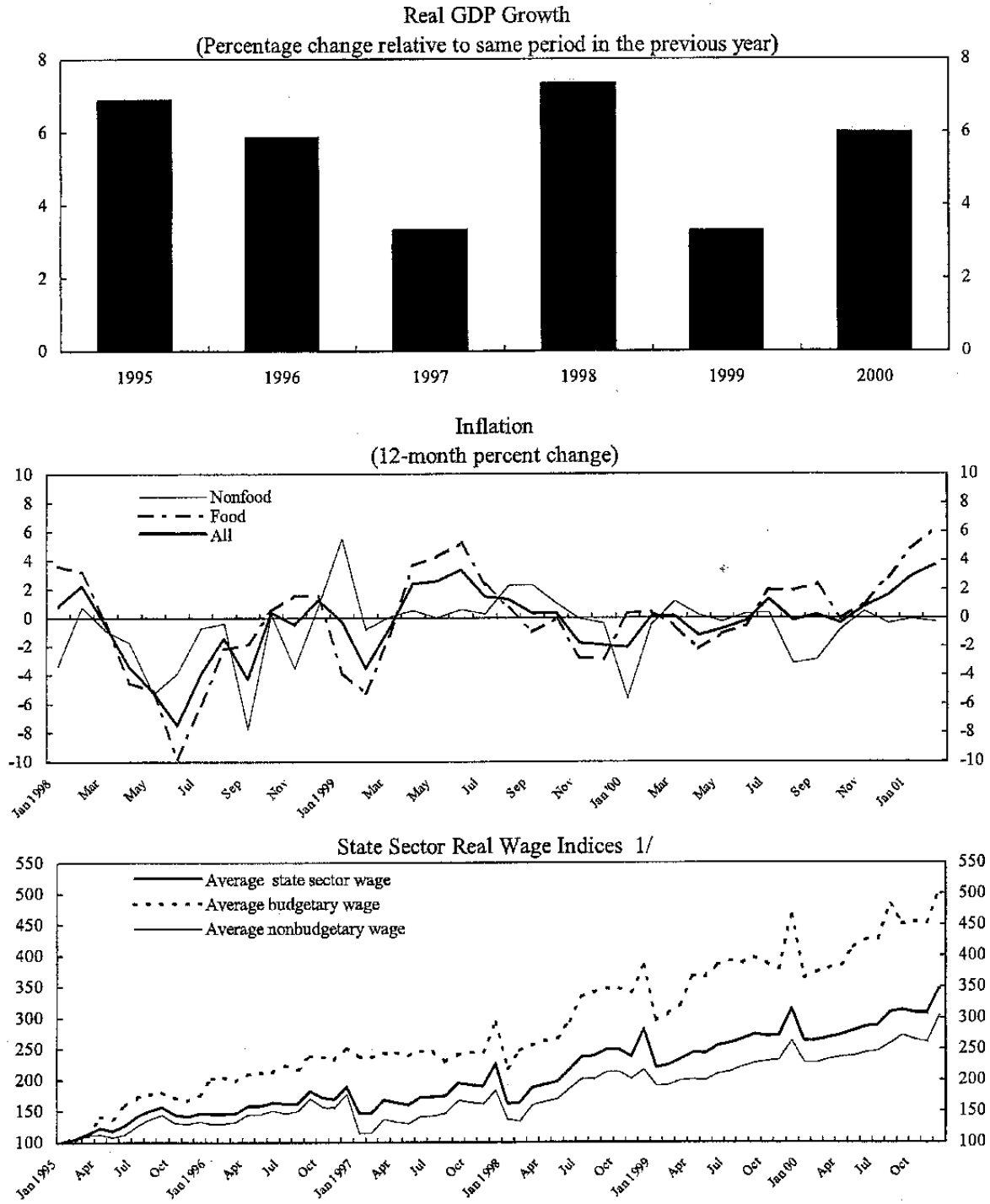
8. The lack of a permanent political solution of the Nagorno-Karabakh issue continues to complicate the economic and political situation. Armenia went through turbulent times in 1999 and the first half of 2000. Following parliamentary elections in May 1999, a new government was formed by the Unity coalition of two parties that together commanded a strong majority in the parliament. On October 27, the prime minister and the speaker of parliament—who headed the two parties that make up the Unity coalition—were assassinated along with six other parliamentarians and cabinet members. Although a new government and parliamentary leadership was quickly established, in line with the requirements of Armenia's constitution, domestic political tensions remained high until the president appointed a new prime minister, Mr. Margaryan (Chairman of the Republican Party and Head of the Unity Coalition parliamentary group) in May 2000 and parliament approved a new government program on June 10. Since then, the political turmoil characterizing the period following the political assassinations of October 1999 has largely subsided.

B. Output and Prices

9. The economy grew by 6.2 percent during the first nine months of 1999 (compared to the same period of the previous year), led by industry, construction, and trade and services. However, real GDP fell by 2.3 percent in the last quarter in the wake of the political assassinations, due especially to contraction in the construction and industry sectors. Real economic activity remained flat in the first quarter of 2000 but began to recover in the second quarter. Real GDP increased by 6.0 percent for 2000 as a whole, despite a severe drought affecting part of agriculture during the summer (Figures 1 and 2, and Table 3). Growth in 2000 was led by industry, construction, and trade and services. Notwithstanding the growth performance, the unemployment rate has not come down despite continued emigration.

10. Inflation remained low in 1999 and 2000, due to a variety of factors including generally non-inflationary monetary and fiscal policies during the period. Inflation in 1999 was substantially lower than programmed, with end-period inflation of only 2.1 percent compared to an original target of 9.9 percent. Consumer prices during the first nine months of 2000 were influenced by a favorable agricultural harvest (the drought did not begin to affect

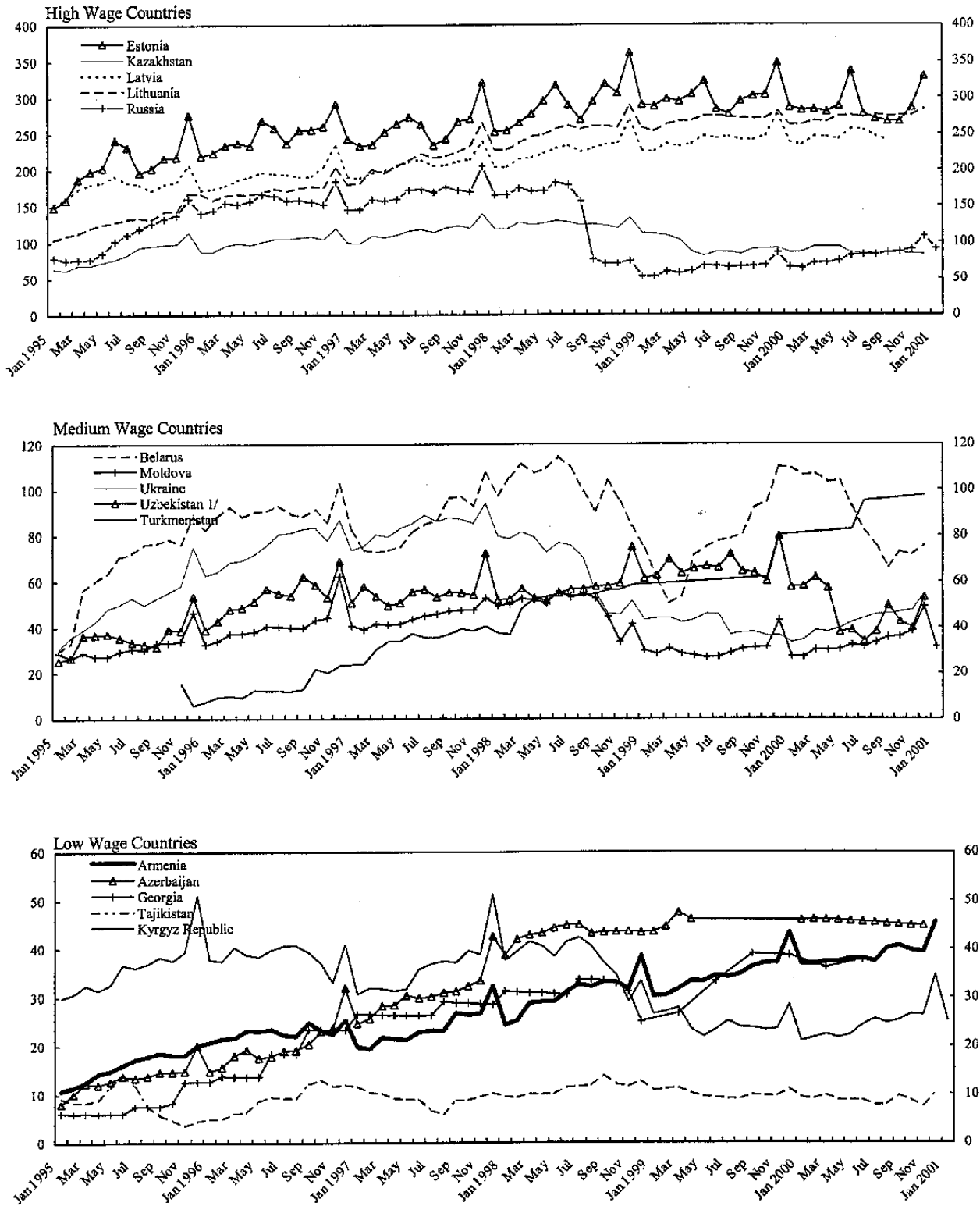
Figure 1. Armenia: GDP, Wages, and Inflation, 1995-2001



Sources: Armenian authorities; and Fund staff estimates.

1/ Nominal wages deflated by CPI (January 1995=100).

Figure 2. BRO Countries: Average Monthly Wages, 1995-2001
(In U.S. dollars, period average)



Source: IMF, European II Centralized Database.

1/ Dollar wages are based on official exchange rates.

agricultural prices until the fourth quarter), and by the appreciation of the U.S. dollar relative to the euro which, given the stability of the dram vis-à-vis the dollar, put downward pressure on prices of imports from the EU expressed in local currency. In the event, the consumer price index fell by 2.8 percent cumulatively in the first nine months of 2000. Although consumer prices rose by almost 3½ percent in the last two months of the year due largely to the catch-up in government spending, cumulative inflation for 2000 as a whole was only 0.4 percent. Inflation was 3.7 percent cumulatively during the first three months of 2001, reflecting both seasonal and special factors including the impact of the drought on food prices and the increase in health care prices due to the introduction of the VAT on medical goods.

C. Fiscal Policy

11. In the first half of 1999, tax arrears increased and expenditure arrears accumulated in the aftermath of the Russian crisis and the political uncertainty prior to the May parliamentary elections. In August 1999, the government included a set of revenue and expenditure measures in an amended budget. Nevertheless, arrears accumulation accelerated in the fourth quarter of 1999, following the political assassinations, due to a decline in budgetary revenues relative to program projections (reflecting significant shortfalls in indirect taxes) and a shortfall in domestic financing. In addition, the third tranche of the World Bank SAC III was \$5.5 million less than anticipated, as a result of the failure to meet full program conditionality. In the event, state budget expenditure arrears rose to 2½ percent of GDP at end-1999.

12. The 2000 budget assumed that the drop in revenues observed in the fourth quarter of 1999 was only short term, and that the underlying trend of increasing tax revenue relative to GDP would continue due to administrative improvements and the increase in excise rates included in the amended 1999 budget. However, tax revenues in the first half of 2000 were only equal to the level in the first half of 1999, which itself had been characterized by difficulties in collection. In addition, until late in the year there were no disbursements under the World Bank SAC III, compared to a total of \$45 million of combined SAC III/IV disbursements expected in the 2000 budget, mainly due to continued slippages in the privatization of the energy distribution companies (EDCs). As a result, state budget expenditure arrears increased dramatically in the first half of 2000, to 4½ percent of GDP at end-June 2000. The staff recommended, but the government decided against, amending the budget in mid-2000, and thereby missed a chance to adjust expenditure commitments in light of lower than budgeted revenues.

13. State budget tax revenues have been on an upward trend since June 2000, except for a weak revenue performance in September, and the authorities succeeded in meeting the indicative target for the fourth quarter agreed with the staff. The stronger tax revenue performance in the second half of 2000 (relative to the budget) reflected increasing political stability, a recovery in economic activity, and improved tax administration. While state budget expenditure arrears increased in the third quarter, to 5.1 percent of GDP, they declined in the fourth quarter, to 4.3 percent of GDP at end-2000 (Table 5). The extent of arrears

clearance in the second half of 2000 reflected the improvement in tax collections, disbursement of the fourth tranche of the SAC III (\$5.5 million) in December 2000, reductions in expenditure commitments in the fourth quarter equal to 2.6 percent of quarterly GDP, and clearance of socially significant arrears (such as family allowances, pensions, and wages) amounting to 2.3 percent of quarterly GDP starting in November using bridge financing from the Special Privatization Account (SPA).

14. In the first quarter of 2001, state budget tax revenues were dram 35.6 billion, which was sufficient to meet the cumulative tax revenue target discussed with the authorities during the January mission. No new state budgetary expenditure arrears were accumulated during the first two months of 2001.⁵ By end-March, the government had repaid the dram 8.25 billion bridge loan from the SPA.

Table 1. Recent and Prospective State Budget Developments, 1998-2001

| | 1998 Actual | 1999 Actual | 2000 Budget | 2000 Prelim. Actual | 2001 Proj. |
|----------------------------------|----------------|----------------|----------------|---------------------------|---------------|
| (In percent of GDP) | | | | | |
| Total revenue and grants | 17.1 | 19.3 | 19.6 | 16.5 | 17.2 |
| <i>o/w tax revenue</i> | 13.6 | 16.1 | 16.6 | 14.8 | 15.1 |
| Total expenditure | 21.9 | 26.5 | 25.1 | 22.8 | 21.2 |
| <i>o/w current expenditure</i> | 16.3 | 19.2 | 18.4 | 17.5 | 16.3 |
| Overall balance (accrual basis) | -4.8 | -7.2 | -5.6 | -6.4 | -4.0 |
| Change in arrears (+ = increase) | 0.5 | 2.0 | -0.7 | 1.9 | -1.5 |
| Statistical discrepancy | -0.4 | -0.2 | -- | 0.5 | -- |
| Overall balance (cash basis) | -4.7 | -5.5 | -6.2 | -4.0 | -5.5 |
| Financing | 4.7 | 5.5 | 6.2 | 4.0 | 5.5 |
| <i>o/w Domestic</i> | 2.1 | 0.8 | 1.6 | 2.5 | 1.2 |
| <i>External</i> | 2.6 | 4.7 | 4.6 | 1.5 | 4.3 |

Source: Armenian authorities and Fund staff estimates.

15. In parallel to the state budget, the State Fund for Social Insurance (SFSI) was facing difficulties collecting contributions; it ended 1999 with arrears equivalent to 0.3 percent of GDP, which increased to 0.8 percent of GDP by mid-2000, equivalent to around 2½ months of pensions. Due to the recovery of GDP growth that also increased wage payments, the increase of the pension contribution rate by mid-2000, and the clearance of pension contribution arrears from the state budget, the SFSI reduced its arrears by end-2000 to around

⁵ End-March arrears data will not be available until May 15.

1½ months of pensions (Table 6). Arrears of the SFSI declined in the first two months of 2001 by dram 700 million.

D. Monetary and Exchange Rate Policy⁶

16. Monetary policy during 1999 and 2000 was consistent with nearly stable prices. While monetary aggregates grew substantially over the period, inflation was low, suggesting a rapid growth in real money demand (Figure 3). The variability in reserve money growth during 1999 and 2000 shows that the stated policy of maintaining reserve money within an indicative corridor with a view to using money as a nominal anchor has been implemented flexibly, with reserve money allowed to move outside the corridor in response to unexpected disturbances associated with delays in external financing, external shocks, and unforeseen fluctuations in government expenditures.

17. Reserve money growth was moderate in the first half of 2000, but exceeded the upper limit of the corridor starting in July (Table 4). In the fourth quarter, reserve money increased by 25 percent, because the net foreign assets of the CBA increased due to official inflows and spending of SPA money on capital expenditures and—through the bridging operation—on clearance of arrears.⁷ The CBA chose not to sell significant amounts of foreign exchange in the market in order to reduce reserve money and bring it back inside the corridor, because it believed this would have led to a substantial appreciation of the dram. It also anticipated that the bridging operation would be reversed in the first quarter of 2001, thereby reducing the net foreign assets of the CBA and reserve money.

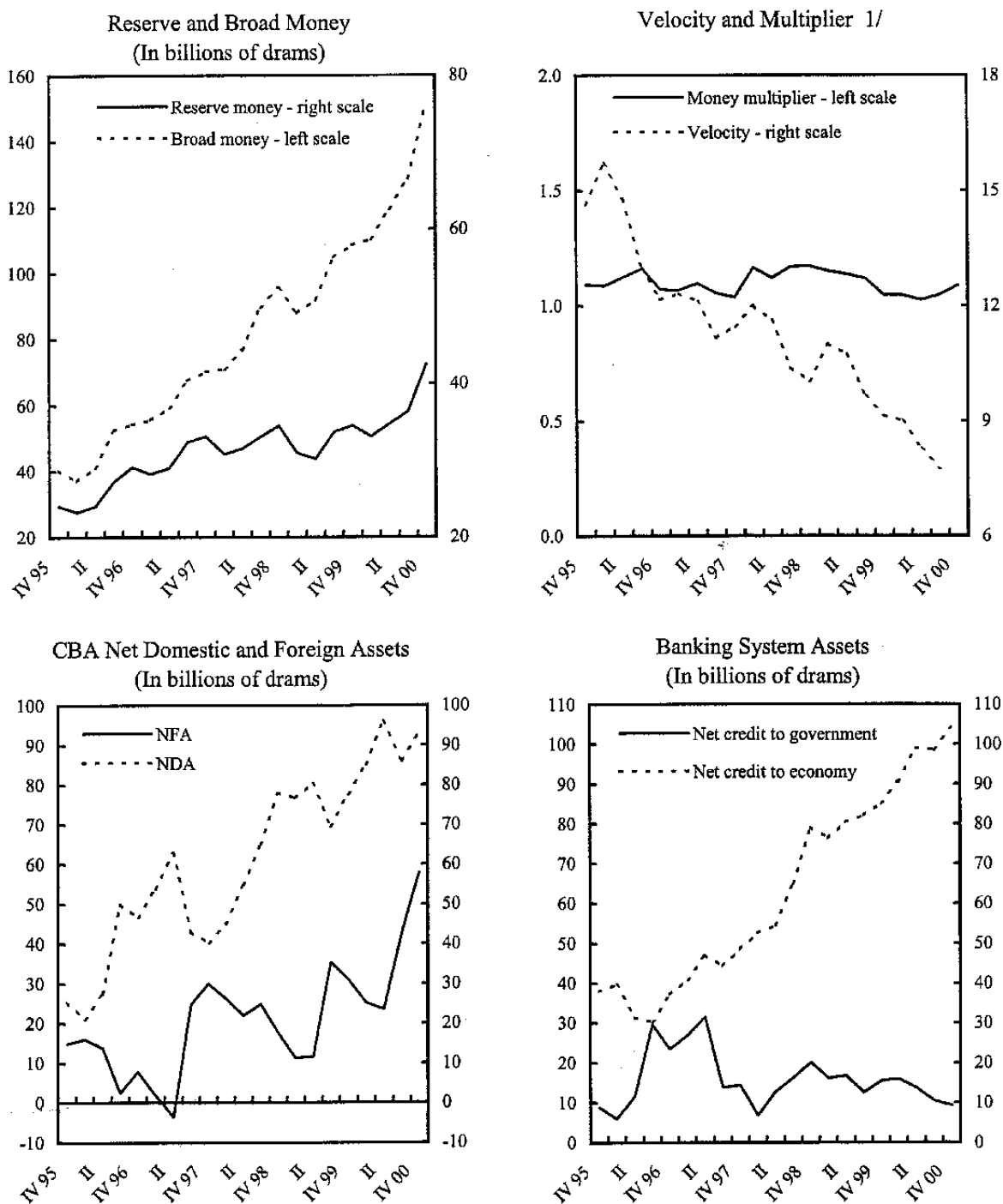
18. Reserve money at end-March 2001 was just below the lower end of the indicative range discussed with the CBA during the January mission, and broad money was modestly above (3 percent) the indicative monetary program due to higher than anticipated foreign exchange deposits. The CBA sold \$8.5 million in the interbank foreign exchange market in the first quarter of 2001, mostly in January, and the dram remained broadly stable in U.S. dollar terms (Figure 4).

19. Following the exodus of nonresident investors and the consequent increase in interest rates in late 1998 and early 1999 in the wake of the Russian crisis, interest rates fell substantially starting in mid-1999 although they have changed little since mid-2000 (Figure 5). The weighted average yield on treasury bills fell from 58 percent in June 1999 to

⁶ Monetary and exchange market developments in 1999-2000 are described in more detail in Chapter I, SM/01/136, 4/30/01.

⁷ The spending of SPA funds increases the net foreign assets of the CBA and reserve money.

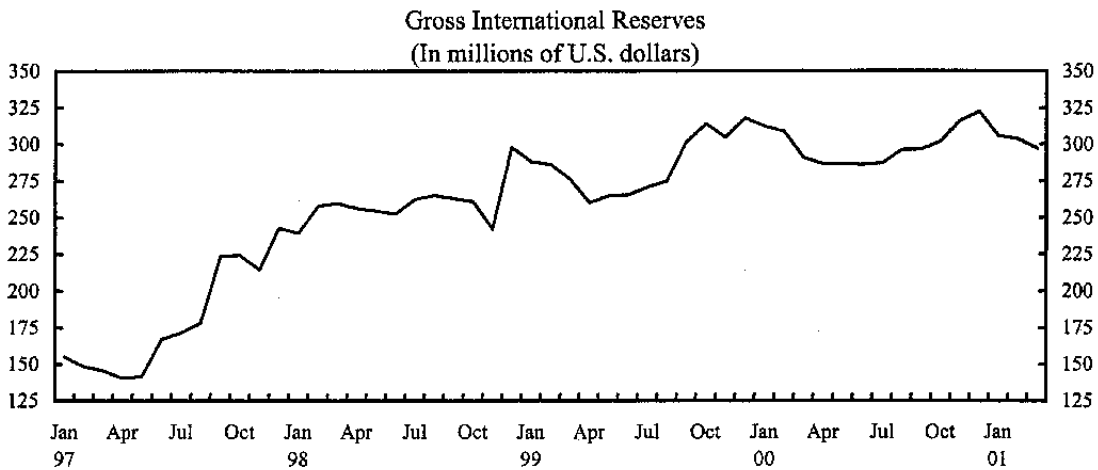
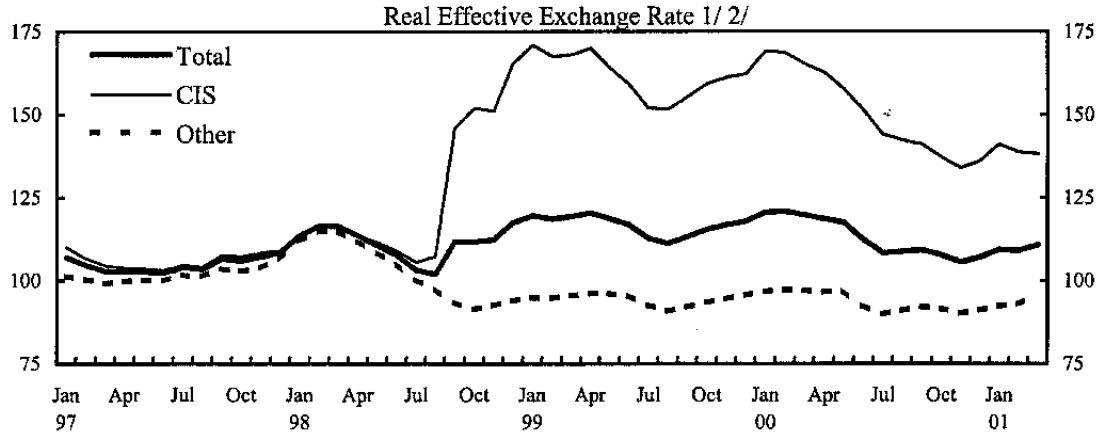
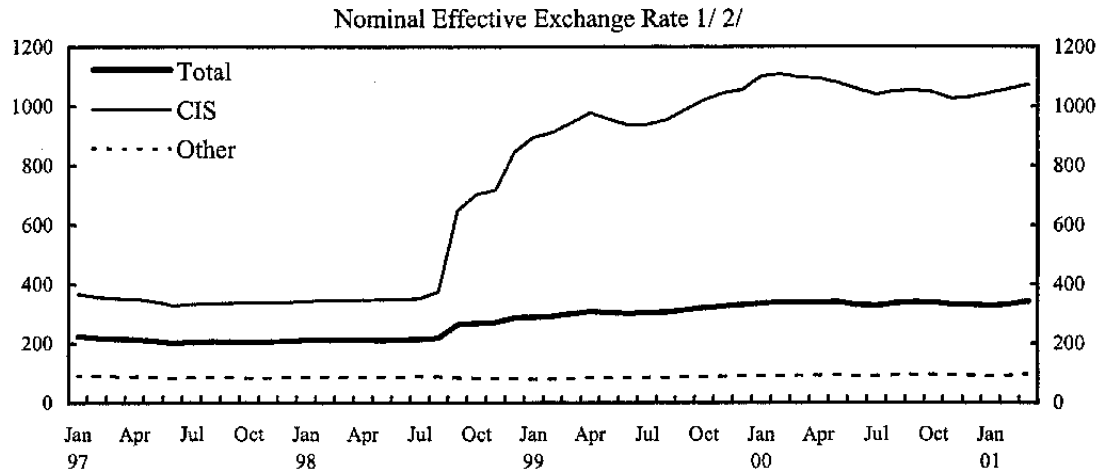
Figure 3. Armenia: Selected Monetary Indicators, 1995-2000



Sources: Armenian authorities; and Fund staff estimates.

1/ Based on dram broad money stocks at end-quarters.

Figure 4. Armenia: Exchange Rate Developments, 1997-2001

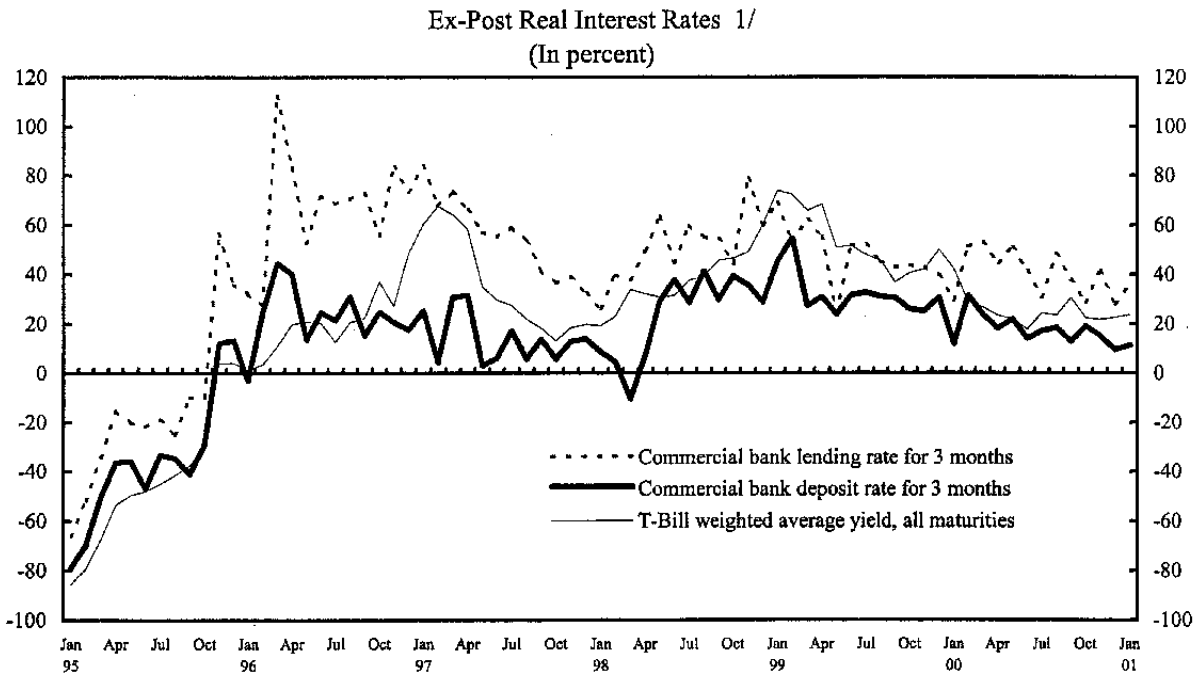
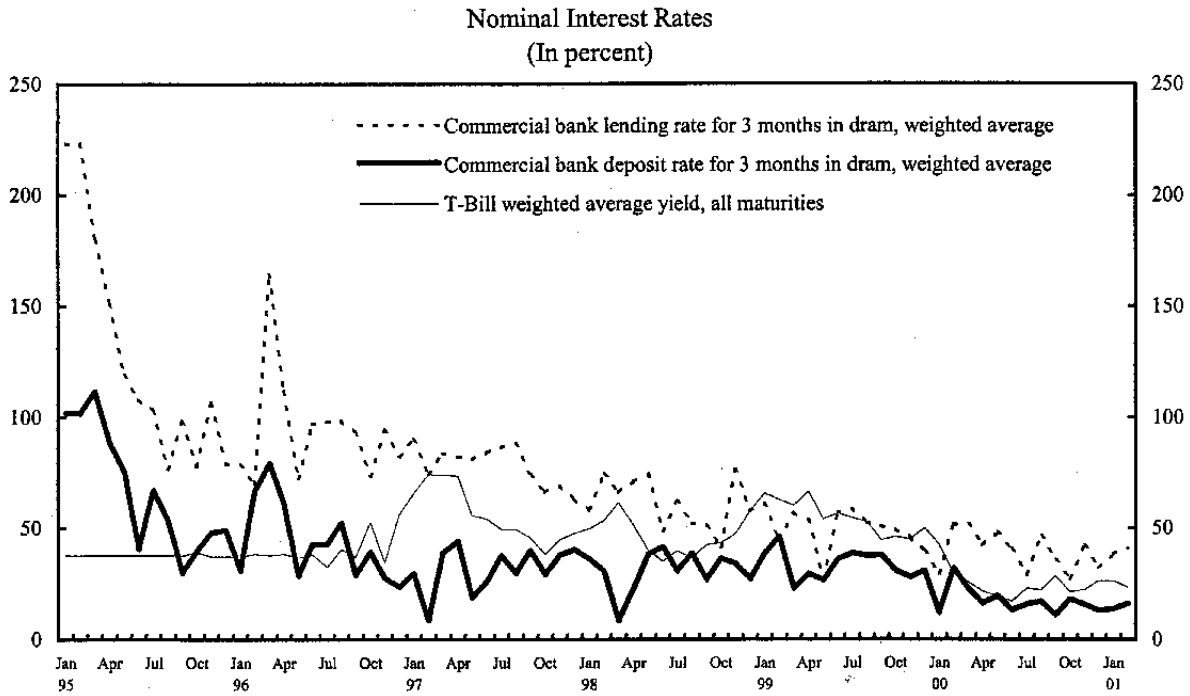


Sources: IMF, Information Notice System, Direction of Trade; and Fund staff estimates.

1/ In 1995-97, INS weights; in 1998-2000 weights based on DOT 1997 trade data. In 1995-97, trading partners include: Belgium, France, Georgia, Germany, I.R. of Iran, Italy, Netherlands, Russia, Turkmenistan, and Ukraine. From 1998 onwards, the trading partners also include Bulgaria, Switzerland, Turkey, and UAE.

2/ Index: 1995=100. Increase indicates an appreciation.

Figure 5. Armenia: Interest Rates, 1995-2001
(Simple annual rates; in percent)



Sources: Armenian authorities; and Fund staff calculations.

1/ Calculated as the nominal interest rate deflated by the ex-post one-period lead of the 12-month CPI inflation.

27 percent in March 2001. Improved coordination of monetary and fiscal policy and the increase in economic stability contributed to the decline in interest rates. Nonetheless, real interest rates remain high in Armenia.

20. As described in the Financial System Stability Assessment (FSSA), while the reported data for the Armenian banking system point to a relatively healthy financial system (Figure 6), the underlying situation contains a number of weaknesses and vulnerabilities. Weaknesses relate in particular to credit and foreign exchange risks because of a generally weak credit culture, inadequate risk identification, insufficiently rigorous monitoring and management practices, and, in the context of a highly dollarized economy, large foreign currency exposure to borrowers without foreign currency earnings. The underlying risks on banks' balance sheets have been masked, in part, by deficiencies in reporting and supervisory practices and, in part, by the relatively stable macroeconomic environment over the last few years. However, the Armenian banking system is quite small, accounting for assets equivalent to only 15 percent of GDP, and therefore a systemic crisis might have a limited effect on the rest of the economy.

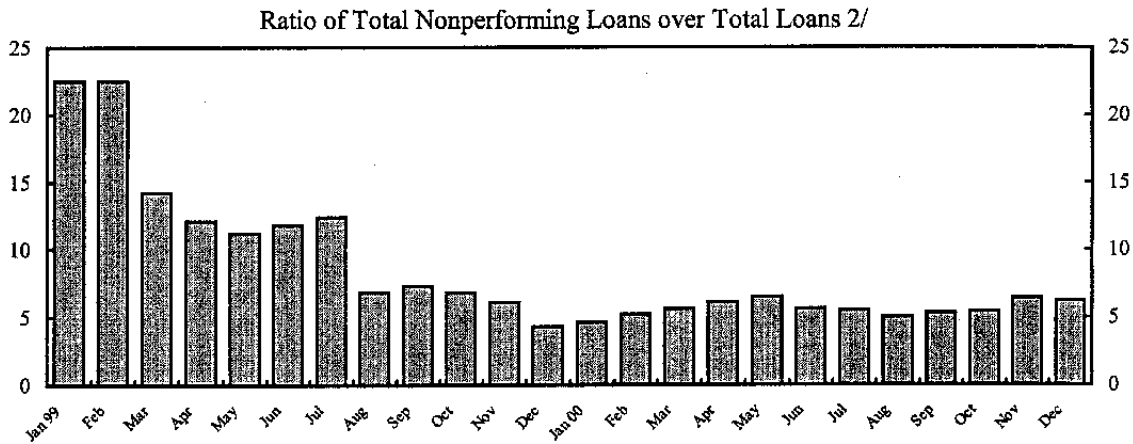
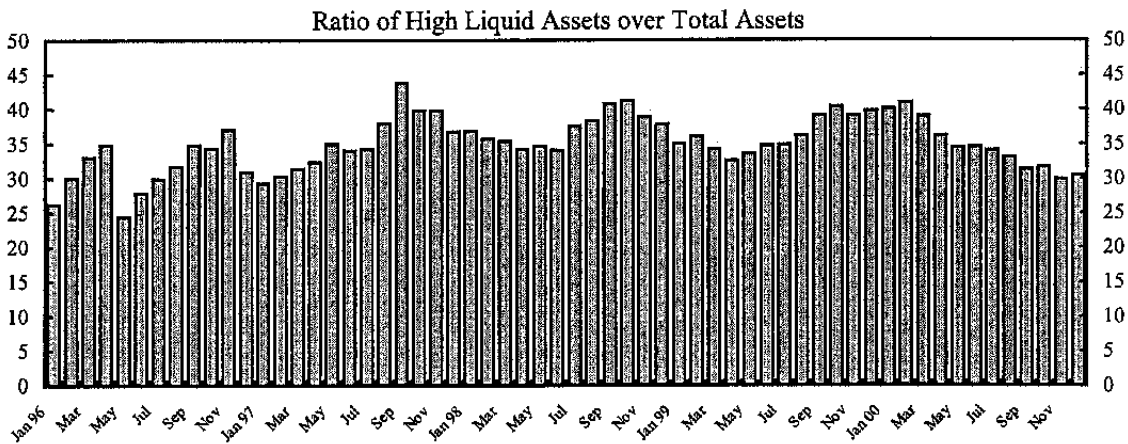
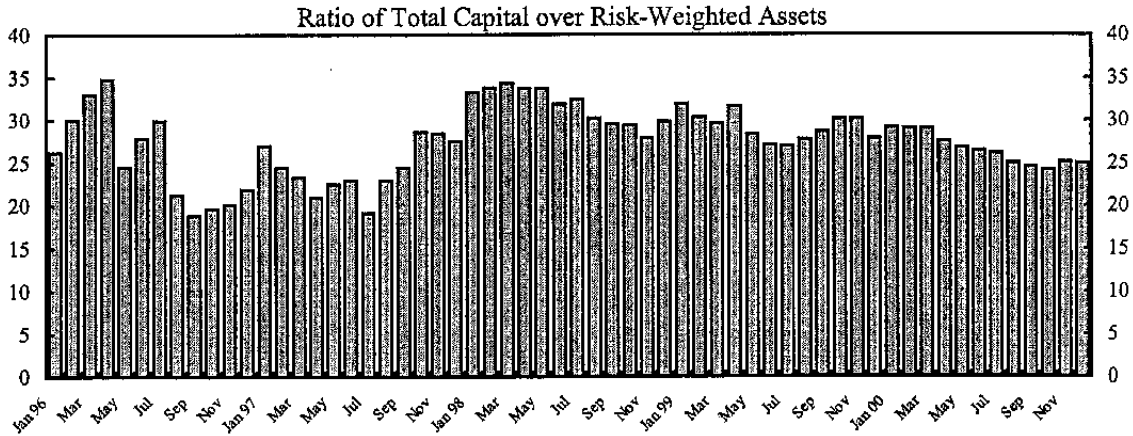
E. Balance of Payments and External Financing⁸

21. In recent years, the external current account position has improved significantly with the deficit falling from 21.2 percent of GDP in 1998 to 14.6 percent in 2000, reflecting a reduced deficit on goods and services (Figure 7 and Table 7). In 1999, the growth in exports in U.S. dollar terms was fairly modest (6½ percent), but imports declined by 8 percent, driven in part by lower Russian export prices and lower humanitarian imports. The trade balance continued to improve in 2000, as merchandise exports increased by 24 percent, with agricultural and base metal exports staging a strong recovery and diamond exports continuing to expand briskly. Foreign direct investment (FDI) played a significant role in supporting this strong export performance. Merchandise imports increased by 8 percent driven by a 31 percent increase in the imports of uncut diamonds and a 15 percent increase in humanitarian imports. Fueled by buoyant agricultural and mineral exports, merchandise exports continued to expand strongly in the first two months of 2001, increasing by 29 percent over the same period in 2000. In contrast, merchandise imports fell by 9 percent over the same period owing in part to lower humanitarian imports.

22. The capital account surplus decreased from around \$400 million in 1998 to around \$300 million in both 1999 and 2000, in the absence of major international privatizations which had boosted FDI in 1998. Notwithstanding the decrease from 1998, FDI inflows averaged around 6 percent of GDP in 1999-2000. Major FDI inflows occurred in the telecommunications and energy sectors, including from Greek and Russian investors. In 2000, the capital account surplus was slightly lower than in 1999, in part because

⁸ Armenia's external competitiveness is considered in Box 1.

Figure 6. Armenia: Banking Sector Prudential Indicators, 1996-2000
(In percent)

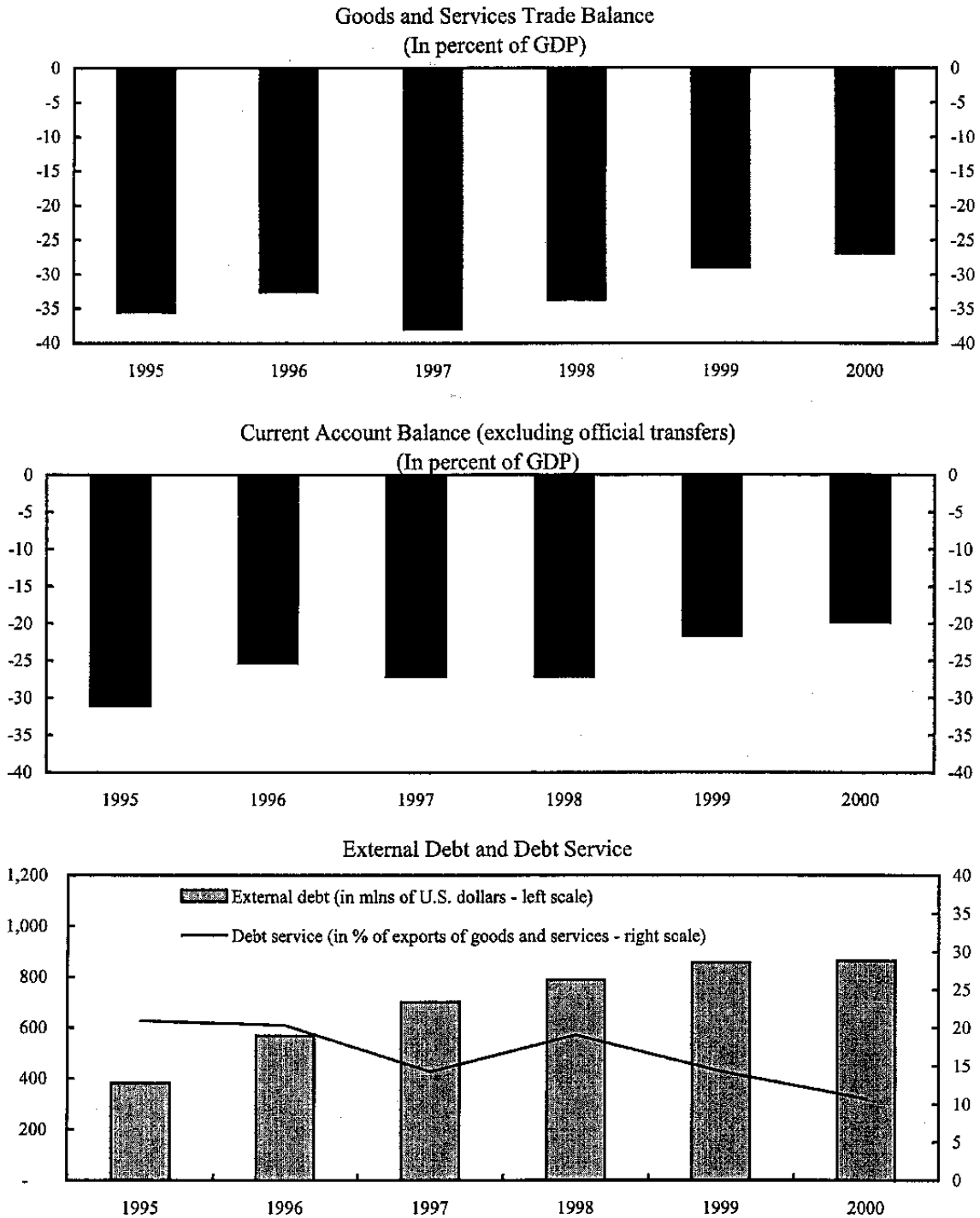


Sources: Armenian authorities; and Fund staff estimates.

1/ Includes government securities.

2/ Data for earlier periods not comparable due to significant revisions by the CBA.

Figure 7. Armenia: External Sector Developments, 1995-2000



Sources: National Statistical Service, Ministry of Finance and Economy; and Fund staff estimates.

disbursements to the public sector were negatively affected by the debt service arrears to Russia, which blocked new Russian disbursements, and problems in securing sufficient budgetary counterpart funds, which slowed the implementation of World Bank projects. Other capital inflows (net) increased from \$90 million in 1999 to \$130 million in 2000 partly on account of new EBRD private sector disbursements.

23. Since late 1999, Armenia has serviced almost none of its debt service obligations falling due to Russia, and as of end-March 2001 external arrears to Russia amounted to \$24 million. The Armenian and Russian authorities have agreed that these arrears are to be settled in two tranches—\$16.3 million in the second quarter and the remainder in the third quarter of 2001. In mid-2000 Armenia rescheduled its debt to Turkmenistan. Debt service to other creditors was serviced in a timely manner.

24. At end-2000, external debt amounted to \$862 million, the equivalent of 45 percent of GDP or 196 percent of (current year) exports. In present value terms, external debt at end-2000 is estimated at \$535 million, or the equivalent of 135 percent of exports, down from \$549 million (154 percent of exports) in 1999.⁹ Owing to the difficult fiscal situation and real exchange rate depreciation in 2000, however, the PV debt/fiscal revenue ratio is estimated to have increased, from 167 percent in 1999 to 179 percent in 2000.

Notwithstanding the improved export debt sustainability indicator in 2000, external debt relative to exports remains high, especially in view of the narrow and vulnerable export base. The authorities are cognizant of the need to lower the external debt burden. In addition to encouraging exports (by privatizing state-owned enterprises, attracting FDI, and improving the business environment) and lowering the externally-financed share of the budget deficit, the authorities' external debt strategy consists of refraining from the contracting of non-concessional debt and using part of the SPA funds to prepay existing non-concessional debt.

25. Armenia maintains a liberal and stable trading system with no non-tariff barriers (for trade protection purposes) and no export taxes. Most imports enter the country duty-free, while goods subject to import duties are assessed a uniform 10 percent import duty. In preparation for WTO accession, a new customs code was adopted by the parliament in July 2000, an effort which was supported by technical assistance from the UK's Department for International Development (DFID). Armenia's trade regime is rated "1," the most liberal, according to the Fund's classification scheme for measuring an economy's overall trade restrictiveness. It is expected that this rating will remain for the duration of the arrangement. Armenia accepted Article VIII, Sections 2, 3, and 4 in May 1997, and maintains an exchange

⁹ Three-year moving average of exports of goods and services, centered on the preceding year. The sharply lower PV debt/export ratio in 2000 is not only a result of the strong growth of exports relative to external debt build up. It also reflects the strengthening of the U.S. dollar and the use of higher discount rates in line with the higher international interest rates prevailing in 2000.

system that is free of restrictions on payments and transfers for current international transactions.

F. Quasi-fiscal Sectors

26. The government's plans for restructuring of the quasi-fiscal sectors (energy, irrigation, drinking water and sewage, district heating, and the chemical company Nairit) during 1999-2000 have been set out in various government decrees, although it is not always clear from these decrees what measures will be taken to achieve the projected improvements in financial performance.¹⁰ In the energy sector, the plans aim to improve collection rates, reduce technical losses and theft, raise tariffs to reach full cost recovery of current costs, and restructure the energy sector's debts. Progress has been made in each of these areas, although the sector remains a considerable financial drain on the budget and the rest of the economy. The authorities believe that the only credible solution to restoring payment discipline and eliminating theft in the energy sector is to privatize the EDCs. In August 2000, the government adopted the EDC Privatization Law, which allows the privatization of the four EDCs (grouped together into two packages) through an international tender. The authorities intend to send the final agreed tender documents to potential bidders in the competitive tender for privatizing the EDCs, conducted under the World Bank supported program, by July 9, 2001.

27. The irrigation and drinking water and sewage companies all suffer from high loss rates, low collection rates, and tariffs which do not fully cover costs, leading to substantial overall deficits and financing gaps in 1999-2000. District heating now covers only a small proportion of households, but it incurred a sizeable financing gap in the 1999/2000 heating season (data on the 2000/01 heating season are not yet available). Nairit, the chemical company, whose output has fallen to about a quarter of the amount demanded during Soviet times, was only able to pay around 30 percent of its electricity bills during January-September 2000, and the energy sector effectively accepted barter payments from Nairit.

IV. REPORT ON THE DISCUSSIONS

28. The staff has been discussing with the authorities since March 2000 a program of macroeconomic and structural policy measures that could be supported under the PRGF. The authorities have agreed with the staff that the program would need to address Armenia's remaining external and fiscal vulnerabilities to ensure sustained economic growth as the cornerstone for efforts to reduce poverty. In particular, the authorities recognize the need to reduce Armenia's high external debt ratios and the stock of budgetary arrears through a strengthening of public finances and by creating a favorable climate for private investment

¹⁰ The financial rehabilitation of the quasi-fiscal sectors is described in more detail in Chapter III, SM/01/136, 4/30/01.

and exports, including by pursuing a monetary policy consistent with continued price stability. The envisaged reforms are consistent with the IPRSP, which sets out the main elements of the authorities' broader program aimed at achieving sustained, rapid growth and poverty reduction, and they will be modified appropriately once the full PRSP has been finalized.¹¹

29. The program includes selected reforms in the structural and governance areas which will be essential to ensure macroeconomic stability, create a favorable climate for private investment and growth, and reduce poverty. In particular, the authorities intend to improve tax administration and expenditure control, progressively eliminate financing gaps in the quasi-fiscal sectors, further improve regulation of the banking sector, and improve governance through increasing transparency and reducing corruption. The authorities are convinced that anti-corruption efforts will be essential to ensure that an acceleration in economic growth will succeed in reducing poverty.

30. In the attached Letter of Intent and Memorandum of Economic and Financial Policies (MEFP), the authorities request support from the Fund through an arrangement under the PRGF, in support of an ambitious program of macroeconomic and structural reforms designed to achieve the objectives enumerated above.

A. Macroeconomic Framework

31. In the medium-term, fiscal policy is designed to increase tax revenues and keep expenditures roughly constant as a share of GDP from 2002 onwards, following a drop of 1½ percent of GDP in 2001, so as to both eliminate the stock of expenditure arrears and gradually reduce Armenia's reliance on external financing, thereby helping to lower the external debt burden over time. Together with appropriate monetary and fiscal policies, structural measures and improvements in governance will improve the overall business climate which, together with the improvement in the fiscal position, should lead to increased private investment (including FDI) and sustained rapid economic growth and poverty reduction. The external position is expected to strengthen due to FDI in the export sector, production of import-competing goods by new or newly privatized firms, and anticipated private inflows.

32. The main macroeconomic projections and objectives for 2001-06, consistent with the I-PRSP, are as follows: (i) real GDP growth is projected to average around 6 percent during 2001-2003 and 5 percent per annum thereafter, broadly in line with average growth since 1993 (5½ percent); (ii) annual inflation will be held to 3 percent; and (iii) the gross official international reserve position of the CBA will be maintained at around 3½ months of imports (Tables 8 – 10). On the basis of present commitments of external financing, the fiscal deficit

¹¹ The main elements of the authorities' program for reducing poverty are set out in Box 2.

(accrual basis) is currently projected to decline, from about 6½ percent of GDP in 2000 to 4 percent in 2001, 3 percent in 2003, and to 2½ percent in 2004-06. This deficit reduction, combined with net private investment of around 7½-8 percent in 2000 and 2003, and around 7½ percent in 2006,¹² would make possible a reduction of the current account deficit from 14½ percent in 2000 to 10½ percent in 2003, and under 10 percent in 2006.

33. The baseline growth projections are, as noted, in line with Armenia's real GDP growth performance in the period since 1993, which has featured a major loss of export contracts in 1997, the 1998 Russian currency crisis, the political assassinations in 1999, and the drought in 2000. The authorities believe these growth objectives are cautious, given the major new investments expected to be financed by the Armenian diaspora, as well as tourism related to the celebration in 2001 of the 1,700 year anniversary of Armenia's adoption of Christianity as a state religion. The staff stressed the risks, including that investment and tourism may turn out to be lower than expected, and the possibility that growth rates could tail off in the absence of major new private sector investments.

B. Fiscal Policy

34. The authorities' medium-term fiscal policy objectives are described in paragraph 8 of the MEFP, (Appendix VIII) and the 2001 budget is summarized in paragraph 33 of the MEFP and Table 1 above. Under the 2001 budget, tax revenues are envisaged to increase by 0.3 percent of GDP. The program envisages an increase in tax revenues of around 0.6 percent of GDP through administrative measures, the main elements of which are the broadening of VAT collection at the border and the introduction of automated audit systems. Tax reform measures approved for 2001, described below, are expected to generate a net revenue loss of around 0.3 percent of GDP.

35. The focal point of adjustment in 2001 will be a further reduction of expenditures. To achieve this, most expenditure categories had to be cut, including those relating to poverty alleviation. On a cash basis, total expenditures for family allowances, health, and education, were reduced from 3.8 percent of GDP in 1999 to 2.9 percent in 2000. Even though social expenditures would drop slightly under the 2001 budget on an accrual basis, 1.1 percent of GDP more would be spent on socially relevant expenditures on a cash basis, compared to 2000. The World Bank believes that the level of social expenditures in the 2001 budget is consistent with the objectives of the IPRSP, given the substantial scope for rationalizing family allowances, pensions, and health expenditures. Although the back loaded nature of the SFSI's revenues limits the extent to which pension arrears can be reduced in the first half of 2001, the authorities intend to ensure that the arrears of the SFSI at least do not increase in

¹² Net private sector investment is projected to increase by about 2½ percentage points of GDP in 2001, mainly on account of major new investments financed by the Armenian diaspora.

the first quarter, are reduced by at least dram 1.0 billion in the second quarter, and are fully eliminated by end-2001. In the medium term, structural reforms in the health and education sectors are expected to generate room for the provision of social services without the need for increased budgetary spending. In parallel, the government intends to reform the pension system and to streamline the family allowance scheme to sharpen the focus of social assistance.

36. Strengthening of tax collections will come largely from better tax and customs administration, and through improved governance including increased transparency and reduced corruption. In approving the 2001 budget, as noted above, the parliament also approved a comprehensive tax package (see paragraph 37 of the MEFP). While the increase in VAT collections at the border to around 50 percent of imported goods is an important step, the authorities were reluctant to expand the coverage further in the near term due to the long lags in obtaining VAT refunds on imported inputs and the associated carrying costs to exporters in an environment of very high real interest rates. Over the program period, as administrative capacity for VAT refunds improves and interest rates decline, the authorities intend to extend collection of the VAT to the border for all eligible goods. Additional measures to be implemented over the medium term will include the elimination of remaining tax exemptions and the unification of widely varying excise taxes on similar products, which the authorities believe currently provide opportunities for tax evasion or avoidance.

37. The authorities intend to undertake a number of measures to improve tax and customs administration in 2001.¹³ To improve tax administration, the authorities intend to implement a comprehensive automated audit system (covered by two structural benchmarks under the program). The Ministry of State Revenues (MSR) plans to strengthen the skills of its staff, step up efforts to seize collateral and initiate bankruptcy procedures for non-payers, and as noted below in connection with governance, implement a system of VAT cross-checks. Regarding customs, the authorities will set up an action plan to implement the findings of the diagnostic workshop held in March 2000. They also plan to take further measures to improve collections of mandatory social contributions.

38. In 2001, to improve expenditure efficiency, the authorities intend to undertake— together with the World Bank—a public expenditure review, enact a treasury law (a structural benchmark under the program), introduce commitment control procedures in all ministries and other government agencies, take steps to improve the reliability of expenditure arrears reporting, and improve internal audit procedures in the line ministries and other government

¹³ Detailed measures to improve tax and customs administration in 2001 are described in paragraphs 38, 39, and 53 of the MEFP.

agencies.¹⁴ The authorities have signed a contract with an external auditor, hired through international tender, for the use of SPA proceeds (a prior action under the program). The program will include a performance criterion on the stock of state budget arrears. The program includes measures to help prevent arrears (including introduction of commitment control procedures and internal audit of line ministries) and improve arrears reporting (including registering the payments in the treasury on an accrual basis). Given that expenditure commitment controls would only be implemented on a pilot basis by end-June 2001, however, the entire system of arrears reporting and control will need to be considered in the context of the first review.

39. Under the approved 2001 state budget, and given the agreement to repay \$19 million (equivalent to dram 10.4 billion) in arrears to Russia outstanding at end-2000, the stock of arrears would fall from dram 44.4 billion at end-2000 to dram 27.1 billion at end-2001, so that only about dram 17.2 billion of arrears (1.5 percent of GDP) could be cleared in 2001 in the absence of higher than budgeted revenues, further debt relief or expanded donor assistance (Table 5).¹⁵

40. However, a number of deviations from the financing assumptions underlying the 2001 budget are possible. For one thing, the authorities have agreed in principle to consider a rescheduling of debt principal due from Georgia, although this remains to be negotiated. If amended to include this possible rescheduling, the stock of arrears of the state budget at end-2001 would amount to dram 29.3 billion, or 2.6 percent of GDP. The World Bank plans to hold a Consultative Group (CG) meeting in July 2001. If \$20 million were to become available from the CG, and even if revenues above and beyond the budget target cannot be achieved, the carryover of arrears into 2002 could be held to dram 18.3 billion (1.5 percent of 2002 GDP). In this case, under current assumptions, there would be no fiscal gap in 2002.

41. With regard to privatization proceeds, the authorities intend to continue to follow the principle that the bulk of proceeds in the SPA should be used for capital expenditures in the context of a well specified medium term expenditure framework, and the remainder for the retirement of non-concessional external debt. The staff agreed that any reduction in the present value of the stock of external debt arising from debt rescheduling agreements would reduce the amount from the SPA to be devoted for the retirement of such debt. In this regard,

¹⁴ The authorities' medium-term objectives for improving expenditure efficiency are described in paragraph 11 of the MEFP, and detailed measures for 2001 are described in paragraphs 40 and 52 of the MEFP.

¹⁵ Due to unforeseen delays in the first disbursement under the SAC IV, the authorities are bridging to this disbursement by drawing down the SPA, in order to avoid running up net domestic arrears within the second quarter (these arrears are programmed to decline for the quarter as a whole).

the staff believes it is important to reduce the external debt burden due to the risk that a more adverse scenario could materialize than envisaged under the program. It will be important to keep the debt burden under review, including in relation to exports.

42. The SFSI is expected to have a balanced budget in 2001 after clearing arrears equal to 0.4 percent of GDP. The rationalization of personal income and pension contribution rates that became effective on January 1, 2001 increases the average pension contribution rate and is expected to generate around 0.1 percent of GDP in additional revenues.

C. Monetary and Exchange Rate Policy

43. The CBA indicated that its main objective will be to implement a monetary policy consistent with its obligation under the law to maintain price stability. Indeed, the CBA succeeded in maintaining low inflation during 1998-2000 (cumulatively, 1½ percent over three years), although the staff expressed concern regarding the acceleration in monetary aggregates during the second half of 2000. The CBA shared this concern and indicated its intention to reduce reserve money sharply in the first half, in line with the government's commitment to reverse the bridging operation conducted in late 2000. As in 1999 and 2000, the monetary program for 2001 anticipates a decline in reserve money during the first half of the year reflecting the seasonal weakness in real money demand, combined with replenishment of the SPA, with the nominal exchange rate expected to remain stable, followed by an increase in reserve money in the second half of the year. The CBA expressed its preference for maintaining the indicative reserve money corridor, which will continue to serve as the nominal anchor for monetary policy. It believes the corridor has helped increase the transparency of monetary policy and shape expectations of market participants. The CBA will also maintain a flexible exchange rate policy and will only intervene in the foreign exchange market to smooth short-term exchange rate fluctuations. In the event that reserve money moves outside the corridor, the CBA will consult promptly with the Fund staff regarding the appropriate policy response, and in particular with a view to a possible further tightening of the monetary program if inflation in the first half is higher than envisaged.

44. The authorities agreed on the need for the government to continue to coordinate closely with the CBA in order to smooth budgetary expenditures as much as possible in the presence of bulky inflows of official external financing or any bridging operation involving the SPA. The government and the CBA agreed that the latter operation would only take place under extraordinary circumstances, and would be coordinated in such a way that the reserve money corridor would not be breached. The government also reaffirmed its view that the continued independence of the CBA is essential to ensure that monetary policy is conducted in a manner that is consistent with price stability.

45. Dram broad money is expected to remain flat in 2001 given the rapid monetary growth in the second half of 2000. The projected growth in overall broad money (12 percent)

is based on the expectation of continuing strong growth in foreign currency deposits¹⁶ and an increase in reserve money of 2 percent. The 2001 program targets the dram equivalent of a \$6 million (end-year to end-year) increase in net official international reserves (NIR), which together with disbursements under the PRGF will enable the central bank to maintain import coverage of gross reserves of around 3½ months of imports.

46. The authorities intend to take steps to strengthen the banking sector further based on the recommendations of the FSSA, including by implementing: (i) legal and regulatory changes to improve the CBA's ability to deal effectively with problem banks; (ii) revisions to the present loan classification system; (iii) progressive increases in minimum capital requirements for existing banks to reach the same level as required for new banks (\$5 million) over time; and (iv) amendments to the Securities Market Regulation Law to ensure that the activity of domestic banks in the government securities market is not regulated by that law.¹⁷ In order to strengthen the CBA's ability to deal effectively with problem banks, the authorities intend to enact a new Law on Bankruptcy of Banks, and to amend as necessary the central bank and commercial bank laws (they are structural benchmarks under the program). The CBA and the government also intend to implement a new loan classification system that will take into account the capacity of the borrower to repay the loan, which will reveal more accurately the quality of banks' loan portfolios.

D. Quasi-fiscal Financial Rehabilitation and Governance

47. Outside of the fiscal and banking sector areas, the specific aspects of the authorities' program discussed with the staff included reforms involving: (i) further progress in the financial rehabilitation of the quasi-fiscal sectors; and (ii) governance issues related to fiscal and financial transparency. It has been agreed with the Bank staff that the Fund staff will take the lead on issues related to fiscal reforms, institutional reforms involving the CBA, and governance issues relating to fiscal and financial transparency. Also, in close cooperation with the Bank staff, the Fund staff will monitor the financial flows of the quasi-fiscal sectors, while the Bank staff will deal with structural reform issues in these sectors. Other structural areas, as well as programs in social protection and the health and education sectors, are being handled by the Bank in the context of the SAC IV and by its other lending programs.

48. The authorities' objective for the quasi-fiscal sectors will be to close the financing gaps of these sectors completely, while undertaking measures (privatization, reductions in

¹⁶ According to the CBA, the strong growth in foreign currency deposits is related to a variety of factors, including high per capita foreign financial support due to the large diaspora, and falling interest premia on dram versus dollar deposits. See Chapter I, SM/01/136, 4/30/01, for further discussion.

¹⁷ Detailed policies for 2001 are specified in paragraphs 44-46 of the MEFP.

loss rates, and increases in collection rates and, where necessary, tariffs) leading to only a minimal subsidy coming from an already strained state budget. While the authorities will aim to implement reforms leading to the financial independence of these sectors by the end of the program period, the Bank staff has suggested that this may not be feasible. In any event, by 2003, any remaining financial gaps should be fully covered by budget support. Given the importance of the energy sector for the budget, the program includes a performance criterion on the primary balance of the energy sector. The authorities' medium-term strategy and detailed policies for 2001 for the financial rehabilitation of the quasi-fiscal sectors are detailed in the MEFP (paragraphs 20-24 and 49-50, respectively).

49. As indicated in the IPRSP, establishment of an efficient governance system is crucial for poverty reduction. The authorities believe this has been one of the main impediments to poverty reduction. Efforts to improve governance will involve structural fiscal reforms in the areas of tax administration and expenditure control to increase transparency (in the areas enumerated above, including external audit of the use of SPA proceeds), as well as legislative changes and other measures to combat corruption. The staff welcomed the authorities' efforts to combat corruption, including by having recently established an anti-corruption commission, to be coordinated by the Prime Minister, which has been charged with elaborating a major program of actions in this area. Actions to reduce corruption are important for improving the fiscal situation, attracting foreign investment, and reducing poverty. As an important first step, and as noted in the IPRSP, the government has submitted a revised draft law on financial disclosure of public officials, taking into account the extensive comments received from Fund staff, to the parliament (a prior action under the program), with a view to obtaining parliamentary approval by end-June 2001 (a structural performance criterion under the program). In parallel, the authorities intend to achieve enactment of a new civil service law, which has been developed in close consultation with the Bank staff. To improve public administration, the government has established a working group that is currently preparing a framework to define government functions consistent with the government's capacities, and to consider ways in which further decentralization and delegation of authority might be beneficial.

E. External Outlook and Capacity to Repay the Fund

50. The trade deficit (goods and services) is expected to narrow significantly from 27 percent of GDP in 2000 to 18 percent in 2006 owing to buoyant export growth and subdued import growth. Part of the lower trade deficit is expected to be offset by higher outflows of profit remittances and lower official transfers. Nevertheless, the external current account deficit is programmed to narrow by 5 percentage points of GDP to less than 10 percent of GDP, about in line with a targeted increase in net public sector saving of a similar magnitude. The program targets an increase in public sector external debt from \$862 million in 2000 to \$1,348 million in 2006. In PV terms, external debt is projected to fall

from 135 percent of exports¹⁸ in 2000 to 110 percent in 2006. Relative to fiscal revenue, PV debt is projected to fall from 179 percent in 2000 to 136 percent in 2006 (Figure 8).

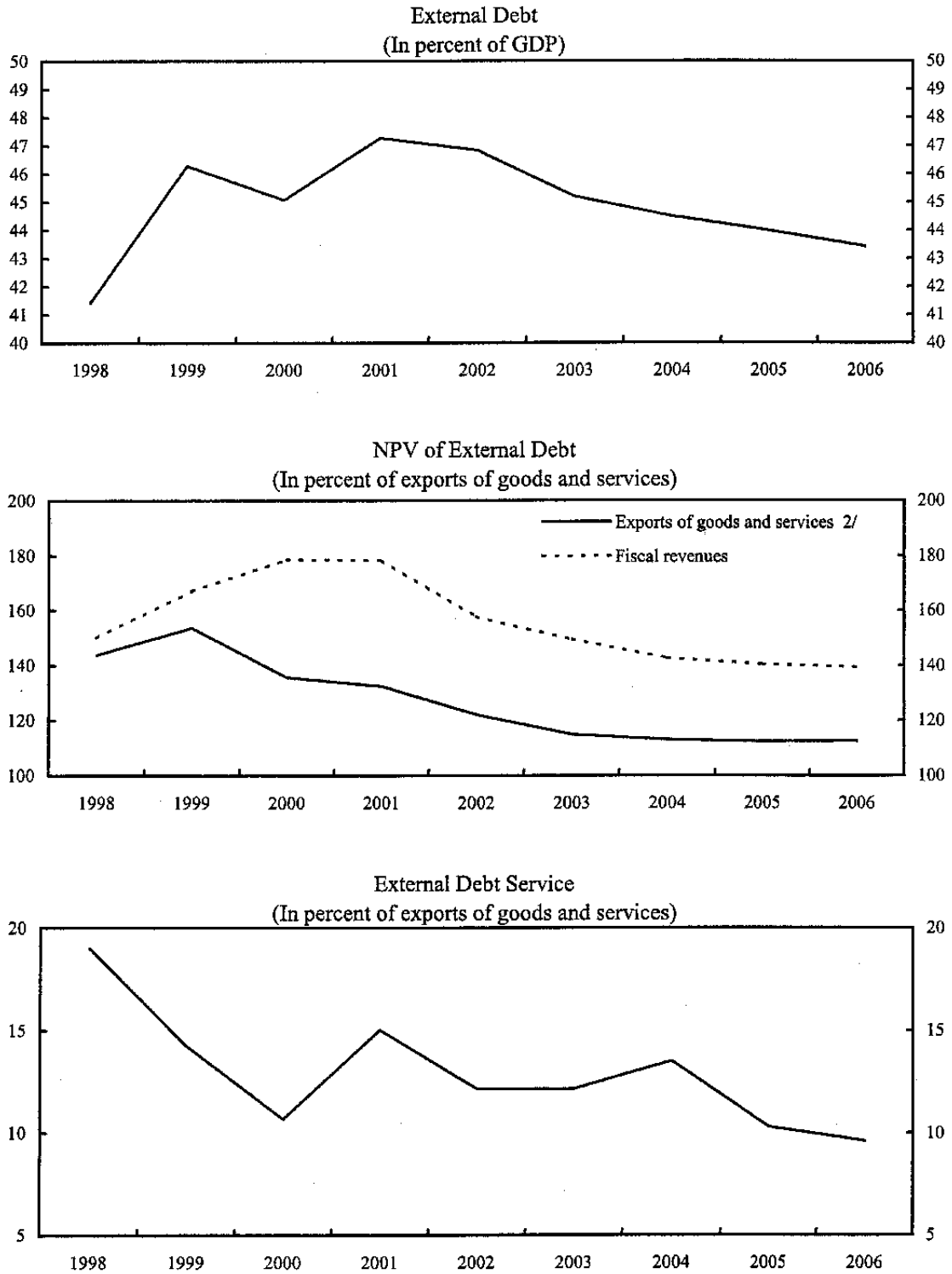
51. The targeted improvement of nearly 4 percentage points of GDP in the government net savings balance under the baseline scenario is ambitious, and it might not materialize. The strong growth of exports in the baseline scenario is predicated on continued strong inflows of FDI. So far, FDI has been boosted by the privatization process but as that process tapers off, FDI inflows may well fall rather than increase. Given the high degree of uncertainty, the staff has developed an alternative scenario under which lower FDI inflows would lead to lower growth of real exports and real GDP, and as a consequence the external debt burden would not fall during the projection period. In the downside risk scenario, the external debt burden after 2006 would become increasingly unsustainable, which might necessitate a debt restructuring in the latter half of the decade. Appendix V contains a more detailed discussion of the assumptions underlying the medium term balance of payments and external debt projections, and the possible implications of the alternative scenario.

52. Over the period of the PRGF arrangement (second quarter 2001 to first quarter 2004) there is an estimated financing gap of \$200 million. The Fund and the Bank are expected to fill the bulk of this financing gap (with new disbursements of \$90 million from each institution). It is anticipated that the remaining financing gap of \$20 million (in the fourth quarter of 2001) could be filled by new donor support in the context of a World Bank CG meeting. In particular, the World Bank has initiated contacts with donors and a CG meeting is planned for early July. After the first quarter of 2004, the overall balance of payments is expected to remain in balance, but this will not allow the central bank to accumulate gross reserves so as to maintain reserves at the equivalent of around 3½ months of imports. The resulting residual financing gap in the outer years (\$152 million from the second quarter of 2004 to 2006) is relatively large, reflecting in part significant repayment obligations to the Fund. If the gap in the outer years were to remain unfilled, gross reserves would only constitute about 2 months of imports by 2006.

53. The proposed access under the PRGF arrangement is SDR 69 million (75 percent of quota). If all disbursements take place as scheduled (Table 14), outstanding credit to the Fund will increase from SDR 133 million (145 percent of quota) as of end-March 2001 to SDR 160 million (174 percent of quota) by end-March 2004. During the period of the arrangement, Fund credit will remain below 60 percent of gross reserves and below 20 percent of external debt (Table 11). Armenia's debt service to the Fund will peak at

¹⁸ Three year moving average of exports of goods and services centered on the preceding year.

Figure 8. Armenia: External Debt and Debt Service, 1998-2006 1/



Sources: Armenian authorities; and Fund staff estimates.

1/ Including debt and debt service arising from potential financing associated with the cumulative financing gap. Medium- and long-term public and publicly guaranteed debt only.

2/ Three-year moving average of exports of goods and services centered on the preceding year.

around SDR 25 million in 2004-05, equivalent to about 4½ percent of export earnings or 8½ percent of gross reserves.

54. To date, Armenia has serviced its debt to the Fund in a timely manner and—given the relatively modest debt service obligations and the authorities' strong commitment to maintain macroeconomic stability—it is expected that Armenia will continue to do so. The main risk to the Fund would lie in an abandonment of policies designed to ensure macroeconomic stability. In such a case—in which gross reserves could soon be depleted and export performance could suffer to the extent that the external debt burden became unsustainable—the relatively high share of Fund credit in total debt could make the Fund vulnerable.

V. PROGRAM MONITORING

55. The authorities have implemented several measures prior to Board consideration of the program, in order to demonstrate their strong commitment, as described in paragraph 54 of the attached MEFP as well as in the Technical Memorandum of Understanding (TMU). Quantitative performance criteria, quantitative benchmarks, and indicative targets under the new program are specified in paragraph 55 and Table 1 attached to the MEFP, as well as in the TMU. In particular, the program includes a quantitative performance criterion on the primary balance of the energy sector, given that sector's importance for the budget as noted above. Structural benchmarks and the structural performance criterion under the new program are specified in Table 2 attached to the MEFP, as well as in the TMU. The arrangement will involve semiannual monitoring, disbursements, and reviews.

56. The set of areas subject to structural conditionality under the proposed PRGF-supported program is broadly the same as under the previous ESAF-supported third year program, although some areas would now be left to the World Bank, and there are fewer structural benchmarks (6 versus 14; see EBS/98/213, Supplement 1, 12/8/98, pp. 14-15). Structural benchmarks were included in the areas of treasury management and tax administration, which are important for fiscal performance, and bank bankruptcy legislation, which is important to ensure that the CBA has the authority to deal effectively with problem banks. Measures in the areas of privatization, civil service reform, and the social safety net had been included under the ESAF-supported program but under the proposed program would be covered under the World Bank SAC IV and its other lending programs.¹⁹ As noted above, the proposed program also includes a structural performance criterion in the

¹⁹ The proposed SAC IV includes board presentation and/or tranche release conditions related to energy sector and other privatization, improved targeting of poverty allowances, and pension reform. The Country Assistance Strategy envisages a separate public sector reform project, preparation of which is scheduled to commence this fall. The proposed SAC IV would also include a number of issues related to public administrative reform, including measures to improve the business environment and strengthen the judiciary.

governance area (approval by the parliament of a financial disclosure law of public officials), reflecting the importance of improved governance for budget execution and for improving the climate for private investment.

VI. STAFF APPRAISAL

57. Following the political turbulence of late 1999 and early 2000, the authorities are to be commended for implementing macroeconomic and structural reform policies that have succeeded in maintaining low inflation and stopping the build-up in arrears, while laying the foundation for a resumption of economic growth. Even prior to the period of political instability, however, the external debt burden had grown to worrisome levels, especially in relation to exports. In addition, starting in the last quarter of 1999, tax revenues fell significantly relative to their budgeted level, reflecting weak economic activity and a deterioration in tax administration. As a result of the revenue decline and delays in disbursements of external financing related to slippages in the privatization of the EDCs, budgetary arrears accelerated sharply. Since the appointment of a new government in mid-2000, however, economic activity and tax revenues have begun to recover and budgetary arrears have stabilized. However, there is still a very large arrears carryover.

58. To address Armenia's external and fiscal vulnerabilities, and to ensure a sustained resumption of economic growth as the cornerstone for efforts to reduce poverty, the authorities have adopted a comprehensive and ambitious three-year macroeconomic and structural adjustment program. They are determined to strengthen public finances to eliminate the outstanding stock of budgetary arrears, maintain a rate of monetary growth consistent with continued price stability, progressively eliminate financing gaps in the quasi-fiscal sectors, further improve regulation of the banking sector, and improve governance and reduce corruption through increased transparency. The envisaged reforms are consistent with the IPRSP and will be modified appropriately once the PRSP has been finalized.

59. The need to strengthen public finances in order to eliminate the stock of budgetary arrears in 2002, and lower the external debt burden progressively over time, will pose a major challenge for the authorities. Nevertheless, the authorities have made a good start by strengthening tax collections and cutting expenditures in the second half of 2000. Importantly, the parliament passed a state budget for 2001 that entails a significant further adjustment in revenues and especially expenditures, which poses certain risks given the large reduction in expenditure commitments and the significant revenue increase predicated on administrative improvements. However, even with these important policy elements in place, it will still be necessary to carry over a substantial amount of arrears into 2002 even if additional sources of financing can be identified, including from a Consultative Group meeting that the World Bank plans to hold in the summer. In view of these challenges, the authorities are strongly urged to implement measures to improve tax administration and strengthen expenditure control, forcefully and without delay. In the event that revenues are higher than the budgeted amount, the excess should go directly to reduce arrears. Pension benefit arrears should be cleared as soon as possible and the collection of overdue pension

contributions expedited. Any bridging operation involving the Special Privatization Account, if absolutely necessary, should only be conducted under extraordinary circumstances, be of brief duration, and should be a bridge to near-certain concessional external financing.

60. While the rapid growth in monetary aggregates in the second half of 2000 is worrisome, the CBA is to be commended for bringing reserve money down in the first quarter of 2001. Nevertheless, the CBA should stand ready to tighten monetary policy further should inflation prove higher than anticipated. The staff welcomes the CBA's decision to continue to use an indicative path for reserve money to guide the day-to-day implementation of the monetary program. Efforts to enhance the coordination of monetary and fiscal policies must continue. The achievement of the monetary targets will depend in part on continuing to enforce the prohibition on inter-quarter net credit to the government by the CBA, while allowing the exchange rate and interest rates to reflect underlying market pressures.

61. The staff believes that the authorities' flexible exchange rate policy is appropriate, although their commitment has not really been tested since the exchange market has not experienced heavy pressure. Indicators of external competitiveness and recent macroeconomic performance suggest that Armenia weathered well the Russian currency crisis in 1998. The staff concurs with the authorities that under the current circumstances the level of the exchange rate is broadly appropriate.

62. While the reported data for the Armenian banking system point to a relatively healthy financial system, the underlying situation contains a number of weaknesses and vulnerabilities. The authorities are urged to implement the measures envisaged in the program to strengthen the banking sector, especially given the weaknesses and vulnerabilities highlighted in the FSSA.

63. Recent progress in reducing the burden of external debt is welcome but a cautious approach to external borrowing must continue to be pursued and the staff supports the authorities' intention to use privatization proceeds to improve the country's debt profile. The authorities should move quickly to regularize external payments arrears with Russia on a transparent basis. They deserve praise for maintaining a liberal trade and exchange system and for their resolute pursuit of WTO membership.

64. Successful implementation of the financial rehabilitation of the quasi-fiscal sectors is necessary to ensure macroeconomic stabilization and should be accorded a high priority. In this regard, privatization of the EDCs is essential for the financial rehabilitation of the energy sector and the staff commends the authorities for moving ahead with the tender process in a transparent manner. Moreover, there is a need to resolve the issue of large energy sector debts. The authorities are also urged to move expeditiously to restructure the other quasi-fiscal sectors, especially since shortfalls in energy payments by these sectors constitute a major source of the financing gaps in the energy sector.

65. The authorities' medium-term strategy to pursue high and sustained growth through a substantial improvement in the overall business climate, with competitive markets guiding the allocation of resources to activities driven by private sector initiative, is appropriate. The authorities understand that the success of this strategy depends on consolidating and sustaining macroeconomic stability, and proceeding decisively with the next stage of structural, legal, and institutional reforms. Their determination to promote domestic savings and private investment, to maintain the official international reserve position, and to reduce the external debt burden over time, is encouraging.

66. The staff welcomes the progress achieved in implementing the GDDS, especially with regard to the periodicity and timeliness of data dissemination. The authorities are encouraged to continue efforts to improve the quality and timeliness of information especially on the national accounts, balance of payments, and socio-demographic indicators. While the authorities regularly report the minimum core data used for surveillance, further improvements are needed especially in the timeliness and quality of data relating to the economic activity and finances of local governments and major state-owned enterprises.

67. Despite the encouraging signs noted above, there are nonetheless risks to the program. The main risk to the Fund would lie in an abandonment of policies designed to ensure macroeconomic stability. The program is also predicated on large amounts of external financing from other IFIs and bilateral donors which, if delayed, would put the program at risk. In addition, the medium term projections are subject to a high degree of uncertainty related to the possibility of external shocks. Nevertheless, the authorities have agreed to a comprehensive and ambitious, yet feasible policy program. In the opinion of the staff, they have demonstrated an acceptable track record based on their performance since mid-2000, and by achieving all prior actions. Despite the risks, the staff recommends Executive Board approval of Armenia's request for an arrangement under the Poverty Reduction and Growth Facility.

68. It is proposed that the next Article IV consultation with Armenia be held on the standard 12-month cycle.

Box 1. External Competitiveness in 1998-2000

1. The real effective exchange rate appreciated significantly following the Russian currency crisis in August 1998 (Figure 4). A key issue for external competitiveness is whether the real effective exchange rate depreciation since early 1999 has restored Armenia's competitiveness or whether the dram remains over-valued. This box considers a variety of evidence including real effective exchange rates, regional comparisons of average U.S. dollar wages, and trends in trade and the current account balances.

2. The evidence suggests that external competitiveness has been restored to the level prevailing prior to the Russian crisis:

- The real effective exchange rate (REER in the INS) appreciated by 11 percent during 1998, reflecting in part a 13 percent real appreciation in September in the immediate aftermath of the Russian devaluation;
- During 1999 and 2000, the REER depreciated by 4 and 12 percent respectively bringing the level of the REER by the end of 2000 down below the level of end-1997;
- The INS weights are increasingly outdated; in particular the share of Turkmenistan is unwarrantedly high. However, using 1997 DOT weights does not qualitatively change the conclusion that the real effective exchange rate shock was reversed by end-2000.

3. A comparison of average U.S. dollar wages in Armenia with those prevailing in other CIS countries indicates that Armenia has remained one of the lowest wage countries in the region (Figure 2). However, the Russian currency crisis did sharply increase Armenian wages relative to CIS-wide wages from 22 percent in 1997 to 32 percent in 1998. This trend has not been reversed; indeed, by 2000 Armenian wages had risen to 54 percent of average CIS wages. The trend in Armenian wages follow broadly similar trends in Georgia and Azerbaijan and it is associated with higher economic growth in these countries relative to CIS over the 1995-2000 period. This may suggest that the increase in relative wages in Armenia mainly reflects relatively higher productivity growth and does not, therefore, evidence an erosion of competitiveness within the CIS.

4. The external current account deficit has narrowed considerably, from 21.2 percent of GDP in 1998 to less than 15 percent in 2000 (preliminary actual), as imports were sharply lower in 1999 and exports were quite buoyant in 2000. At the same time, economic growth remained robust.

These indicators—and macroeconomic performance in 1999 and 2000—suggest that Armenia weathered well the real exchange shock to its economy and that there is no apparent evidence to suggest that external competitiveness is not adequate.

Box 2. The Poverty Reduction Strategy

1. As described in the IPRSP, there was a sharp increase in poverty in the 1990s as a result of the 1988 earthquake, the collapse of regional trade and payments arrangements with the dissolution of the Soviet Union in 1991, and the conflict in Nagorno-Karabakh and related disruptions in regional trade. The increase in poverty was associated with an increase in inequality.
2. Declining economic activity, growing unemployment, decreasing wages, and the growing informal sector of the economy caused a near collapse of the old social insurance and safety nets mechanisms.
3. A major effort to reduce poverty is central to the authorities' program. The authorities' poverty reduction program consists of the following main components:
 - Measures to enhance economic growth prospects which will have the greatest impact on reducing poverty. The key to poverty alleviation, and to reversing the pattern of increasing income inequality, will be economic growth;
 - Efforts to fight corruption and reform the civil service;
 - Improved targeting of the allocation mechanism for family allowances and strengthened administrative capacity for monitoring and evaluation;
 - Advancing the pension reform. In the medium term the objective is to strengthen the public pension system to provide security for old age pensioners while reducing budgetary costs;
 - A shift in government expenditure toward the poor (particularly in the health and education areas); and
 - Strengthened labor market policies through simplifying administration of payroll taxation, streamlining the legal framework, and liberalized employment regulations.

Table 2. Armenia: Quantitative Benchmarks and Indicative Targets, 1998-2000 1/

| | 1998 | 1999 | | | | 2000 | | | |
|--|---------|--|--------|---------|---------|----------------------|--------|---------|---------|
| | Dec. | Mar. | Jun. | Sep. | Dec. | Mar. | Jun. | Sep. | Dec. |
| | | ESAF-supported program | | | | Authorities' program | | | |
| Quantitative benchmarks | | (Maximum levels in millions of drams; end-period stocks) | | | | | | | |
| Net domestic banking system credit to general government | | | | | | | | | |
| Program 2/ | 20,640 | 24,370 | 17,535 | 21,159 | 21,989 | ... | ... | ... | ... |
| Actual | 20,006 | 15,989 | 16,747 | 12,482 | 15,368 | 15,864 | 13,656 | 10,374 | 9,302 |
| Net domestic assets of CBA | | | | | | | | | |
| Program 2/ | 6,122 | 7,683 | 6,181 | 5,042 | 6,339 | 4,050 | 7,521 | 6,255 | 2,296 |
| Actual | 2,857 | 3,636 | 4,566 | -4,430 | 651 | 1,377 | 5,856 | 1,437 | 293 |
| Domestic expenditure arrears (continuous criterion) 3/ | 2,176 | 1,825 | 13,460 | 2,072 | 26,303 | 42,233 | 50,818 | 56,311 | 56,961 |
| | | (Maximum levels in millions of U.S. dollars; end-of-period stocks) | | | | | | | |
| Net disbursements of short-term external debt 4/ 5/ | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Contracting and guaranteeing of new nonconcessional medium- and long-term external debt longer than one year 5/ 6/ | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Of which: debt of 1-5 years maturities 5/ 6/ | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| External arrears (continuous criterion) | | | | | | | | | |
| Program | 0 | 0 | 0 | 0 | 0 | ... | ... | ... | ... |
| Actual | 0 | 0 | 0 | 0 | 1 | 5 | 10 | 14 | 19 |
| | | (Minimum levels in millions of U.S. dollars; end-period stocks) | | | | | | | |
| Net official international reserves | | | | | | | | | |
| Program 2/ | 99.5 | 95.0 | 79.4 | 93.6 | 97.0 | 89.7 | 88.2 | 92.9 | 107.3 |
| Actual | 108.5 | 89.2 | 83.2 | 119.8 | 113.2 | 93.6 | 92.5 | 107.8 | 137.3 |
| | | (Minimum levels in millions of drams) | | | | | | | |
| State budget tax revenue 7/ 8/ | | | | | | | | | |
| Program 2/ | 136,843 | 31,423 | 64,710 | 110,503 | 165,734 | ... | ... | ... | 171,753 |
| Actual | 133,434 | 28,171 | 64,814 | 111,051 | 161,283 | 27,206 | 62,688 | 104,289 | 152,357 |
| | | (Maximum levels in millions of drams) | | | | | | | |
| State budget overall cash deficit (year to day) 7/ 9/ | | | | | | | | | |
| Program 2/ | 52,468 | 11,973 | 28,054 | 41,677 | 62,795 | ... | ... | ... | 64,482 |
| Actual | 45,264 | 7,133 | 18,052 | 35,181 | 55,090 | 1,820 | 8,240 | 21,286 | 41,374 |
| Memorandum Item (Indicative Targets): | | | | | | | | | |
| State budget expenditure | 212,907 | 41,806 | 95,996 | 177,835 | 267,764 | 47,283 | 53,688 | 64,300 | 76,234 |
| Dram broad money (end-of-period stock) | | | | | | | | | |
| Program 2/ | 53,770 | 54,308 | 48,289 | 51,792 | 57,163 | ... | ... | ... | ... |
| Actual | 57,539 | 45,819 | 49,666 | 57,956 | 56,288 | 52,828 | 55,730 | 60,741 | 76,722 |
| Reserve money (end-of-period stock) 10/ | | | | | | | | | |
| Program 2/ | 52,897 | 52,343 | 46,809 | 49,017 | 51,939 | 51,120 | 53,816 | 55,047 | 58,604 |
| Actual | 53,839 | 45,561 | 43,689 | 51,872 | 53,853 | 50,498 | 54,404 | 58,057 | 72,390 |

Sources: Armenian authorities; and Fund staff estimates.

1/ Performance criteria for March 1999. Indicative targets for June, September, and December, 1999. The definitions of quantitative benchmarks and indicative targets used under the program were presented in a Technical Annex (TA) to the memorandum of economic and financial policies (MEFP) in EBS/99/181.

2/ Targets for 1999 are as defined in EBS/99/181 Supplement 1. For 2000, the targets are the authorities' program i.e., CBA's monetary program presented to parliament and the approved budget.

3/ Expenditure arrears of the state budget and SFSI budget. For December 1998 and March 1999 arrears refer to core expenditures as defined in the TA to the original MEFP. For June 1999, arrears relate to all verified claims on the government as defined in the Supplement to the TA. Due to changes in the methodology of reporting arrears and the extent of reporting, these figures differ from those in the previous staff report.

4/ Cumulative from December 31, 1998. Excluding normal import-related credits and sales of T-bills to nonresidents.

5/ Program and actual figures were both equal to zero.

6/ Cumulative from December 31, 1998. The definition and coverage of nonconcessional debt is presented in the TA to the MEFP.

7/ Targets for each year are cumulative from end of previous year.

8/ In 1998-99, includes local government revenue, but excludes land and property taxes. In contrast, the definition of "state budget" in Table 5 refers only to central government and excludes local governments.

9/ Includes expenditures financed with the use of privatization proceeds.

10/ In addition, this target was subject to an upper and lower bound as specified in the supplement to the TA to the MEFP.

Table 3. Armenia: Selected Economic Indicators, 1998-2003

| | 1998 | 1999 | 2000 | | | | 2001 | | | | 2002 | 2003 | | |
|---|-------|-------|-------|-------|-------|-------------|-------|-------------|-------|-------|-------|-------|-------|-------|
| | Year | Year | Q1 | Q2 | Q3 | Q4 | Year | Q1 | Q2 | Q3 | Q4 | Year | | |
| | | | | | | Preliminary | | Projections | | | | | | |
| Real sector | | | | | | | | | | | | | | |
| Nominal GDP (in billions of dram) | 959 | 988 | 131 | 218 | 327 | 356 | 1,032 | 155 | 239 | 353 | 402 | 1,149 | 1,254 | 1,369 |
| Real GDP growth (percent change) 1/ | 7.3 | 3.3 | 0.3 | 4.0 | 3.2 | 12.5 | 6.0 | 11.8 | 7.3 | 2.9 | 5.7 | 6.5 | 6.0 | 6.0 |
| GDP in millions of U.S. dollars | 1,899 | 1,847 | 248 | 407 | 602 | 648 | 1,915 | 283 | 434 | 642 | 730 | 2,089 | 2,280 | 2,489 |
| GDP deflator (percent change) 1/ | 11.2 | 0.1 | 0.2 | -2.8 | -2.4 | 0.0 | -1.4 | 6.4 | 1.9 | 2.9 | 6.7 | 4.5 | 3.0 | 3.0 |
| Inflation (in percent) 2/ | | | | | | | | | | | | | | |
| Period average 1/ | 8.7 | 0.7 | 0.1 | -1.5 | -1.0 | -0.7 | -0.8 | 2.5 | 4.3 | 6.2 | 4.9 | 4.5 | 3.0 | 3.0 |
| End-of-period 3/ | -1.2 | 2.1 | 0.3 | -2.0 | -1.2 | 0.4 | 0.4 | 2.5 | 5.0 | 6.1 | 3.5 | 3.5 | 3.0 | 3.0 |
| Exchange rates (drams/U.S. dollar) 2/ | | | | | | | | | | | | | | |
| Period average | 505 | 535 | 527 | 536 | 543 | 550 | 540 | 551 | ... | ... | ... | ... | ... | ... |
| End-of-period | 522 | 524 | 528 | 548 | 536 | 552 | 552 | 545 | ... | ... | ... | ... | ... | ... |
| Fiscal sector (in percent of GDP) | | | | | | | | | | | | | | |
| State budget | | | | | | | | | | | | | | |
| Revenue and grants | 17.1 | 19.3 | 23.6 | 17.8 | 13.9 | 15.4 | 16.5 | 29.0 | 19.4 | 14.5 | 13.7 | 17.2 | 17.6 | 18.0 |
| Of which: tax revenue | 13.6 | 16.1 | 20.8 | 16.2 | 12.7 | 13.5 | 14.8 | 22.8 | 17.8 | 13.2 | 12.1 | 15.1 | 16.5 | 16.9 |
| Expenditure | 21.9 | 26.5 | 36.2 | 24.6 | 19.7 | 19.8 | 22.8 | 28.0 | 26.8 | 19.1 | 17.1 | 21.2 | 20.2 | 20.9 |
| Of which: current expenditure | 16.3 | 19.2 | 31.6 | 18.5 | 14.9 | 14.0 | 17.5 | 22.1 | 19.8 | 14.6 | 13.6 | 16.3 | 15.6 | 16.5 |
| Cash deficit 3/ | -4.7 | -5.5 | -1.4 | -2.9 | -4.0 | -5.5 | -4.0 | 0.9 | -11.5 | -6.7 | -3.4 | -5.5 | -3.8 | -3.0 |
| Accrual deficit | -4.8 | -7.2 | -12.6 | -6.8 | -5.7 | -4.4 | -6.4 | 1.1 | -7.4 | -4.6 | -3.4 | -4.0 | -2.5 | -3.0 |
| Change in arrears | 0.5 | 2.0 | 11.5 | 2.9 | 2.2 | -2.4 | 1.9 | -0.2 | -4.0 | -2.1 | 0.0 | -1.5 | -3.0 | 0.0 |
| Measures/Gap | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.9 | 0.0 |
| Statistical discrepancy | -0.4 | -0.2 | -0.3 | 1.0 | -0.4 | 1.3 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Monetary sector 2/ | | | | | | | | | | | | | | |
| Net domestic assets of the CBA 5/ | 4.2 | 0.7 | 1.8 | 8.9 | -8.1 | -2.0 | -0.3 | -0.8 | 2.9 | -0.9 | -3.6 | -2.7 | ... | ... |
| Reserve money (end-of-period growth rate, in percent) | 6.5 | 0.0 | -6.2 | 7.7 | 6.7 | 24.7 | 34.4 | -15.1 | 9.0 | 5.4 | 4.6 | 2.0 | ... | ... |
| Broad money (end-of-period growth rate, in percent) | 36.0 | 13.6 | 1.5 | 8.3 | 7.7 | 17.1 | 38.7 | -4.5 | 3.3 | 6.0 | 7.1 | 12.0 | ... | ... |
| Broad money velocity 6/ | 10.0 | 9.1 | 4.7 | 7.3 | 10.2 | 9.5 | 6.9 | 4.3 | 6.4 | 9.0 | 9.5 | 6.8 | ... | ... |
| Dram broad money (end-of-period growth rate, in percent) | 23.3 | -2.2 | -6.1 | 5.5 | 9.0 | 26.3 | 36.3 | -15.2 | 5.8 | 5.3 | 5.1 | -0.6 | ... | ... |
| Dram velocity 6/ | 16.7 | 17.6 | 9.9 | 15.7 | 21.5 | 18.6 | 13.5 | 9.6 | 13.9 | 19.5 | 21.1 | 15.1 | ... | ... |
| External Sector | | | | | | | | | | | | | | |
| Current account balance 7/ | | | | | | | | | | | | | | |
| (in millions of U.S. dollars) | -515 | -401 | -108 | -100 | -63 | -110 | -382 | -68 | -108 | -106 | -113 | -394 | -375 | -361 |
| (in percent of GDP) | -27.1 | -21.7 | -43.7 | -24.6 | -10.5 | -16.7 | -19.9 | -24.0 | -24.9 | -16.4 | -15.5 | -18.9 | -16.4 | -14.5 |
| Total external debt | | | | | | | | | | | | | | |
| (in millions of U.S. dollars) | 787 | 855 | 856 | 858 | 860 | 862 | 862 | 873 | 895 | 933 | 968 | 968 | 1048 | 1105 |
| (in percent of GDP) | 41.4 | 46.3 | 44.8 | 44.9 | 45.0 | 45.1 | 45.1 | 41.8 | 42.9 | 44.7 | 46.3 | 46.3 | 46.0 | 44.4 |
| External debt service (in percent of exports of goods and services) | 19.0 | 14.3 | 22.2 | 8.0 | 7.8 | 7.4 | 10.7 | 16.8 | 15.2 | 14.2 | 14.2 | 15.0 | 12.0 | 12.0 |
| Gross official international reserves (in millions of U.S.\$) | 298 | 305 | 287 | 280 | 286 | 314 | 314 | 293 | 311 | 327 | 336 | 336 | 344 | 347 |
| (in months of next year's imports of goods and services) | 3.9 | 3.8 | 3.3 | 3.2 | 3.2 | 3.6 | 3.6 | 3.2 | 3.4 | 3.6 | 3.7 | 3.7 | 3.6 | 3.5 |

Sources: Armenian authorities; and Fund staff estimates.

1/ With respect to the same period in the previous year.

2/ Figures for Q1 2001 are preliminary actuals.

3/ Inflation during the previous 12 months.

4/ Deficit as measured by financing.

5/ Change in percent of reserve money at the beginning of the period.

6/ Based on GDP for the period, seasonally unadjusted for quarterly figures.

7/ Excludes official transfers.

Table 4: Armenia: Monetary Program, 1998-2001
(In millions of drams; unless otherwise indicated)

| | 1998 1/ | | 1999 1/ | | 2000 1/ | | | | 2000 2/ | 2001 2/ | | | | |
|---|---------|---------|---------|---------|---------|---------|-----------|-----------|-------------|---------|---------|---------|-----------|--|
| | Year | | Q1 | Q2 | Q3 | Q4 | Year | Year | Q1 | Q2 | Q3 | Q4 | Year | |
| | Actual | | Actual | | | | Actual | Actual | Projections | | | | | |
| Central Bank of Armenia | | | | | | | | | | | | | | |
| Net international reserves 3/ | 50,982 | 53,425 | 49,121 | 48,548 | 56,620 | 72,097 | 72,097 | 76,360 | 66,005 | 69,769 | 73,951 | 79,780 | 79,780 | |
| Net domestic assets | 2,857 | 428 | 1,377 | 5,856 | 1,437 | 293 | 293 | -3,970 | -4,575 | -2,819 | -3,389 | -5,955 | -5,955 | |
| Credit to government (net) | 9,270 | 8,306 | 7,045 | 7,881 | 7,930 | 8,292 | 8,292 | 8,292 | 5,201 | 8,292 | 8,292 | 8,292 | 8,292 | |
| Credit to banks (net) | 2,738 | 1,352 | 2,385 | 5,080 | 3,340 | 3,332 | 3,332 | 3,332 | 2,454 | 3,172 | 3,444 | 2,747 | 2,747 | |
| Other items (net) | -9,151 | -9,230 | -8,053 | -7,105 | -9,833 | -11,331 | -11,331 | -15,594 | -12,230 | -14,283 | -15,125 | -16,994 | -16,994 | |
| Reserve money | 53,839 | 53,853 | 50,498 | 54,404 | 58,057 | 72,390 | 72,390 | 72,390 | 61,430 | 66,950 | 70,562 | 73,825 | 73,825 | |
| Currency issue | 45,345 | 45,482 | 39,040 | 41,825 | 46,376 | 61,873 | 61,873 | 61,873 | 49,020 | 52,303 | 55,019 | 57,919 | 57,919 | |
| Deposits | 8,494 | 8,371 | 11,458 | 12,579 | 11,681 | 10,517 | 10,517 | 10,517 | 12,410 | 14,647 | 15,543 | 15,906 | 15,906 | |
| Banking system | | | | | | | | | | | | | | |
| Net foreign assets | 17,564 | 31,105 | 25,151 | 23,459 | 42,531 | 57,844 | 57,844 | 62,107 | 55,288 | 55,964 | 59,729 | 67,925 | 67,925 | |
| Net domestic assets | 77,948 | 77,440 | 85,072 | 95,934 | 86,064 | 92,755 | 92,755 | 88,492 | 88,544 | 92,633 | 97,795 | 100,746 | 100,746 | |
| Credit to government (net) | 20,006 | 15,368 | 15,864 | 13,656 | 10,374 | 9,302 | 9,302 | 9,302 | 5,556 | 10,769 | 11,101 | 12,003 | 12,003 | |
| Credit to economy (net) | 78,992 | 85,105 | 90,645 | 98,950 | 98,652 | 104,039 | 104,039 | 104,039 | 102,551 | 105,149 | 109,947 | 113,873 | 113,873 | |
| Other items (net) | -21,050 | -23,033 | -21,437 | -16,672 | -22,962 | -20,585 | -20,585 | -24,849 | -19,563 | -23,285 | -23,253 | -25,129 | -25,129 | |
| Broad money (M2X) 4/ | 95,512 | 108,545 | 110,223 | 119,393 | 128,595 | 150,599 | 150,599 | 150,599 | 143,832 | 148,597 | 157,524 | 168,671 | 168,671 | |
| Currency in circulation | 41,370 | 42,610 | 36,639 | 39,286 | 44,158 | 59,486 | 59,486 | 59,486 | 46,905 | 50,031 | 52,582 | 55,439 | 55,439 | |
| Deposits | 54,144 | 65,935 | 73,584 | 80,107 | 84,437 | 91,113 | 91,113 | 91,113 | 96,927 | 98,566 | 104,942 | 113,232 | 113,232 | |
| Dram | 16,167 | 13,678 | 16,189 | 16,444 | 16,583 | 17,236 | 17,236 | 17,236 | 18,152 | 18,816 | 19,937 | 20,805 | 20,805 | |
| Foreign currency | 37,975 | 52,257 | 57,395 | 63,663 | 67,854 | 73,877 | 73,877 | 73,877 | 78,775 | 79,750 | 85,005 | 92,427 | 92,427 | |
| Memorandum items: | | | | | | | | | | | | | | |
| Dram broad money (M2) | 57,537 | 56,288 | 52,828 | 55,730 | 60,741 | 76,722 | 76,722 | 76,722 | 65,057 | 68,847 | 72,519 | 76,244 | 76,244 | |
| (in percent of M2X) | 60.2 | 51.9 | 47.9 | 46.7 | 47.2 | 50.9 | 50.9 | 50.9 | 45.2 | 46.3 | 46.0 | 45.2 | 45.2 | |
| Annual GDP | 958,791 | 988,074 | n.a. | n.a. | n.a. | n.a. | 1,032,455 | 1,032,455 | n.a. | n.a. | n.a. | n.a. | 1,149,000 | |
| Quarterly GDP | n.a. | n.a. | 130,719 | 218,449 | 327,136 | 356,151 | n.a. | n.a. | 155,479 | 238,681 | 353,070 | 401,770 | n.a. | |
| Velocity M2X 5/ | | | | | | | | | | | | | | |
| (end-of-period) | 10.0 | 9.1 | ... | ... | ... | ... | 6.9 | 6.9 | ... | ... | ... | ... | 6.8 | |
| (average) | 11.5 | 10.0 | ... | ... | ... | ... | 8.1 | 8.1 | ... | ... | ... | ... | 7.5 | |
| Velocity M2 5/ | | | | | | | | | | | | | | |
| (end-of-period) | 16.7 | 17.6 | ... | ... | ... | ... | 13.5 | 13.5 | ... | ... | ... | ... | 15.1 | |
| (average) | 18.7 | 18.9 | ... | ... | ... | ... | 16.8 | 16.8 | ... | ... | ... | ... | 16.3 | |
| Multiplier M2X | 1.77 | 2.02 | 2.18 | 2.19 | 2.21 | 2.08 | 2.08 | 2.08 | 2.34 | 2.22 | 2.23 | 2.28 | 2.28 | |
| Of which: c/d | 0.84 | 0.69 | 0.53 | 0.52 | 0.55 | 0.68 | 0.68 | 0.68 | 0.51 | 0.53 | 0.52 | 0.51 | 0.51 | |
| r/d | 0.16 | 0.13 | 0.16 | 0.16 | 0.14 | 0.16 | 0.16 | 0.16 | 0.13 | 0.15 | 0.15 | 0.14 | 0.14 | |
| Percentage change in RM (nominal) 7/ | 6.5 | 0.0 | ... | ... | ... | ... | 34.4 | 34.4 | ... | ... | ... | ... | 2.0 | |
| Percentage change in M2X (nominal) 6/ | 6.5 | ... | 1.5 | 8.3 | 7.7 | 17.1 | ... | ... | -4.5 | 6.1 | 6.0 | 7.1 | ... | |
| Percentage change in M2 (nominal) 6/ | 8.0 | ... | -6.2 | 5.5 | 9.0 | 26.3 | ... | ... | -15.2 | 7.4 | 5.3 | 5.1 | ... | |
| Percentage change in M2X (nominal) 7/ | 36.0 | 13.7 | ... | ... | ... | ... | 38.7 | 38.7 | ... | ... | ... | ... | 12.0 | |
| Percentage change in M2 (nominal) 7/ | 23.3 | -2.1 | ... | ... | ... | ... | 36.3 | 36.3 | ... | ... | ... | ... | -0.6 | |
| Change in NDA of banking system 6/ | ... | ... | 7,632 | 10,862 | -9,870 | 6,691 | ... | ... | 52 | 3,956 | 5,162 | 2,951 | ... | |
| Change in NDA of banking system 7/ | 37,650 | -508 | ... | ... | ... | ... | 15,315 | 11,052 | ... | ... | ... | ... | 12,254 | |
| Stock/GDP (annual) | 8.3 | 7.8 | ... | ... | ... | ... | 9.0 | 8.6 | ... | ... | ... | ... | 8.8 | |
| Change NDA/M2X beginning of period 6/ | ... | ... | 7.0 | 9.9 | -8.3 | 5.2 | ... | ... | 0.0 | 2.8 | 3.5 | 1.9 | ... | |
| Change NDA/M2X beginning of period 7/ | 53.6 | ... | ... | ... | ... | ... | 14.1 | 10.2 | ... | ... | ... | ... | 8.1 | |
| Change in credit to economy 6/ | ... | ... | 5,541 | 8,305 | -298 | 5,387 | ... | ... | -1,488 | 3,585 | 4,798 | 3,926 | ... | |
| Change in credit to economy 7/ | 30,503 | 6,115 | ... | ... | ... | ... | 18,934 | 18,934 | ... | ... | ... | ... | 9,834 | |
| Stock/GDP (annual) | 8.4 | 8.6 | ... | ... | ... | ... | 10.1 | 10.1 | ... | ... | ... | ... | 9.9 | |
| Change in credit/M2X beginning of period 6/ | ... | ... | 5.1 | 7.5 | -0.2 | 4.2 | ... | ... | -1.0 | 2.6 | 3.2 | 2.5 | ... | |
| Change in credit/M2X beginning of period 7/ | 43.4 | 6.4 | ... | ... | ... | ... | 17.4 | 17.4 | ... | ... | ... | ... | 6.5 | |

Sources: Central Bank of Armenia; and Fund staff estimates.

1/ NIR is based on the program exchange rate of dram 470 per US dollar for 1998 and of 525 per U.S. dollar for 1999-2000 as indicated.

2/ NIR is based on the new program exchange rate of dram 552.18 per U.S. dollar.

3/ NIR is adjusted to exclude KfW loans (which are long term loans) from the liabilities side.

4/ Broad money (M2X) is defined as dram broad money (M2) plus foreign currency deposits.

5/ Quarterly velocity are derived from corresponding quarterly GDP and year velocity are derived from year GDP.

6/ Compared to the previous quarter.

7/ Compared to the previous year.

Table 5. Armenia: State Budget, 1998-2001
(In millions of dram)

| | 1998 | | 1999 | | 2000 | | | | 2001 | | | | |
|---|---------|---------|---------|---------|---------|---------|---------|---------|--------|---------|---------|---------|---------|
| | Year | | Q1 | Q2 | Q3 | Q4 | Year | | Q1 | Q2 | Q3 | Q4 | Year |
| | Actual | Prelim. | | | | | Budget | Prelim. | | | | | |
| Total revenue and grants | 163,812 | 190,917 | 30,848 | 38,786 | 45,546 | 54,835 | 202,096 | 170,015 | 45,158 | 46,328 | 51,126 | 54,990 | 197,602 |
| Total revenue | 154,755 | 175,817 | 30,808 | 38,532 | 42,821 | 51,273 | 184,522 | 163,434 | 40,405 | 44,139 | 48,400 | 50,267 | 183,210 |
| Tax revenue | 130,394 | 158,803 | 27,206 | 35,482 | 41,601 | 48,068 | 171,753 | 152,357 | 35,480 | 42,512 | 46,646 | 48,668 | 173,304 |
| Value-added tax | 59,844 | 68,270 | 11,543 | 16,141 | 17,190 | 22,617 | 76,785 | 67,491 | 15,728 | 20,631 | 21,938 | 24,239 | 82,535 |
| Excises | 19,397 | 21,677 | 4,209 | 5,682 | 7,149 | 8,363 | 29,007 | 25,403 | 7,733 | 7,375 | 9,719 | 9,650 | 34,476 |
| Enterprise profits tax | 12,294 | 21,499 | 2,749 | 4,415 | 7,491 | 5,665 | 17,000 | 20,320 | 5,177 | 6,047 | 5,129 | 4,493 | 20,846 |
| Personal income tax | 13,492 | 17,548 | 3,041 | 2,968 | 3,401 | 3,957 | 11,700 | 13,367 | 2,323 | 2,435 | 3,191 | 3,119 | 11,067 |
| Land tax | 66 | 71 | 12 | 3 | 1 | 3 | 47 | 19 | 0 | 1 | 1 | 5 | 8 |
| Customs duties | 10,625 | 8,051 | 1,682 | 1,873 | 2,271 | 2,846 | 8,800 | 8,672 | 1,983 | 2,229 | 1,926 | 2,491 | 8,629 |
| Other taxes | 10,519 | 16,413 | 3,085 | 3,446 | 3,102 | 3,297 | 25,373 | 12,930 | 1,689 | 2,763 | 3,597 | 3,263 | 11,312 |
| of which stamp duties | 9,910 | 9,743 | 1,595 | 2,130 | 2,504 | 2,593 | 9,543 | 8,822 | 1,438 | 2,415 | 2,777 | 1,771 | 8,400 |
| Presumptive income tax | 3,915 | 5,000 | 856 | 925 | 969 | 1,284 | 3,001 | 4,034 | 843 | 1,026 | 1,136 | 1,401 | 4,406 |
| Property tax | 243 | 269 | 29 | 29 | 27 | 35 | 40 | 120 | 4 | 5 | 9 | 8 | 26 |
| Nontax revenue | 24,361 | 16,254 | 3,602 | 3,050 | 1,220 | 3,191 | 11,509 | 11,063 | 4,155 | 1,387 | 1,723 | 1,289 | 8,555 |
| Capital revenue | 0 | 760 | 0 | 0 | 0 | 14 | 1,260 | 14 | 770 | 240 | 32 | 310 | 1,351 |
| Grants 1/ | 9,056 | 15,100 | 40 | 254 | 2,725 | 3,561 | 17,574 | 6,582 | 4,753 | 2,190 | 2,725 | 4,724 | 14,392 |
| Total expenditure | 210,133 | 262,005 | 47,283 | 53,688 | 64,300 | 70,499 | 259,621 | 235,770 | 43,468 | 64,085 | 67,517 | 68,802 | 243,872 |
| Current expenditure | 156,544 | 189,658 | 41,341 | 40,468 | 48,752 | 49,883 | 190,049 | 180,444 | 34,314 | 47,279 | 51,586 | 54,466 | 187,646 |
| Wages | 26,364 | 30,486 | 8,162 | 7,051 | 7,923 | 9,727 | 32,647 | 32,863 | 7,441 | 8,190 | 8,187 | 8,933 | 32,750 |
| Subsidies | 812 | 13,958 | 582 | 2,968 | 3,225 | 1,444 | 7,449 | 8,218 | 101 | 210 | 3,135 | 3,141 | 6,587 |
| Interest | 17,808 | 19,845 | 4,971 | 4,819 | 4,039 | 3,491 | 17,209 | 17,320 | 3,698 | 5,114 | 4,757 | 4,079 | 17,648 |
| domestic interest | 10,677 | 12,907 | 2,449 | 3,068 | 2,310 | 1,527 | 8,999 | 9,354 | 1,666 | 2,416 | 2,746 | 1,991 | 8,819 |
| external interest | 7,131 | 6,938 | 2,522 | 1,751 | 1,729 | 1,964 | 8,211 | 7,966 | 2,031 | 2,697 | 2,011 | 2,089 | 8,829 |
| Transfers | 30,422 | 48,031 | 10,240 | 8,321 | 11,992 | 15,212 | 48,106 | 45,765 | 12,125 | 11,164 | 12,809 | 13,667 | 49,763 |
| Family allowances | 14,754 | 21,391 | 4,801 | 4,081 | 4,680 | 6,148 | 19,206 | 19,710 | 4,177 | 4,177 | 4,177 | 4,177 | 16,706 |
| Pension contributions | 3,557 | 5,225 | 1,293 | 1,202 | 1,420 | 2,553 | 5,173 | 6,468 | 1,607 | 1,923 | 1,921 | 2,234 | 7,684 |
| Reserve fund and contingent liabilities | 0 | 8,540 | 929 | 0 | 960 | 98 | 6,260 | 1,987 | 2,942 | 500 | 767 | 1,198 | 5,407 |
| Other transfers | 8,632 | 8,672 | 1,567 | 2,023 | 3,144 | 4,933 | 11,590 | 11,667 | 1,643 | 2,807 | 4,188 | 4,301 | 12,936 |
| Transfer to State Fund for Social Insurance | 3,479 | 4,203 | 1,649 | 1,016 | 1,788 | 1,479 | 5,878 | 5,932 | 1,758 | 1,758 | 1,758 | 1,758 | 7,030 |
| Goods and services | 81,138 | 77,338 | 17,386 | 17,308 | 21,574 | 20,009 | 84,636 | 76,277 | 10,950 | 22,602 | 22,698 | 24,647 | 80,898 |
| Health | 17,112 | 14,257 | 4,512 | 590 | 7,246 | 2,227 | 16,662 | 14,575 | 2,002 | 3,130 | 4,015 | 6,071 | 15,218 |
| Education | 5,262 | 6,723 | 1,278 | 1,598 | 4,341 | 348 | 9,857 | 7,565 | 1,828 | 2,170 | 3,538 | 1,859 | 9,396 |
| Other | 58,764 | 56,358 | 11,596 | 15,120 | 9,987 | 17,434 | 58,117 | 54,137 | 7,120 | 17,302 | 15,145 | 16,717 | 56,284 |
| Capital expenditure and net lending | 53,589 | 72,347 | 5,943 | 13,220 | 15,548 | 20,616 | 69,572 | 55,326 | 9,153 | 16,806 | 15,931 | 14,336 | 56,226 |
| Capital expenditure | 44,749 | 45,661 | 3,225 | 8,573 | 10,624 | 17,296 | 51,657 | 39,719 | 6,396 | 14,208 | 12,265 | 11,766 | 44,633 |
| Foreign financed | 21,036 | 24,031 | 2,509 | 3,567 | 4,020 | 6,921 | 26,800 | 17,018 | 4,683 | 8,351 | 8,303 | 7,790 | 29,125 |
| Domestic financed 2/ | 23,713 | 21,630 | 716 | 5,006 | 6,604 | 10,375 | 24,857 | 22,701 | 1,713 | 5,856 | 3,962 | 3,976 | 15,508 |
| Net lending | 8,840 | 26,686 | 2,718 | 4,646 | 4,923 | 3,320 | 17,915 | 15,607 | 2,757 | 2,598 | 3,666 | 2,570 | 11,593 |
| Foreign financed | 1,601 | 8,153 | 943 | 1,441 | 2,467 | 1,197 | 8,741 | 6,048 | 1,274 | 238 | 1,294 | -97 | 2,711 |
| Domestic financed | 7,239 | 18,533 | 1,775 | 3,205 | 2,456 | 2,123 | 9,174 | 9,559 | 1,483 | 2,361 | 2,372 | 2,667 | 8,882 |
| Overall deficit (accrual)(-) | -46,321 | -71,088 | -16,435 | -14,902 | -18,754 | -15,664 | -57,525 | -65,754 | 1,691 | -17,757 | -16,391 | -13,811 | -46,269 |
| Accumulation of new arrears 3/ | 3,070 | 19,420 | 19,606 | 8,279 | 9,485 | -6,416 | 0 | 30,955 | -349 | -9,581 | -7,308 | 0 | -17,238 |
| Clearance of 1999 arrears | 0 | 0 | -4,549 | -1,980 | -2,407 | -2,156 | -6,961 | -11,092 | 0 | 0 | 0 | 0 | 0 |
| Overall deficit (cash) before measures (-) | -41,251 | -51,668 | -1,378 | -8,602 | -11,676 | -24,236 | -64,486 | -45,891 | 1,341 | -27,338 | -23,699 | -13,811 | -63,507 |
| Measures/gap | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Statistical discrepancy | -3,783 | -2,445 | -442 | 2,182 | -1,370 | 4,701 | 4 | 5,071 | 0 | 0 | 0 | 0 | 0 |
| Overall deficit (cash) after measures (-) | -45,034 | -54,113 | -1,820 | -6,420 | -13,046 | -19,534 | -64,482 | -40,820 | 1,341 | -27,338 | -23,699 | -13,811 | -63,507 |
| Deficit / Financing | 45,034 | 54,113 | 1,820 | 6,420 | 13,046 | 19,534 | 64,482 | 40,820 | -1,341 | 27,338 | 23,699 | 13,811 | 63,507 |
| Domestic financing | 20,463 | 7,804 | 818 | 3,917 | 6,880 | 13,753 | 16,608 | 25,368 | -5,840 | 12,419 | 3,741 | 3,214 | 13,535 |
| Banking system | 5,712 | -4,488 | 495 | -2,207 | -3,282 | -1,074 | 0 | -6,068 | 1,026 | 440 | 332 | 902 | 2,700 |
| Central Bank of Armenia | -65 | 75 | -1,262 | 837 | 48 | 364 | 0 | -13 | 0 | 0 | 0 | 0 | 0 |
| Rest of banking system | 5,777 | -4,563 | 1,757 | -3,044 | -3,330 | -1,438 | 0 | -6,055 | 1,026 | 440 | 332 | 902 | 2,700 |
| Nonbank | 14,751 | 12,292 | 323 | 6,124 | 10,162 | 14,827 | 16,608 | 31,436 | -6,867 | 11,978 | 3,409 | 2,313 | 10,835 |
| Privatization proceeds 2/ | 21,277 | 10,971 | 562 | 1,432 | 4,630 | 14,885 | 14,715 | 21,509 | -7,525 | 11,720 | 3,228 | 1,752 | 9,175 |
| Treasury bills | -6,009 | 2,041 | -239 | 4,772 | 5,532 | -45 | 2,000 | 10,020 | 684 | 293 | 221 | 601 | 1,800 |
| Promissory notes / Other | -517 | -720 | 0 | -80 | 0 | -13 | -107 | -93 | -26 | -35 | -40 | -40 | -140 |
| External Financing | 24,571 | 46,309 | 1,002 | 2,503 | 6,166 | 5,781 | 47,874 | 15,452 | 4,499 | 14,919 | 19,958 | 10,596 | 49,972 |
| Gross inflow 4/ | 60,903 | 56,789 | 3,777 | 5,507 | 8,016 | 9,302 | 65,147 | 26,602 | 6,375 | 18,560 | 22,339 | 17,790 | 65,064 |
| Amortization | 36,332 | 10,480 | 2,775 | 3,004 | 1,850 | 3,520 | 17,273 | 11,150 | 1,876 | 3,640 | 2,382 | 7,194 | 15,091 |

Table 5 (Cont'd). Armenia: State Budget, 1998-2001
(In percent of GDP)

| | 1998 | 1999 | 2000 | | | | 2001 | | | | | | |
|---|---------|---------|-------------|---------|---------|---------|-----------|-----------|-------------|---------|---------|---------|-----------|
| | Year | Year | Q1 | Q2 | Q3 | Q4 | Year | | Q1 | Q2 | Q3 | Q4 | Year |
| | Actual | Prelim. | Preliminary | | | | Budget | Prelim. | Projections | | | | |
| Total revenue and grants | 17.1 | 19.3 | 23.6 | 17.8 | 13.9 | 15.4 | 19.6 | 16.5 | 29.0 | 19.4 | 14.5 | 13.7 | 17.2 |
| Total revenue | 16.1 | 17.8 | 23.6 | 17.6 | 13.1 | 14.4 | 17.9 | 15.8 | 26.0 | 18.5 | 13.7 | 12.5 | 15.9 |
| Tax revenue | 13.6 | 16.1 | 20.8 | 16.2 | 12.7 | 13.5 | 16.6 | 14.8 | 22.8 | 17.8 | 13.2 | 12.1 | 15.1 |
| Value-added tax | 6.2 | 6.9 | 8.8 | 7.4 | 5.3 | 6.4 | 7.4 | 6.5 | 10.1 | 8.6 | 6.2 | 6.0 | 7.2 |
| Excises | 2.0 | 2.2 | 3.2 | 2.6 | 2.2 | 2.3 | 2.8 | 2.5 | 5.0 | 3.1 | 2.8 | 2.4 | 3.0 |
| Enterprise profits tax | 1.3 | 2.2 | 2.1 | 2.0 | 2.3 | 1.6 | 1.6 | 2.0 | 3.3 | 2.5 | 1.5 | 1.1 | 1.8 |
| Personal income tax | 1.4 | 1.8 | 2.3 | 1.4 | 1.0 | 1.1 | 1.1 | 1.3 | 1.5 | 1.0 | 0.9 | 0.8 | 1.0 |
| Land tax | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Customs duties | 1.1 | 0.8 | 1.3 | 0.9 | 0.7 | 0.8 | 0.9 | 0.8 | 1.3 | 0.9 | 0.5 | 0.6 | 0.8 |
| Other taxes | 1.1 | 1.7 | 2.4 | 1.6 | 0.9 | 0.9 | 2.5 | 1.3 | 1.1 | 1.2 | 1.0 | 0.8 | 1.0 |
| of which stamp duties | 1.0 | 1.0 | 1.2 | 1.0 | 0.8 | 0.7 | 0.9 | 0.9 | 0.9 | 1.0 | 0.8 | 0.4 | 0.7 |
| Presumptive income tax | 0.4 | 0.5 | 0.7 | 0.4 | 0.3 | 0.4 | 0.3 | 0.4 | 0.5 | 0.4 | 0.3 | 0.3 | 0.4 |
| Property tax | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nontax revenue | 2.5 | 1.6 | 2.8 | 1.4 | 0.4 | 0.9 | 1.1 | 1.1 | 2.7 | 0.6 | 0.5 | 0.3 | 0.7 |
| Capital revenue | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.5 | 0.1 | 0.0 | 0.1 | 0.1 |
| Grants 1/ | 0.9 | 1.5 | 0.0 | 0.1 | 0.8 | 1.0 | 1.7 | 0.6 | 3.1 | 0.9 | 0.8 | 1.2 | 1.3 |
| Total expenditure | 21.9 | 26.5 | 36.2 | 24.6 | 19.7 | 19.8 | 25.1 | 22.8 | 28.0 | 26.8 | 19.1 | 17.1 | 21.2 |
| Current expenditure | 16.3 | 19.2 | 31.6 | 18.5 | 14.9 | 14.0 | 18.4 | 17.5 | 22.1 | 19.8 | 14.6 | 13.6 | 16.3 |
| Wages | 2.7 | 3.1 | 6.2 | 3.2 | 2.4 | 2.7 | 3.2 | 3.2 | 4.8 | 3.4 | 2.3 | 2.2 | 2.9 |
| Subsidies | 0.1 | 1.4 | 0.4 | 1.4 | 1.0 | 0.4 | 0.7 | 0.8 | 0.1 | 0.1 | 0.9 | 0.8 | 0.6 |
| Interest | 1.9 | 2.0 | 3.8 | 2.2 | 1.2 | 1.0 | 1.7 | 1.7 | 2.4 | 2.1 | 1.3 | 1.0 | 1.5 |
| domestic interest | 1.1 | 1.3 | 1.9 | 1.4 | 0.7 | 0.4 | 0.9 | 0.9 | 1.1 | 1.0 | 0.8 | 0.5 | 0.8 |
| external interest | 0.7 | 0.7 | 1.9 | 0.8 | 0.5 | 0.6 | 0.8 | 0.8 | 1.3 | 1.1 | 0.6 | 0.5 | 0.8 |
| Transfers | 3.2 | 4.9 | 7.8 | 3.8 | 3.7 | 4.3 | 4.7 | 4.4 | 7.8 | 4.7 | 3.6 | 3.4 | 4.3 |
| Family allowances | 1.5 | 2.2 | 3.7 | 1.9 | 1.4 | 1.7 | 1.9 | 1.9 | 2.7 | 1.7 | 1.2 | 1.0 | 1.5 |
| Pension contributions | 0.4 | 0.5 | 1.0 | 0.6 | 0.4 | 0.7 | 0.5 | 0.6 | 1.0 | 0.8 | 0.5 | 0.6 | 0.7 |
| Reserve fund and contingent liabilities | 0.0 | 0.9 | 0.7 | 0.0 | 0.3 | 0.0 | 0.6 | 0.2 | 1.9 | 0.2 | 0.2 | 0.3 | 0.5 |
| Other transfers | 0.9 | 0.9 | 1.2 | 0.9 | 1.0 | 1.4 | 1.1 | 1.1 | 1.1 | 1.2 | 1.2 | 1.1 | 1.1 |
| Transfer to State Fund for Social Insurance | 0.4 | 0.4 | 1.3 | 0.5 | 0.5 | 0.4 | 0.6 | 0.6 | 1.1 | 0.7 | 0.5 | 0.4 | 0.6 |
| Goods and services | 8.5 | 7.8 | 13.3 | 7.9 | 6.6 | 5.6 | 8.2 | 7.4 | 7.0 | 9.5 | 6.4 | 6.1 | 7.0 |
| Health | 1.8 | 1.4 | 3.5 | 0.3 | 2.2 | 0.6 | 1.6 | 1.4 | 1.3 | 1.3 | 1.1 | 1.5 | 1.3 |
| Education | 0.5 | 0.7 | 1.0 | 0.7 | 1.3 | 0.1 | 1.0 | 0.7 | 1.2 | 0.9 | 1.0 | 0.5 | 0.8 |
| Other | 6.1 | 5.7 | 8.9 | 6.9 | 3.1 | 4.9 | 5.6 | 5.2 | 4.6 | 7.2 | 4.3 | 4.2 | 4.9 |
| Capital expenditure and net lending | 5.6 | 7.3 | 4.5 | 6.1 | 4.8 | 5.8 | 6.7 | 5.4 | 5.9 | 7.0 | 4.5 | 3.6 | 4.9 |
| Capital expenditure | 4.7 | 4.6 | 2.5 | 3.9 | 3.2 | 4.9 | 5.0 | 3.8 | 4.1 | 6.0 | 3.5 | 2.9 | 3.9 |
| Foreign financed | 2.2 | 2.4 | 1.9 | 1.6 | 1.2 | 1.9 | 2.6 | 1.6 | 3.0 | 3.5 | 2.4 | 1.9 | 2.5 |
| Domestic financed 2/ | 2.5 | 2.2 | 0.5 | 2.3 | 2.0 | 2.9 | 2.4 | 2.2 | 1.1 | 2.5 | 1.1 | 1.0 | 1.3 |
| Net lending | 0.9 | 2.7 | 2.1 | 2.1 | 1.5 | 0.9 | 1.7 | 1.5 | 1.8 | 1.1 | 1.0 | 0.6 | 1.0 |
| Foreign financed | 0.2 | 0.8 | 0.7 | 0.7 | 0.8 | 0.3 | 0.8 | 0.6 | 0.8 | 0.1 | 0.4 | 0.0 | 0.2 |
| Domestic financed | 0.8 | 1.9 | 1.4 | 1.5 | 0.8 | 0.6 | 0.9 | 0.9 | 1.0 | 1.0 | 0.7 | 0.7 | 0.8 |
| Overall deficit (accrual)(-) | -4.8 | -7.2 | -12.6 | -6.8 | -5.7 | -4.4 | -5.6 | -6.4 | 1.1 | -7.4 | -4.6 | -3.4 | -4.0 |
| Accumulation of new arrears 3/ | 0.5 | 2.0 | 15.0 | 3.8 | 2.9 | -1.8 | 0.0 | 3.0 | -0.2 | -4.0 | -2.1 | 0.0 | -1.5 |
| Clearance of 1999 arrears | 0.0 | | -3.5 | -0.9 | -0.7 | -0.6 | -0.7 | -1.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall deficit (cash) before measures(-) | -4.3 | -5.2 | -1.1 | -3.9 | -3.6 | -6.8 | -6.2 | -4.4 | 0.9 | -11.5 | -6.7 | -3.4 | -5.5 |
| Measures/gap | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Statistical discrepancy | -0.4 | -0.2 | -0.3 | 1.0 | -0.4 | 1.3 | 0.0 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall deficit (cash) after measures(-) | -4.7 | -5.5 | -1.4 | -2.9 | -4.0 | -5.5 | -6.2 | -4.0 | 0.9 | -11.5 | -6.7 | -3.4 | -5.5 |
| Deficit / Financing | 4.7 | 5.5 | 1.4 | 2.9 | 4.0 | 5.5 | 6.2 | 4.0 | -0.9 | 11.5 | 6.7 | 3.4 | 5.5 |
| Domestic financing | 2.1 | 0.8 | 0.6 | 1.8 | 2.1 | 3.9 | 1.6 | 2.5 | -3.8 | 5.2 | 1.1 | 0.8 | 1.2 |
| Banking system | 0.6 | -0.5 | 0.4 | -1.0 | -1.0 | -0.3 | 0.0 | -0.6 | 0.7 | 0.2 | 0.1 | 0.2 | 0.2 |
| Central Bank of Armenia | 0.0 | 0.0 | -1.0 | 0.4 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Rest of banking system | 0.6 | -0.5 | 1.3 | -1.4 | -1.0 | -0.4 | 0.0 | -0.6 | 0.7 | 0.2 | 0.1 | 0.2 | 0.2 |
| Nonbank | 1.5 | 1.2 | 0.2 | 2.8 | 3.1 | 4.2 | 1.6 | 3.0 | -4.4 | 5.0 | 1.0 | 0.6 | 0.9 |
| Privatization proceeds 2/ | 2.2 | 1.1 | 0.4 | 0.7 | 1.4 | 4.2 | 1.4 | 2.1 | -4.8 | 4.9 | 0.9 | 0.4 | 0.8 |
| Treasury bills | -0.6 | 0.2 | -0.2 | 2.2 | 1.7 | 0.0 | 0.2 | 1.0 | 0.4 | 0.1 | 0.1 | 0.1 | 0.2 |
| Promissory notes / Other | -0.1 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| External Financing | 2.6 | 4.7 | 0.8 | 1.1 | 1.9 | 1.6 | 4.6 | 1.5 | 2.9 | 6.3 | 5.7 | 2.6 | 4.3 |
| Gross inflow 4/ | 6.4 | 5.7 | 2.9 | 2.5 | 2.5 | 2.6 | 6.3 | 2.6 | 4.1 | 7.8 | 6.3 | 4.4 | 5.7 |
| Amortization | 3.8 | 1.1 | 2.1 | 1.4 | 0.6 | 1.0 | 1.7 | 1.1 | 1.2 | 1.5 | 0.7 | 1.8 | 1.3 |
| Memorandum items: | | | | | | | | | | | | | |
| GDP | 958,791 | 988,074 | 130,719 | 218,449 | 327,136 | 356,151 | 1,032,455 | 1,032,455 | 155,479 | 238,681 | 353,070 | 401,770 | 1,149,000 |
| Stock of arrears at end-period | 5,070 | 24,490 | 39,547 | 45,846 | 52,924 | 44,353 | | 44,353 | 44,003 | 34,422 | 27,115 | 27,115 | 27,115 |
| Accrual deficit excl. grants in percent of GDP | -5.8 | -8.7 | -12.6 | -6.9 | -6.6 | -5.4 | -7.3 | -7.0 | -2.0 | -8.4 | -5.4 | -4.6 | -5.3 |
| Cash deficit excl. grants in percent of GDP | | -7.0 | -1.4 | -3.1 | -4.8 | -6.5 | -7.9 | -4.6 | -2.2 | -12.4 | -7.5 | -4.6 | -6.8 |
| Adjustments for expenditures: | | | | | | | | | | | | | |
| Estimate for energy subsidy | | 0.7 | | | | | 0.0 | 0.0 | | | | | 0.0 |
| Capital expenditure financing from privatization proceeds | | 1.1 | | | | | 1.4 | 1.3 | | | | | 0.5 |
| Expenditures after adjustments | | 24.8 | | | | | 23.7 | 21.6 | | | | | 20.7 |

Sources: Armenian Ministry of Finance; Central Bank of Armenia; and Fund staff estimates.

1/ The grants are different from the 2001 budget figure due to delays in the monetarization of grants in 2000, which increased the expected receipts in 2001, and the delay in the disbursement of a grant.

2/ Assuming the use of dram 7 billion of privatization proceeds for capital expenditures in 2001.

3/ The allocation of the arrears within the different quarters of 2000 and the stock at end-2000 is preliminary.

4/ Dram 10,396 millions of WB disbursements for SAC III are reported in 1999 as they were used to finance 1999 expenditures. In the BOP, this amount is reported in 2000.

Table 6. Armenia: State Fund for Social Insurance Budget, 1998-2001

| | 1998 | 1999 | 2000 | | | | | 2001 | | | | | |
|---|--------|--------|--------|--------|--------|--------|------------------|--------|-------|--------|--------|--------|------------------|
| | Actual | Prel. | Q1 | Q2 | Q3 | Q4 | Annual Budget | Prel. | Q1 | Q2 | Q3 | Q4 | Annual Budget |
| (In millions of dram) | | | | | | | | | | | | | |
| Total revenue and grants | 33,751 | 35,195 | 7,943 | 8,056 | 10,517 | 10,814 | 43,600 | 37,330 | 9,726 | 10,874 | 11,967 | 12,528 | 45,094 |
| Total revenue | 30,272 | 31,521 | 6,293 | 7,041 | 8,729 | 9,389 | 37,702 | 31,453 | 7,968 | 9,116 | 10,209 | 10,770 | 38,064 |
| Contributions from payroll | 29,797 | 31,032 | 6,179 | 6,953 | 8,626 | 9,268 | 35,696 | 31,025 | 7,914 | 9,049 | 10,144 | 10,598 | 37,706 |
| State payroll | 4,785 | 5,225 | 1,293 | 1,202 | 1,420 | 2,349 | 5,173 | 6,264 | 1,607 | 1,923 | 1,921 | 2,234 | 7,684 |
| Enterprise payroll | 25,012 | 25,807 | 4,885 | 5,751 | 7,206 | 6,919 | 30,523 | 24,762 | 6,308 | 7,126 | 8,224 | 8,364 | 30,022 |
| Self-employed and agriculture | 475 | 462 | 101 | 84 | 100 | 118 | 1,986 | 403 | 40 | 60 | 60 | 163 | 323 |
| Other revenue | 0 | 27 | 13 | 4 | 3 | 4 | 20 | 24 | 14 | 7 | 4 | 9 | 35 |
| Transfers | 3,479 | 3,674 | 1,649 | 1,016 | 1,788 | 1,425 | 5,878 | 5,878 | 1,758 | 1,758 | 1,758 | 1,758 | 7,030 |
| Total expenditure | 34,387 | 37,670 | 9,887 | 10,585 | 9,622 | 8,089 | 40,760 | 38,182 | 9,726 | 9,835 | 9,977 | 11,056 | 40,594 |
| Pensions | 33,127 | 34,111 | 8,955 | 9,894 | 8,944 | 7,786 | 36,126 | 35,579 | 9,162 | 9,162 | 9,162 | 9,162 | 36,647 |
| <i>Of which: Pension to soldiers and officers</i> | 3,479 | 3,770 | 1,649 | 1,016 | 1,788 | 1,425 | 5,878 | 5,878 | 1,758 | 1,758 | 1,758 | 1,758 | 7,030 |
| Social safety net compensation | 0 | 1,422 | 416 | 302 | 265 | 29 | 1,493 | 1,012 | 250 | 340 | 292 | 277 | 1,158 |
| Unemployment compensations and programs | 767 | 1,394 | 285 | 241 | 213 | 9 | 2,242 | 747 | 150 | 150 | 283 | 1,337 | 1,920 |
| Other expenditures, and statis.discrepancy | 494 | 743 | 231 | 148 | 200 | 265 | 898 | 844 | 164 | 183 | 240 | 281 | 869 |
| | | | 0 | 0 | 0 | 0 | | | | | | | |
| Overall deficit (accrual) (-) | -635 | -2,475 | -1,944 | -2,528 | 895 | 2,725 | 2,840 | -852 | 0 | 1,039 | 1,990 | 1,472 | 4,500 |
| Change in arrears | 1,306 | 2,068 | 1,867 | 2,619 | -913 | -2,760 | -2,840 | 812 | 0 | -1,000 | -1,900 | -1,286 | -4,186 |
| Overall deficit (cash) (-) | 671 | -407 | -76 | 90 | -18 | -35 | 0 | -40 | 0 | 39 | 90 | 186 | 314 |
| | | | 0 | 0 | 0 | 0 | | | | | | | |
| Financing | -671 | 407 | 76 | -90 | 18 | 35 | 0 | 40 | 0 | -39 | -90 | -186 | -314 |
| Gap | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Stock of arrears by end of the FY | 1,306 | 3,374 | 5,241 | 7,860 | 6,946 | 4,186 | 0 | 4,186 | 4,186 | 3,186 | 1,286 | 0 | 0 |
| (In percent of GDP) | | | | | | | | | | | | | |
| Total revenue and grants | 3.5 | 3.6 | 6.1 | 3.7 | 3.2 | 3.0 | 4.2 | 3.6 | 6.3 | 4.6 | 3.4 | 3.1 | 3.9 |
| Total revenue | 3.2 | 3.2 | 4.8 | 3.2 | 2.7 | 2.6 | 3.7 | 3.0 | 5.1 | 3.8 | 2.9 | 2.7 | 3.3 |
| Contributions from payroll | 3.1 | 3.1 | 4.7 | 3.2 | 2.6 | 2.6 | 3.5 | 3.0 | 5.1 | 3.8 | 2.9 | 2.6 | 3.3 |
| State payroll | 0.5 | 0.5 | 1.0 | 0.6 | 0.4 | 0.7 | 0.5 | 0.6 | 1.0 | 0.8 | 0.5 | 0.6 | 0.7 |
| Enterprise payroll | 2.6 | 2.6 | 3.7 | 2.6 | 2.2 | 1.9 | 3.0 | 2.4 | 4.1 | 3.0 | 2.3 | 2.1 | 2.6 |
| Self-employed and agriculture | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Revenue | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Transfers | 0.4 | 0.4 | 1.3 | 0.5 | 0.5 | 0.4 | 0.6 | 0.6 | 1.1 | 0.7 | 0.5 | 0.4 | 0.6 |
| Total expenditure | 3.6 | 3.8 | 7.6 | 4.8 | 2.9 | 2.3 | 3.9 | 3.7 | 6.3 | 4.1 | 2.8 | 2.8 | 3.5 |
| Pensions | 3.5 | 3.5 | 6.9 | 4.5 | 2.7 | 2.2 | 3.5 | 3.4 | 5.9 | 3.8 | 2.6 | 2.3 | 3.2 |
| <i>Of which: Pension to soldiers and officers</i> | 0.4 | 0.4 | 1.3 | 0.5 | 0.5 | 0.4 | 0.6 | 0.6 | 1.1 | 0.7 | 0.5 | 0.4 | 0.6 |
| Social safety net compensation | 0.0 | 0.1 | 0.3 | 0.1 | 0.1 | 0.0 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Unemployment compensations and programs | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.3 | 0.2 |
| Interest on bank credit | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other expenditures, and statis.discrepancy | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Overall deficit (accrual) (-) | -0.1 | -0.3 | -1.5 | -1.2 | 0.3 | 0.8 | 0.3 | -0.1 | 0.0 | 0.4 | 0.6 | 0.4 | 0.4 |
| Change in arrears | 0.1 | 0.2 | 1.4 | 1.2 | -0.3 | -0.8 | -0.3 | 0.1 | 0.0 | -0.4 | -0.5 | -0.3 | -0.4 |
| Overall deficit (cash) (-) | 0.1 | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Financing | -0.1 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Gap | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Stock of arrears by end of the FY | 0.1 | 0.3 | 4.0 | 3.6 | 2.1 | 1.2 | 0.0 | 0.4 | 2.7 | 1.3 | 0.4 | 0.0 | 0.0 |

Sources: Armenian Ministry of Finance; and State Fund for Social Insurance.

Table 7. Armenia: Balance of Payments, 1998-2003

(In millions of U.S. dollars; unless otherwise indicated)

| | 1998 | 1999 | 2000 | | | | | 2001 | | | | | 2002 | 2003 |
|---------------------------------------|--------|-------|-------------|-------|-------|-------|-------|---------|-------|-------|-------|-------|-------------|-------|
| | Year | | Q1 | Q2 | Q3 | Q4 | Year | Q1 | Q2 | Q3 | Q4 | Year | Year | |
| | Actual | | Preliminary | | | | | Program | | | | | Projections | |
| Current account | -403 | -307 | -89 | -69 | -46 | -75 | -279 | -58 | -78 | -76 | -83 | -294 | -275 | -261 |
| Trade balance | -577 | -474 | -113 | -121 | -99 | -134 | -467 | -81 | -134 | -136 | -142 | -492 | -478 | -476 |
| Exports | 229 | 247 | 61 | 84 | 74 | 87 | 307 | 78 | 90 | 92 | 96 | 356 | 392 | 432 |
| Imports | -806 | -721 | -174 | -206 | -173 | -221 | -774 | -159 | -224 | -228 | -238 | -848 | -870 | -908 |
| Services (net) | -63 | -62 | -13 | -14 | -9 | -18 | -54 | -11 | -12 | -8 | -13 | -44 | -41 | -33 |
| Credits | 131 | 136 | 30 | 33 | 34 | 39 | 136 | 39 | 39 | 46 | 42 | 166 | 181 | 198 |
| Debits | -194 | -198 | -43 | -47 | -43 | -57 | -191 | -50 | -51 | -54 | -55 | -210 | -222 | -231 |
| Income (net) | 60 | 55 | 1 | 15 | 20 | 18 | 54 | 5 | 16 | 16 | 16 | 53 | 47 | 42 |
| Private transfers (net) | 65 | 80 | 17 | 20 | 24 | 24 | 86 | 19 | 22 | 22 | 26 | 89 | 97 | 106 |
| Official transfers (net) | 113 | 94 | 19 | 32 | 17 | 35 | 103 | 10 | 30 | 30 | 30 | 100 | 100 | 100 |
| Capital and financial account | 406 | 311 | 76 | 62 | 55 | 98 | 290 | 35 | 86 | 70 | 58 | 250 | 245 | 251 |
| Capital transfers (net) | 10 | 13 | 7 | 5 | 5 | 11 | 28 | 12 | 19 | 19 | 20 | 70 | 60 | 20 |
| Foreign direct investments (net) | 221 | 122 | 45 | 36 | 20 | 3 | 104 | 35 | 35 | 35 | 35 | 140 | 140 | 140 |
| Portfolio investments (net) | -16 | 2 | 0 | -1 | -1 | -17 | -19 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Public sector (net) | 34 | 84 | 22 | 3 | 10 | 11 | 46 | 8 | 12 | 16 | 4 | 41 | 45 | 50 |
| Disbursements | 105 | 102 | 27 | 10 | 15 | 18 | 70 | 12 | 19 | 21 | 17 | 68 | 75 | 79 |
| Amortization | -71 | -18 | -5 | -7 | -5 | -7 | -24 | -3 | -7 | -4 | -13 | -27 | -29 | -29 |
| Other capital (net) 1/ | 158 | 90 | 2 | 19 | 20 | 90 | 130 | -20 | 20 | 0 | 0 | 0 | 0 | 40 |
| Overall balance | 4 | 4 | -14 | -7 | 8 | 23 | 11 | -23 | 8 | -5 | -24 | -45 | -30 | -10 |
| Change in gross reserves (- increase) | -55 | -20 | 14 | 5 | -10 | -26 | -18 | 21 | -18 | -17 | -9 | -23 | -8 | -3 |
| IMF (net) 2/ | 52 | 15 | -4 | -4 | -4 | -4 | -16 | -2 | -2 | -4 | -2 | -10 | -18 | -23 |
| Arrears, net to Russia (+ increase) | | 1 | 4 | 5 | 5 | 5 | 18 | 5 | -16 | -7 | 0 | -19 | | |
| Debt relief from Turkmenistan | | | | 2 | 2 | 2 | 5 | | | | | | | |
| Financing gap | | | | | | | | | 28 | 33 | 35 | 96 | 56 | 36 |
| IMF | | | | | | | | | 13 | 13 | 0 | 26 | 26 | 26 |
| World Bank | | | | | | | | | 15 | 20 | 15 | 50 | 30 | 10 |
| Possible Consultative Group meeting | | | | | | | | | 0 | 0 | 20 | 20 | 0 | 0 |
| Memorandum items: | | | | | | | | | | | | | | |
| Current account (in percent of GDP) | | | | | | | | | | | | | | |
| Including official transfers | -21.2 | -16.6 | -36.0 | -16.9 | -7.7 | -11.4 | -14.6 | -20.5 | -18.0 | -11.8 | -11.4 | -14.1 | -12.1 | -10.5 |
| Excluding official transfers | -27.1 | -21.7 | -43.7 | -24.6 | -10.5 | -16.7 | -19.9 | -24.0 | -24.9 | -16.4 | -15.5 | -18.9 | -16.4 | -14.5 |
| Gross reserves (end of period) | 297.9 | 304.6 | 286.6 | 280.1 | 285.9 | 313.5 | 313.5 | 292.9 | 310.9 | 327.5 | 336.2 | 336.2 | 344.0 | 347.3 |
| In months of imports | 3.9 | 3.8 | 3.3 | 3.2 | 3.2 | 3.6 | 3.6 | 3.2 | 3.4 | 3.6 | 3.7 | 3.7 | 3.6 | 3.5 |
| In months of amortization 3/ | 115.2 | 157.8 | 93.0 | 90.9 | 92.8 | 101.8 | 101.8 | 73.6 | 78.1 | 82.3 | 84.5 | 84.5 | 79.8 | 56.9 |
| External debt 4/ | 787 | 855 | 856 | 858 | 860 | 862 | 862 | 873 | 895 | 933 | 968 | 968 | 1,048 | 1,105 |
| External debt (in percent of GDP) 4/ | 41.4 | 46.3 | 44.8 | 44.9 | 45.0 | 45.1 | 45.1 | 41.8 | 42.9 | 44.7 | 46.3 | 46.3 | 46.0 | 44.4 |
| Debt service (in percent of exports) | 19.0 | 14.3 | 22.2 | 8.0 | 7.7 | 7.3 | 10.6 | 16.8 | 15.2 | 14.2 | 14.2 | 15.0 | 12.0 | 12.0 |

Sources: Armenian authorities; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Excluding prospective PRGF disbursements which are included in the financing gap.

3/ Excludes amortization of short term debt, deposits held by nonresidents and debt acquired domestically by nonresidents.

4/ Government and government-guaranteed medium- and long-term debt; before the possible use of privatization proceeds to retire external debt.

Table 8. Armenia: Macroeconomic Framework, 1998-2006

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|--------|-------|-------------|-------|-------|------------|-------|-------|-------|
| | Actual | | Preliminary | | | Projection | | | |
| Output and Key Prices (in percent) | | | | | | | | | |
| Real GDP growth | 7.3 | 3.3 | 6.0 | 6.5 | 6.0 | 6.0 | 5.0 | 5.0 | 5.0 |
| Average inflation for period | 8.7 | 0.7 | -0.8 | 4.5 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| End of period inflation | -1.2 | 2.1 | 0.4 | 3.5 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| GDP Deflator | 11.2 | 0.1 | -1.4 | 4.5 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Average real wages (state sector, 1995:1 =100) | | | | | | | | | |
| Budgetary sector | 303 | 370 | 426 | 499 | 524 | 550 | 578 | 607 | 637 |
| Nonbudgetary sector | 183 | 215 | 251 | 332 | 348 | 366 | 384 | 403 | 423 |
| (In percent of GDP) | | | | | | | | | |
| External current account | -21.2 | -16.6 | -14.6 | -14.1 | -12.1 | -10.5 | -10.2 | -9.9 | -9.8 |
| Exports of goods and services | 18.9 | 20.7 | 23.2 | 25.0 | 25.1 | 25.3 | 25.4 | 25.4 | 25.5 |
| Imports of goods and services | -52.7 | -49.8 | -50.4 | -50.6 | -47.9 | -45.7 | -44.8 | -43.9 | -43.1 |
| Income (net) | 3.2 | 3.0 | 2.8 | 2.5 | 2.1 | 1.7 | 1.3 | 0.8 | 0.2 |
| Transfers (net) | 9.3 | 9.4 | 9.8 | 9.0 | 8.6 | 8.3 | 8.0 | 7.8 | 7.6 |
| Official transfers | 5.9 | 5.1 | 5.4 | 4.8 | 4.4 | 4.0 | 3.8 | 3.6 | 3.4 |
| Private transfers | 3.4 | 4.4 | 4.5 | 4.3 | 4.3 | 4.3 | 4.2 | 4.2 | 4.2 |
| Government balance | -4.8 | -7.2 | -6.4 | -4.0 | -2.5 | -3.0 | -2.5 | -2.5 | -2.5 |
| Saving | -0.2 | -2.6 | -2.5 | -0.1 | 1.3 | 1.3 | 2.3 | 2.0 | 2.2 |
| Investment | 4.7 | 4.6 | 3.8 | 3.9 | 3.8 | 4.3 | 4.7 | 4.5 | 4.7 |
| Nongovernment balance | -16.4 | -9.4 | -8.2 | -10.1 | -9.5 | -7.5 | -7.7 | -7.4 | -7.3 |
| Saving | -2.1 | 5.3 | 7.4 | 7.8 | 8.4 | 9.7 | 9.5 | 9.8 | 9.9 |
| Investment | 14.3 | 14.7 | 15.6 | 17.9 | 17.9 | 17.2 | 17.2 | 17.2 | 17.2 |
| Total Investment | 19.0 | 19.3 | 19.4 | 21.8 | 21.7 | 21.5 | 21.9 | 21.7 | 21.9 |
| National saving | -2.2 | 2.7 | 4.9 | 7.7 | 9.6 | 11.0 | 11.8 | 11.8 | 12.1 |
| (In millions of U.S. dollars; unless otherwise indicated) | | | | | | | | | |
| Gross external reserves | 298 | 305 | 314 | 336 | 344 | 347 | 369 | 396 | 419 |
| (in months of imports of goods and services) | 3.9 | 3.8 | 3.6 | 3.7 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 |
| Total external debt ^{1/} | 787 | 855 | 862 | 968 | 1,048 | 1,105 | 1,178 | 1,263 | 1,353 |
| (in percent of GDP) | 41 | 46 | 45 | 46 | 46 | 44 | 44 | 43 | 43 |
| Memorandum items: | | | | | | | | | |
| (In percent of GDP) | | | | | | | | | |
| Consumption | 114.8 | 109.7 | 107.8 | 103.9 | 101.0 | 99.0 | 97.5 | 96.8 | 95.7 |
| Current account excluding official transfers | -27.1 | -21.7 | -19.9 | -18.9 | -16.4 | -14.5 | -14.0 | -13.5 | -13.2 |
| Government balances excluding grants | -5.6 | -7.0 | -4.6 | -6.8 | -4.1 | -3.2 | -2.5 | -2.5 | -2.5 |
| (In billions of drams) | | | | | | | | | |
| Nominal GDP | 959 | 988 | 1,032 | 1,149 | 1,255 | 1,370 | 1,482 | 1,602 | 1,733 |
| Nominal GNI | 1,079 | 1,111 | 1,163 | 1,282 | 1,389 | 1,506 | 1,619 | 1,740 | 1,868 |

Sources: Armenian authorities; and Fund staff estimates.

^{1/} Medium- and long-term government and government-guaranteed debt.

Table 9. Armenia: Medium-term State Budget, 1998-2006

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | |
|---|-----------------------|-----------------------|---------|---------|---------|------------|---------|---------|---------|--|
| | Actual | Actual Preliminary | | | | Projection | | | | |
| | (in millions of dram) | | | | | | | | | |
| Total revenue and grants | 163,812 | 190,917 | 170,015 | 197,602 | 221,166 | 246,109 | 273,949 | 301,209 | 329,692 | |
| Total revenue | 154,755 | 175,817 | 163,434 | 183,210 | 218,166 | 243,109 | 273,949 | 301,209 | 329,692 | |
| Tax revenue | 130,394 | 158,803 | 152,357 | 173,304 | 207,445 | 231,716 | 261,604 | 287,938 | 315,420 | |
| Nontax revenue | 24,361 | 16,254 | 11,063 | 8,555 | 9,521 | 10,393 | 11,345 | 12,271 | 13,272 | |
| Capital revenue | 0 | 760 | 14 | 1,351 | 1,200 | 1,000 | 1,000 | 1,000 | 1,000 | |
| Grants 1/ | 9,056 | 15,100 | 6,582 | 14,392 | 3,000 | 3,000 | 0 | 0 | 0 | |
| Total expenditure | 210,133 | 262,005 | 235,770 | 243,872 | 253,136 | 286,759 | 310,785 | 341,149 | 372,743 | |
| Current expenditure | 156,544 | 189,658 | 180,444 | 187,646 | 195,521 | 226,030 | 249,495 | 267,214 | 289,820 | |
| Capital expenditure and net lending | 53,589 | 72,347 | 55,326 | 56,226 | 57,615 | 60,729 | 61,290 | 73,935 | 82,923 | |
| Capital expenditure | 44,749 | 45,661 | 39,719 | 44,633 | 47,749 | 58,288 | 70,290 | 71,935 | 80,923 | |
| Foreign financed | 21,036 | 24,031 | 17,018 | 29,125 | 33,660 | 42,586 | 47,215 | 44,467 | 51,596 | |
| Domestic financed 2/ | 23,713 | 21,630 | 22,701 | 15,508 | 14,089 | 15,702 | 23,075 | 27,467 | 29,327 | |
| Net lending | 8,840 | 26,686 | 15,607 | 11,593 | 9,866 | 2,441 | -9,000 | 2,000 | 2,000 | |
| Overall deficit (accrual)(-) | -46,321 | -71,088 | -65,754 | -46,269 | -31,970 | -40,650 | -36,835 | -39,940 | -43,051 | |
| Accumulation of new arrears 3/ | 5,070 | 19,420 | 30,955 | -17,238 | -27,115 | 0 | 0 | 0 | 0 | |
| Clearance of 1999 arrears | 0 | 0 | -11,092 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Overall deficit (cash) before measures (-) | -41,251 | -51,668 | -45,891 | -63,507 | -59,085 | -40,650 | -36,835 | -39,940 | -43,051 | |
| Measures/gap | 0 | 0 | 0 | 0 | 10,893 | 0 | 0 | 0 | 0 | |
| Statistical discrepancy | -3,783 | -2,445 | 5,071 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Overall deficit excl. grants | -53,378 | -86,188 | -72,336 | -60,661 | -34,970 | -43,650 | -36,835 | -39,940 | -43,051 | |
| Overall deficit (cash) after measures (-) | -45,034 | -54,113 | -40,820 | -63,507 | -48,192 | -40,650 | -36,835 | -39,940 | -43,051 | |
| Deficit / Financing | 45,034 | 54,113 | 40,820 | 63,507 | 48,192 | 40,650 | 36,835 | 39,940 | 43,051 | |
| Domestic financing | 20,463 | 7,804 | 25,368 | 13,535 | 6,700 | 7,715 | 7,210 | 7,900 | 8,400 | |
| Banking system | 5,712 | -4,488 | -6,068 | 2,700 | 3,400 | 1,715 | 1,710 | 1,700 | 1,700 | |
| Nonbank | 14,751 | 12,292 | 31,436 | 10,835 | 5,300 | 6,000 | 5,500 | 6,200 | 6,700 | |
| o/w Privatization receipts 2/ | 21,277 | 10,971 | 21,509 | 9,175 | 0 | 0 | 0 | 0 | 0 | |
| External Financing | 24,571 | 46,309 | 15,452 | 49,972 | 41,492 | 32,935 | 29,625 | 32,040 | 34,651 | |
| Gross inflow 4/ | 60,903 | 56,789 | 26,602 | 65,064 | 57,688 | 48,887 | 53,221 | 45,167 | 50,078 | |
| Amortization | 36,332 | 10,480 | 11,150 | 15,091 | 16,196 | 15,952 | 23,596 | 13,127 | 15,427 | |
| | (in percent of GDP) | | | | | | | | | |
| Total revenue and grants | 17.1 | 19.3 | 16.5 | 17.2 | 17.6 | 18.0 | 18.5 | 18.8 | 19.0 | |
| Total revenue | 16.1 | 17.8 | 15.8 | 15.9 | 17.4 | 17.8 | 18.5 | 18.8 | 19.0 | |
| Tax revenue | 13.6 | 16.1 | 14.8 | 15.1 | 16.5 | 16.9 | 17.7 | 18.0 | 18.2 | |
| Nontax revenue | 2.5 | 1.6 | 1.1 | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | |
| Capital revenue | 0.0 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | |
| Grants 1/ | 0.9 | 1.5 | 0.6 | 1.3 | 0.2 | 0.2 | 0.0 | 0.0 | 0.0 | |
| Total expenditure | 21.9 | 26.5 | 22.8 | 21.2 | 20.2 | 20.9 | 21.0 | 21.3 | 21.5 | |
| Current expenditure | 16.3 | 19.2 | 17.5 | 16.3 | 15.6 | 16.5 | 16.8 | 16.7 | 16.7 | |
| Capital expenditure and net lending | 5.6 | 7.3 | 5.4 | 4.9 | 4.6 | 4.4 | 4.1 | 4.6 | 4.8 | |
| Capital expenditure | 4.7 | 4.6 | 3.8 | 3.9 | 3.8 | 4.3 | 4.7 | 4.5 | 4.7 | |
| Foreign financed | 2.2 | 2.4 | 1.6 | 2.5 | 2.7 | 3.1 | 3.2 | 2.8 | 3.0 | |
| Domestic financed 2/ | 2.5 | 2.2 | 2.2 | 1.3 | 1.1 | 1.1 | 1.6 | 1.7 | 1.7 | |
| Net lending | 0.9 | 2.7 | 1.5 | 1.0 | 0.8 | 0.2 | -0.6 | 0.1 | 0.1 | |
| Overall deficit (accrual)(-) | -4.8 | -7.2 | -6.4 | -4.0 | -2.5 | -3.0 | -2.5 | -2.5 | -2.5 | |
| Accumulation of new arrears 3/ | 0.5 | 2.0 | 3.0 | -1.5 | -2.2 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Clearance of 1999 arrears | 0.0 | 0.0 | -1.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Overall deficit (cash) before measures (-) | -4.3 | -5.2 | -4.4 | -5.5 | -4.7 | -3.0 | -2.5 | -2.5 | -2.5 | |
| Measures/gap | 0.0 | 0.0 | 0.0 | 0.0 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Statistical discrepancy | -0.4 | -0.2 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Overall deficit excl. grants | -5.8 | -8.7 | -7.0 | -5.3 | -2.8 | -3.2 | -2.5 | -2.5 | -2.5 | |
| Overall deficit (cash) after measures (-) | -4.7 | -5.5 | -4.0 | -5.5 | -3.8 | -3.0 | -2.5 | -2.5 | -2.5 | |
| Deficit / Financing | 4.7 | 5.5 | 4.0 | 5.5 | 3.8 | 3.0 | 2.5 | 2.5 | 2.5 | |
| Domestic financing | 2.1 | 0.8 | 2.5 | 1.2 | 0.5 | 0.6 | 0.5 | 0.5 | 0.5 | |
| Banking system | 0.6 | -0.5 | -0.6 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | |
| Nonbank | 1.5 | 1.2 | 3.0 | 0.9 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | |
| o/w Privatization receipts 2/ | 2.2 | 1.1 | 2.1 | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| External Financing | 2.6 | 4.7 | 1.5 | 4.3 | 3.3 | 2.4 | 2.0 | 2.0 | 2.0 | |
| Gross inflow 4/ | 6.4 | 5.7 | 2.6 | 5.7 | 4.6 | 3.6 | 3.6 | 2.8 | 2.9 | |
| Amortization | 3.8 | 1.1 | 1.1 | 1.3 | 1.3 | 1.2 | 1.6 | 0.8 | 0.9 | |
| Memorandum items: | | | | | | | | | | |
| End-period stock of arrears (in millions of dram) | 5,070 | 24,490 | 44,353 | 27,115 | 0 | 0 | 0 | 0 | 0 | |
| Social expenditures on an accrual basis (in percent of GDP) | 3.9 | 4.3 | 4.1 | 3.6 | 3.8 | 4.4 | 4.7 | 4.8 | 4.9 | |
| Social expenditures on a cash basis (in percent of GDP) | 3.5 | 3.8 | 2.9 | 4.0 | 3.8 | 4.4 | 4.7 | 4.8 | 4.9 | |

Sources: Armenian Ministry of Finance; Central Bank of Armenia; and Fund staff estimates

1/ The grants are different from the 2001 budget figure due to delays in the monetization of grants in 2000, which increased the expected receipts in 2001, and the delay in the disbursement of a grant.

2/ Assuming the use of dram 7 billion of privatization proceeds for capital expenditures in 2001.

3/ The allocation of the arrears within the different quarters of 2000 and the stock at end-2000 is preliminary.

4/ Dram 10,396 millions of WB disbursements for SAC III are reported in 1999 as they were used to finance 1999 expenditures. In the BOP, this amount is reported in 2000.

Table 10. Armenia: Medium-Term Balance of Payments and External Debt Projections, 1998-2010

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|--------|-------|-------|--------|--------|--------|--------|------------|--------|--------|--------|--------|--------|
| | | | Prel. | Prog. | | | | Projection | | | | | |
| (in millions of U.S. dollars) | | | | | | | | | | | | | |
| Current account | -403 | -307 | -279 | -294 | -275 | -261 | -274 | -288 | -308 | -318 | -329 | -340 | -346 |
| Net exports of goods and services | -640 | -536 | -521 | -536 | -519 | -509 | -524 | -539 | -554 | -567 | -580 | -593 | -605 |
| Exports | 360 | 383 | 443 | 522 | 573 | 630 | 683 | 741 | 803 | 871 | 945 | 1,024 | 1,111 |
| Imports | -1,000 | -919 | -965 | -1,058 | -1,092 | -1,139 | -1,207 | -1,280 | -1,357 | -1,438 | -1,525 | -1,617 | -1,716 |
| Income excl. workers' remittances (net) | -22 | -24 | -24 | -36 | -50 | -64 | -79 | -97 | -126 | -147 | -171 | -198 | -223 |
| Workers' remittances and private transfers (net) | 147 | 159 | 164 | 178 | 194 | 212 | 227 | 243 | 264 | 286 | 310 | 337 | 365 |
| Official transfers (net) | 113 | 94 | 103 | 100 | 100 | 100 | 102 | 105 | 107 | 110 | 112 | 115 | 117 |
| Capital and financial account | 406 | 311 | 290 | 250 | 245 | 251 | 274 | 288 | 308 | 318 | 329 | 340 | 346 |
| Capital transfers (net) | 10 | 13 | 28 | 70 | 60 | 20 | 20 | 20 | 20 | 20 | 20 | 20 | 20 |
| Foreign direct investments (net) | 221 | 122 | 104 | 140 | 140 | 140 | 150 | 160 | 170 | 170 | 170 | 170 | 170 |
| Portfolio investments (net) | -16 | 2 | -19 | 0 | 0 | 0 | 10 | 10 | 10 | 10 | 10 | 10 | 10 |
| Public sector (net) | 34 | 84 | 46 | 41 | 45 | 50 | 54 | 58 | 63 | 68 | 74 | 80 | 86 |
| Disbursements | 105 | 102 | 70 | 68 | 75 | 79 | 97 | 82 | 91 | 97 | 92 | 100 | 109 |
| Amortizations | -71 | -18 | -24 | -27 | -29 | -29 | -43 | -24 | -28 | -29 | -18 | -20 | -23 |
| Other capital inflows (net) 1/ | 158 | 90 | 130 | 0 | 0 | 40 | 40 | 40 | 45 | 50 | 55 | 60 | 60 |
| Overall balance | 4 | 4 | 11 | -45 | -30 | -10 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net international reserves (- increase) 2/ | -4 | -5 | -34 | -32 | -26 | -26 | -52 | -59 | -53 | -51 | -50 | -55 | -50 |
| Arrears and debt relief (net) | | 1 | 23 | #REF! | | | | | | | | | |
| Financing gap 2/ | | | | 96 | 56 | 36 | 52 | 59 | 53 | 51 | 50 | 55 | 50 |
| IMF | | | | 26 | 26 | 26 | 12 | | | | | | |
| World Bank | | | | 50 | 30 | 10 | 0 | | | | | | |
| Other | | | | 20 | 0 | 0 | 40 | | | | | | |
| (in percent of GDP) | | | | | | | | | | | | | |
| Current account | -21.2 | -16.6 | -14.6 | -14.1 | -12.1 | -10.5 | -10.2 | -9.9 | -9.8 | -9.3 | -8.9 | -8.5 | -8.0 |
| Net exports of goods and services | -33.7 | -29.0 | -27.2 | -25.7 | -22.8 | -20.4 | -19.5 | -18.5 | -17.6 | -16.6 | -15.7 | -14.9 | -14.0 |
| Exports | 18.9 | 20.7 | 23.2 | 25.0 | 25.1 | 25.3 | 25.4 | 25.4 | 25.5 | 25.6 | 25.6 | 25.7 | 25.8 |
| Imports | -52.7 | -49.8 | -50.4 | -50.6 | -47.9 | -45.7 | -44.8 | -43.9 | -43.1 | -42.2 | -41.4 | -40.6 | -39.8 |
| Income excl. workers' remittances (net) | -1.2 | -1.3 | -1.3 | -1.7 | -2.2 | -2.6 | -2.9 | -3.3 | -4.0 | -4.3 | -4.6 | -5.0 | -5.2 |
| Workers' remittances and private transfers (net) | 7.7 | 8.6 | 8.6 | 8.5 | 8.5 | 8.5 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 | 8.5 |
| Official transfers (net) | 5.9 | 5.1 | 5.4 | 4.8 | 4.4 | 4.0 | 3.8 | 3.6 | 3.4 | 3.2 | 3.0 | 2.9 | 2.7 |
| Capital and financial account | 21.4 | 16.8 | 15.1 | 11.9 | 10.7 | 10.1 | 10.2 | 9.9 | 9.8 | 9.3 | 8.9 | 8.5 | 8.0 |
| Capital transfers (net) | 0.5 | 0.7 | 1.5 | 3.3 | 2.6 | 0.8 | 0.7 | 0.7 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 |
| Foreign direct investments (net) | 11.6 | 6.6 | 5.4 | 6.7 | 6.1 | 5.6 | 5.6 | 5.5 | 5.4 | 5.0 | 4.6 | 4.3 | 3.9 |
| Portfolio investments (net) | -0.8 | 0.1 | -1.0 | 0.0 | 0.0 | 0.0 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 |
| Public sector (net) | 1.8 | 4.6 | 2.4 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Disbursements | 5.5 | 5.5 | 3.7 | 3.3 | 3.3 | 3.2 | 3.6 | 2.8 | 2.9 | 2.8 | 2.5 | 2.5 | 2.5 |
| Amortizations | -3.7 | -1.0 | -1.3 | -1.3 | -1.3 | -1.2 | -1.6 | -0.8 | -0.9 | -0.8 | -0.5 | -0.5 | -0.5 |
| Other capital inflows (net) 1/ | 8.3 | 4.9 | 6.8 | 0.0 | 0.0 | 1.6 | 1.5 | 1.4 | 1.4 | 1.5 | 1.5 | 1.5 | 1.4 |
| Overall balance | 0.2 | 0.2 | 0.6 | -2.1 | -1.3 | -0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net international reserves (- increase) 2/ | -0.2 | -0.3 | -1.8 | -1.5 | -1.1 | -1.0 | -1.9 | -2.0 | -1.7 | -1.5 | -1.4 | -1.4 | -1.2 |
| Arrears, debt relief and financing gap 2/ | | 0.1 | 1.2 | #REF! | 2.5 | 1.4 | 1.9 | 2.0 | 1.7 | 1.5 | 1.4 | 1.4 | 1.2 |
| (in units indicated) | | | | | | | | | | | | | |
| Memorandum items: | | | | | | | | | | | | | |
| Current account excluding official transfers | | | | | | | | | | | | | |
| (in millions of U.S. dollars) | -515 | -401 | -382 | -394 | -375 | -361 | -376 | -393 | -415 | -428 | -441 | -454 | -463 |
| (in percent of GDP) | -27.1 | -21.7 | -19.9 | -18.9 | -16.4 | -14.5 | -14.0 | -13.5 | -13.2 | -12.6 | -12.0 | -11.4 | -10.8 |
| External PV debt 3/ 4/ | 144 | 154 | 135 | 128 | 119 | 112 | 110 | 110 | 110 | 111 | 112 | 114 | 116 |
| External PV debt 3/ 4/ 5/ | 144 | 154 | 144 | 136 | 127 | 121 | 119 | 118 | 118 | 118 | 119 | 121 | 122 |
| External debt service 3/ | 19.0 | 14.3 | 10.6 | 15.0 | 12.0 | 12.0 | 13.4 | 10.2 | 9.5 | 9.1 | 6.8 | 7.1 | 6.4 |
| Gross reserves (end of period) 6/ | 3.9 | 3.8 | 3.6 | 3.7 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Real GDP (percent change) | 7.2 | 3.3 | 6.0 | 6.5 | 6.0 | 6.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Percent change in nominal dollar values of | | | | | | | | | | | | | |
| Exports of goods and services | 8.9 | 6.5 | 15.7 | 17.7 | 9.8 | 9.9 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 |
| Imports of goods and services | 5.0 | -8.1 | 5.0 | 9.7 | 3.2 | 4.3 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.1 |
| GDP | 15.9 | -2.8 | 3.6 | 9.2 | 9.2 | 9.2 | 8.2 | 8.2 | 8.1 | 8.2 | 8.1 | 8.2 | 8.1 |
| of which: Domestic demand | 12.3 | -6.2 | 2.2 | 7.8 | 6.7 | 7.1 | 7.3 | 7.3 | 7.3 | 7.3 | 7.3 | 7.3 | 7.4 |

Sources: Armenian authorities; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Prospective disbursements under the PRGF are included in the financing gap and excluded from net international reserves.

3/ Medium- and long-term public and publicly guaranteed debt/debt service in percent of exports of goods and services.

4/ Three year moving average of exports of goods and services centered on the preceding year.

5/ Using the exchange and discount rates from SM/01/36, 8 February 2001 that were based on the 1999 DSA.

6/ In months of next year's imports of goods and services.

Table 11. Armenia: Indicators of Fund Credit, 2000-2010

(In units indicated)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|-------|-------|-------|-------|-------|-------|-------|------|------|------|------|
| Existing and prospective Fund credit 1/ | | | | | | | | | | | |
| In millions of SDRs | 134.7 | 147.3 | 153.3 | 155.8 | 141.5 | 116.9 | 95.7 | 77.2 | 60.3 | 41.1 | 27.3 |
| In percent of exports 2/ | 39.6 | 36.8 | 34.9 | 32.2 | 27.0 | 20.6 | 15.5 | 11.6 | 8.3 | 5.2 | 3.2 |
| In percent of external debt | 20.3 | 19.8 | 19.1 | 18.4 | 15.7 | 12.1 | 9.2 | 7.0 | 5.1 | 3.2 | 2.0 |
| In percent of gross reserves | 56.0 | 57.1 | 58.1 | 58.5 | 50.0 | 38.5 | 29.7 | 22.6 | 16.7 | 10.7 | 6.7 |
| In percent of quota | 146.4 | 160.2 | 166.6 | 169.4 | 153.8 | 127.0 | 104.0 | 84.0 | 65.5 | 44.7 | 29.7 |
| Existing Fund credit 1/ | | | | | | | | | | | |
| In millions of SDRs | 134.7 | 127.3 | 113.3 | 95.8 | 72.5 | 47.9 | 27.7 | 14.2 | 4.2 | 0.0 | ... |
| In percent of exports 2/ | 39.6 | 31.8 | 25.8 | 19.8 | 13.8 | 8.4 | 4.5 | 2.1 | 0.6 | 0.0 | ... |
| In percent of external debt | 20.3 | 17.1 | 14.1 | 11.3 | 8.0 | 4.9 | 2.7 | 1.3 | 0.4 | 0.0 | ... |
| In percent of gross reserves | 56.0 | 49.3 | 42.9 | 36.0 | 25.6 | 15.8 | 8.6 | 4.2 | 1.2 | 0.0 | ... |
| In percent of quota | 146.4 | 138.4 | 123.1 | 104.2 | 78.8 | 52.0 | 30.1 | 15.5 | 4.5 | 0.0 | ... |
| Prospective Fund credit 1/ | | | | | | | | | | | |
| In millions of SDRs | ... | 20.0 | 40.0 | 60.0 | 69.0 | 69.0 | 68.0 | 63.0 | 56.1 | 41.1 | 27.3 |
| In percent of exports 2/ | ... | 5.0 | 9.1 | 12.4 | 13.2 | 12.1 | 11.0 | 9.4 | 7.7 | 5.2 | 3.2 |
| In percent of external debt | ... | 2.7 | 5.0 | 7.1 | 7.6 | 7.1 | 6.6 | 5.7 | 4.7 | 3.2 | 2.0 |
| In percent of gross reserves | ... | 7.8 | 15.2 | 22.5 | 24.4 | 22.7 | 21.1 | 18.5 | 15.5 | 10.7 | 6.7 |
| In percent of quota | ... | 21.7 | 43.5 | 65.2 | 75.0 | 75.0 | 73.9 | 68.5 | 61.0 | 44.7 | 29.7 |
| Repurchases, repayments, and charges due from existing and prospective drawings | | | | | | | | | | | |
| In millions of SDRs | ... | 8.9 | 15.7 | 18.8 | 24.4 | 25.4 | 21.7 | 18.9 | 17.3 | 19.4 | 14.0 |
| In percent of exports 2/ | ... | 2.2 | 3.6 | 3.9 | 4.7 | 4.5 | 3.5 | 2.8 | 2.4 | 2.5 | 1.6 |
| In percent of external debt | ... | 1.2 | 2.0 | 2.2 | 2.7 | 2.6 | 2.1 | 1.7 | 1.5 | 1.5 | 1.0 |
| In percent of gross reserves | ... | 3.5 | 6.0 | 7.1 | 8.6 | 8.4 | 6.7 | 5.5 | 4.8 | 5.1 | 3.4 |
| In percent of quota | ... | 9.7 | 17.1 | 20.5 | 26.5 | 27.6 | 23.6 | 20.5 | 18.8 | 21.1 | 15.2 |
| Repurchases and charges due from existing drawings | | | | | | | | | | | |
| In millions of SDRs | ... | 8.8 | 15.6 | 18.6 | 24.1 | 25.1 | 20.4 | 13.5 | 10.1 | 4.2 | ... |
| In percent of exports 2/ | ... | 2.2 | 3.5 | 3.8 | 4.6 | 4.4 | 3.3 | 2.0 | 1.4 | 0.5 | ... |
| In percent of external debt | ... | 1.2 | 1.9 | 2.2 | 2.7 | 2.6 | 2.0 | 1.2 | 0.9 | 0.3 | ... |
| In percent of gross reserves | ... | 3.4 | 5.9 | 7.0 | 8.5 | 8.2 | 6.3 | 4.0 | 2.8 | 1.1 | ... |
| In percent of quota | ... | 9.6 | 16.9 | 20.2 | 26.2 | 27.2 | 22.1 | 14.7 | 11.0 | 4.6 | ... |
| Repurchases and charges due from prospective drawings | | | | | | | | | | | |
| In millions of SDRs | ... | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 1.3 | 5.3 | 7.2 | 15.2 | 14.0 |
| In percent of exports 2/ | ... | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.8 | 1.0 | 1.9 | 1.6 |
| In percent of external debt | ... | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.5 | 0.6 | 1.2 | 1.0 |
| In percent of gross reserves | ... | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.4 | 1.6 | 2.0 | 4.0 | 3.4 |
| In percent of quota | ... | 0.1 | 0.2 | 0.3 | 0.4 | 0.4 | 1.5 | 5.8 | 7.8 | 16.5 | 15.2 |

Sources: Armenian authorities; and Fund staff estimates.

1/ End of period.

2/ Exports of goods and services.

Table 12. Armenia: Downside Risk Medium-Term Balance of Payments and External Debt Projections, 1998-2010

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|-------------------------------|-------|-------|--------|--------|--------|--------|-------------|--------|--------|--------|--------|--------|
| | | | Prel. | Prog. | | | | Projections | | | | | |
| | (in millions of U.S. dollars) | | | | | | | | | | | | |
| Current account | -403 | -307 | -279 | -294 | -277 | -264 | -276 | -289 | -308 | -318 | -329 | -340 | -348 |
| Net exports of goods and services | -640 | -536 | -521 | -536 | -521 | -512 | -527 | -542 | -558 | -573 | -589 | -604 | -620 |
| Exports | 360 | 383 | 443 | 522 | 560 | 603 | 639 | 678 | 719 | 762 | 808 | 856 | 908 |
| Imports | -1,000 | -919 | -965 | -1,058 | -1,082 | -1,115 | -1,166 | -1,220 | -1,277 | -1,335 | -1,397 | -1,460 | -1,528 |
| Income excl. workers' remittances (net) | -22 | -24 | -24 | -36 | -50 | -64 | -78 | -95 | -121 | -141 | -163 | -188 | -211 |
| Workers' remittances and private transfers (net) | 147 | 159 | 164 | 178 | 194 | 212 | 227 | 243 | 264 | 286 | 310 | 337 | 365 |
| Official transfers (net) | 113 | 94 | 103 | 100 | 100 | 100 | 102 | 105 | 107 | 110 | 112 | 115 | 117 |
| Capital and financial account | 406 | 311 | 290 | 250 | 220 | 224 | 236 | 239 | 247 | 256 | 264 | 273 | 278 |
| Capital transfers (net) | 10 | 13 | 28 | 70 | 60 | 20 | 20 | 20 | 20 | 20 | 20 | 20 | 20 |
| Foreign direct investments (net) | 221 | 122 | 104 | 140 | 115 | 115 | 115 | 115 | 115 | 115 | 115 | 115 | 115 |
| Portfolio investments (net) | -16 | 2 | -19 | 0 | 0 | 0 | 10 | 10 | 10 | 10 | 10 | 10 | 10 |
| Public sector (net) | 34 | 84 | 46 | 41 | 45 | 49 | 51 | 54 | 57 | 61 | 64 | 68 | 73 |
| Disbursements | 105 | 102 | 70 | 68 | 75 | 78 | 94 | 78 | 85 | 90 | 83 | 89 | 95 |
| Amortizations | -71 | -18 | -24 | -27 | -29 | -29 | -43 | -24 | -28 | -29 | -18 | -20 | -23 |
| Other capital inflows (net) 1/ | 158 | 90 | 130 | 0 | 0 | 40 | 40 | 40 | 45 | 50 | 55 | 60 | 60 |
| Overall balance | 4 | 4 | 11 | -45 | -57 | -40 | -40 | -50 | -61 | -62 | -65 | -67 | -71 |
| Net international reserves (- increase) 2/ | -4 | -5 | -34 | -32 | -26 | -26 | -37 | -51 | -46 | -43 | -42 | -46 | -40 |
| Arrears and debt relief (net) | | 1 | 23 | -19 | | | | | | | | | |
| Financing gap 2/ | | | | 96 | 83 | 66 | 77 | 101 | 107 | 106 | 107 | 113 | 110 |
| IMF | | | | 26 | 26 | 26 | 12 | | | | | | |
| World Bank | | | | 50 | 30 | 10 | 0 | | | | | | |
| Other | | | | 20 | 27 | 30 | 65 | | | | | | |
| | (in percent of GDP) | | | | | | | | | | | | |
| Current account | -21.2 | -16.6 | -14.6 | -14.1 | -12.4 | -11.0 | -10.8 | -10.7 | -10.8 | -10.5 | -10.2 | -10.0 | -9.6 |
| Net exports of goods and services | -33.7 | -29.0 | -27.2 | -25.7 | -23.3 | -21.4 | -20.7 | -20.1 | -19.5 | -18.9 | -18.3 | -17.7 | -17.1 |
| Exports | 18.9 | 20.7 | 23.2 | 25.0 | 25.0 | 25.2 | 25.1 | 25.1 | 25.1 | 25.1 | 25.1 | 25.1 | 25.0 |
| Imports | -52.7 | -49.8 | -50.4 | -50.6 | -48.3 | -46.5 | -45.9 | -45.2 | -44.6 | -44.0 | -43.4 | -42.7 | -42.1 |
| Income excl. workers' remittances (net) | -1.2 | -1.3 | -1.3 | -1.7 | -2.2 | -2.7 | -3.1 | -3.5 | -4.2 | -4.6 | -5.1 | -5.5 | -5.8 |
| Workers' remittances and private transfers (net) | 7.7 | 8.6 | 8.6 | 8.5 | 8.7 | 8.8 | 8.9 | 9.0 | 9.2 | 9.4 | 9.6 | 9.8 | 10.1 |
| Official transfers (net) | 5.9 | 5.1 | 5.4 | 4.8 | 4.5 | 4.2 | 4.0 | 3.9 | 3.7 | 3.6 | 3.5 | 3.4 | 3.2 |
| Capital and financial account | 21.4 | 16.8 | 15.1 | 11.9 | 9.8 | 9.4 | 9.3 | 8.9 | 8.6 | 8.4 | 8.2 | 8.0 | 7.7 |
| Capital transfers (net) | 0.5 | 0.7 | 1.5 | 3.3 | 2.7 | 0.8 | 0.8 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 |
| Foreign direct investments (net) | 11.6 | 6.6 | 5.4 | 6.7 | 5.1 | 4.8 | 4.5 | 4.3 | 4.0 | 3.8 | 3.6 | 3.4 | 3.2 |
| Portfolio investments (net) | -0.8 | 0.1 | -1.0 | 0.0 | 0.0 | 0.0 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Public sector (net) | 1.8 | 4.6 | 2.4 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Disbursements | 5.5 | 5.5 | 3.7 | 3.3 | 3.3 | 3.2 | 3.7 | 2.9 | 3.0 | 3.0 | 2.6 | 2.6 | 2.6 |
| Amortizations | -3.7 | -1.0 | -1.3 | -1.3 | -1.3 | -1.2 | -1.7 | -0.9 | -1.0 | -1.0 | -0.6 | -0.6 | -0.6 |
| Other capital inflows (net) 1/ | 8.3 | 4.9 | 6.8 | 0.0 | 0.0 | 1.7 | 1.6 | 1.5 | 1.6 | 1.6 | 1.7 | 1.8 | 1.7 |
| Overall balance | 0.2 | 0.2 | 0.6 | -2.1 | -2.5 | -1.7 | -1.6 | -1.9 | -2.1 | -2.0 | -2.0 | -2.0 | -2.0 |
| Net international reserves (- increase) 2/ | -0.2 | -0.3 | -1.8 | -1.5 | -1.2 | -1.1 | -1.4 | -1.9 | -1.6 | -1.4 | -1.3 | -1.3 | -1.1 |
| Arrears, debt relief and financing gap 2/ | | 0.1 | 1.2 | 3.7 | 3.7 | 2.8 | 3.0 | 3.7 | 3.7 | 3.5 | 3.3 | 3.3 | 3.0 |
| Memorandum items: | (in units indicated) | | | | | | | | | | | | |
| Current account excluding official transfers | | | | | | | | | | | | | |
| (in millions of U.S. dollars) | -515 | -401 | -382 | -394 | -377 | -364 | -378 | -394 | -415 | -427 | -441 | -455 | -466 |
| (in percent of GDP) | -27.1 | -21.7 | -19.9 | -18.9 | -16.9 | -15.2 | -14.9 | -14.6 | -14.5 | -14.1 | -13.7 | -13.3 | -12.8 |
| External PV debt 3/ 4/ | 144 | 154 | 135 | 128 | 124 | 122 | 126 | 133 | 142 | 151 | 161 | 170 | 179 |
| External debt service 3/ | 19.0 | 14.3 | 10.6 | 15.0 | 12.3 | 12.8 | 14.7 | 11.7 | 11.4 | 11.5 | 9.3 | 10.1 | 9.7 |
| Gross reserves (end of period) 5/ | 3.9 | 3.8 | 3.6 | 3.7 | 3.7 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Real GDP (percent change) | 7.2 | 3.3 | 6.0 | 6.5 | 4.0 | 4.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Percent change in nominal dollar values of | | | | | | | | | | | | | |
| Exports of goods and services | 8.9 | 6.5 | 15.7 | 17.7 | 7.4 | 7.6 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Imports of goods and services | 5.0 | -8.1 | 5.0 | 9.7 | 2.2 | 3.1 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 |
| GDP | 15.9 | -2.8 | 3.6 | 9.2 | 7.1 | 7.1 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 |
| Of which: Domestic demand | 12.3 | -6.2 | 2.2 | 7.8 | 5.1 | 5.5 | 5.5 | 5.5 | 5.6 | 5.5 | 5.6 | 5.5 | 5.6 |

Sources: Armenian authorities; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Prospective disbursements under the PRGF are included in the financing gap and excluded from net international reserves.

3/ Medium- and long-term public and publicly guaranteed debt/debt service in percent of exports of goods and services.

4/ Three year moving average of exports of goods and services centered on the preceeding year.

5/ In months of next year's imports of goods and services.

Table 13. Armenia: Debt Sustainability Analysis, 1998-2010
(In units indicated)

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|------|------|-------|-------|------|------|------|-------------|------|------|------|------|------|
| | | | Prel. | Prog. | | | | Projections | | | | | |
| Baseline scenario | | | | | | | | | | | | | |
| Present value of debt | | | | | | | | | | | | | |
| In percent of exports 1/ | 144 | 154 | 135 | 128 | 119 | 112 | 110 | 110 | 110 | 111 | 112 | 114 | 116 |
| In percent of fiscal revenue 2/ | 150 | 167 | 179 | 172 | 154 | 146 | 139 | 137 | 136 | 137 | 140 | 143 | 146 |
| Debt service | | | | | | | | | | | | | |
| In percent of exports 1/ | 19 | 14 | 11 | 15 | 12 | 12 | 13 | 10 | 9 | 9 | 7 | 7 | 6 |
| In percent of fiscal revenue 2/ | 22 | 17 | 16 | 24 | 17 | 17 | 18 | 14 | 13 | 12 | 9 | 10 | 9 |
| Downside risk scenario | | | | | | | | | | | | | |
| Present value of debt | | | | | | | | | | | | | |
| In percent of exports 1/ | | | | | 124 | 122 | 126 | 133 | 142 | 151 | 161 | 170 | 179 |
| In percent of fiscal revenue 2/ | | | | | 162 | 161 | 161 | 167 | 177 | 188 | 200 | 212 | 222 |
| Debt service | | | | | | | | | | | | | |
| In percent of exports 1/ | | | | | 12 | 13 | 15 | 12 | 11 | 12 | 9 | 10 | 10 |
| In percent of fiscal revenue 2/ | | | | | 18 | 18 | 20 | 16 | 15 | 15 | 12 | 13 | 13 |
| Restructuring under Georgia-like terms in downside risk scenario 3/ | | | | | | | | | | | | | |
| Present value of debt | | | | | | | | | | | | | |
| In percent of exports 1/ | | | | | | | | | | 150 | 161 | 170 | 179 |
| In percent of fiscal revenue 2/ | | | | | | | | | | 187 | 200 | 212 | 222 |
| Debt service | | | | | | | | | | | | | |
| In percent of exports 1/ | | | | | | | | | | 12 | 9 | 9 | 10 |
| In percent of fiscal revenue 2/ | | | | | | | | | | 15 | 12 | 12 | 13 |
| Restructuring under Naples terms in downside risk scenario | | | | | | | | | | | | | |
| Present value of debt 4/ | | | | | | | | | | | | | |
| In percent of exports 1/ | | | | | | | | | | 149 | 158 | 166 | 123 |
| In percent of fiscal revenue 2/ | | | | | | | | | | 186 | 196 | 206 | 152 |
| Debt service | | | | | | | | | | | | | |
| In percent of exports 1/ | | | | | | | | | | 12 | 5 | 6 | 6 |
| In percent of fiscal revenue 2/ | | | | | | | | | | 15 | 7 | 8 | 8 |

Sources: Armenian authorities; and Fund staff estimates.

1/ Exports of goods and services; three-year moving average centered on the preceding year.

2/ Central government revenue excluding grants.

3/ Paris Club Agreed Minute on the Consolidation of the Debt of the Republic of Georgia, March 6, 2001.

4/ In 2010, after a stock of debt operation following the satisfactory three-year track record under the end-2007 rescheduling agreement.

Table 14. Armenia: Review and Phasing of Disbursements
Under the Requested PRGF Arrangement

| Date of Disbursement | Conditions | Amount (In millions of SDRs) |
|----------------------|--|---------------------------------|
| Upon Board approval | Board approval of the PRGF Arrangement | 10.00 |
| September 2001 | Completion of first review (end-June 2001 test date) | 10.00 |
| March 2002 | Completion of second review (end-December 2001 test date) | 10.00 |
| September 2002 | Completion of third review (end-June 2002 test date) | 10.00 |
| March 2003 | Completion of fourth review (end-December 2002 test date) | 10.00 |
| September 2003 | Completion of fifth review (end-June 2003 test date) | 10.00 |
| March 2004 | Completion of sixth review (end-December 2003 test date) | 9.00 |

Armenia: Fund Relations
(As of December 31, 2000)

I. Membership Status: Joined 05/28/1992; Article VIII

| II. General Resources Account: | SDR Million | Percent of Quota |
|---------------------------------------|--------------------|-------------------------|
| Quota | 92.00 | 100.0 |
| Fund holdings of currency | 117.32 | 127.5 |

| III. SDR Department: | SDR Million | Percent of Allocation |
|-----------------------------|--------------------|------------------------------|
| Holdings | 16.54 | N/A |

| IV. Outstanding Purchases and Loans: | SDR Million | Percent of Quota |
|---|--------------------|-------------------------|
| Systemic Transformation Facility | 25.31 | 27.5 |
| PRGF arrangements | 109.35 | 118.9 |

V. Financial Arrangements:

| <u>Type</u> | <u>Approval Date</u> | <u>Expiration Date</u> | <u>Amount Approved (SDR Million)</u> | <u>Amount Drawn (SDR Million)</u> |
|-------------|----------------------|------------------------|--------------------------------------|-----------------------------------|
| ESAF/PRGF | 02/14/1996 | 12/20/1999 | 109.35 | 109.35 |
| Stand-by | 06/28/1995 | 02/14/1996 | 43.88 | 13.50 |

VI. Projected Obligations to Fund (SDR Million; based on existing use of resources and present holdings of SDRs):

| | <u>Overdue</u> | <u>Forthcoming</u> | | | | |
|------------------|-------------------|--------------------|-------------|-------------|-------------|-------------|
| | <u>12/31/2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> |
| Principal | | 7.3 | 14.1 | 17.4 | 23.3 | 24.7 |
| Charges/Interest | | 1.8 | 1.4 | 1.1 | 0.7 | 0.4 |
| Total | | 9.1 | 15.5 | 18.5 | 24.0 | 25.1 |

VII. Exchange Rate Arrangement:

(a) On November 22, 1993, the Republic of Armenia introduced its national currency, the dram, at a rate of 200 Armenian rubles per dram. Subsequently, the exchange rate has been allowed to float in a defacto managed float regime. The official exchange rate is set on a daily basis as a weighted average of the previous day's interbank exchange rates.

(b) Armenia maintains no exchange restrictions.

VIII. Article IV Consultations:

(a) Armenia is on a 12-month consultation cycle

(b) The 1999 Article IV Consultation with Armenia was concluded on October 8, 1999.

IX. Technical Assistance:

See Appendix III.

X. Resident Representative:

Mr. Garbis Iradian assumed the position of resident representative in Armenia in July 2000.

XI. Resident Advisors:

A peripatetic MAE banking supervision advisor, assigned to the CBA in October 1997, completed his assignment in July 1999. A resident advisor in monetary policy and foreign exchange management was assigned from November 1997 to November 1998. The latter has been replaced by a peripatetic MAE monetary operations advisor since 1999. A new resident advisor in banking supervision has been assigned to the CBA since April 2000. An FAD resident advisor, assigned to the MFE to supervise the development of the Treasury, started his assignment in September 1998.

**Armenia: Relations with Multilaterals
(As of December 31, 2000)**

World Bank

The Republic of Armenia joined the International Bank for Reconstruction and Development (IBRD) in September 1992. The first project, and only IBRD loan to date, was an Institution Building Loan (US\$12.0 million approved in March 1993), to support implementation of the government's reform program in the areas of financial sector reform, enterprise reform and privatization, mobilization of fiscal revenue, and social and employment services.

The first IDA credit was granted to Armenia in February 1994 (an **Earthquake Rehabilitation Credit** for US\$28.0 million). To date, a total of 22 IDA credits have been approved across a number of sectors. Investment credits approved to date include a **Highway Rehabilitation Credit** (US\$31.0 million), an **Enterprise Development Project** (US\$16.7 million), a **Social Investment Fund** (US\$12.0 million), a **Health Credit** (US\$10.0 million), an **Education Credit** (US\$15.0 million), an **Agriculture Reform Credit** (US\$14.5 million), a **Title Registration Project** (US\$8.0 million), and a **Municipal Development Project** (US\$30.0 million). Most recently, in 1999-2000 an **Electricity Transmission and Distribution Adaptable Program Loan** (US\$21.0 million), an **Irrigation Dam Safety Credit** (US\$26.6 million), a **Transport Credit** (US\$40.0 million) the **Second Social Investment Fund Credit** (US\$20.0 million) and the **Judicial Reform Credit** (US\$11.4 million) were approved. Disbursements against these investment credits now total roughly US\$169.2 million, against commitments of US\$340.9 million approved.

Adjustment lending began in February 1995 with the approval of the US\$60.0 million **Economic Rehabilitation Credit**. In February 1996 this was followed by the first **Structural Adjustment Credit** (SAC) of US\$60 million and an accompanying **Technical Assistance Credit** (SATAC) of US\$3.8 million. **SAC II** (US\$60.0) million and **SATAC II** (US\$5.0 million) were approved on August 26, 1997. The adjustment loans above were all fully disbursed on satisfactory completion of the reform programs they supported. Disbursements to date under the technical assistance credits stand at US\$2.7 million for SATAC I, and US\$2.4 million for SATAC II. On December 1998 a **SAC III** for US\$65.0 million was approved, of which four tranches, totaling US\$63.4 million was disbursed. Total approved adjustment lending to date totals US\$245 million, and technical assistance financing (including the Institution Building Loan) provided totals US\$20.8 million.

World Bank lending to Armenia to date totals US\$606.7 million, of which US\$424.4 million has been disbursed to date. Of the 22 IDA credits and one IBRD loan approved, 15 remain under implementation, and eight have closed.

A second Country Assistance Strategy was presented to the World Bank's Board of Directors in August 1997, which envisaged lending of up to US\$260 million from blended resources

over the FY98-00 period. A third Country Assistance Strategy is under preparation and is scheduled to be presented to the World Bank's Board of Directors in Spring 2001.

Table 1. List of World Bank Lending to Armenia

| | Active Projects | Credit amount as of 12/31/00 | Disbursement as of 12/31/00 | Approval Date | Closing Date |
|-----|----------------------------------|------------------------------|-----------------------------|---------------|--------------|
| | Total | 606.7 | 429.6 | | |
| | Active Projects | 304.2 | 128.7 | | |
| 1 | Irrigation Rehabilitation | 43.0 | 37.9 | 12/8/94 | 05/31/01 |
| 2 | Highway | 31.0 | 29.6 | 09/14/95 | 12/31/00 |
| 3. | Social Investment Fund | 12.0 | 11 | 11/9/95 | 12/31/01 |
| 4. | Enterprise Development | 16.7 | 13.8 | 12/24/96 | 07/1/02 |
| 5. | Health | 10.0 | 2.7 | 07/29/97 | 06/30/02 |
| 6. | SATAC II | 5.0 | 2.4 | 08/26/97 | 06/30/02 |
| 7. | Education | 15.0 | 9.8 | 11/20/97 | 06/30/02 |
| 8. | Agriculture Reform Support | 14.5 | 9.4 | 01/27/98 | 12/31/02 |
| 9. | Municipal Development | 30.0 | 7.4 | 06/11/98 | 12/31/03 |
| 10. | Title Registration | 8.0 | 1.6 | 10/13/98 | 12/31/02 |
| 11. | Electric. Transm. & Distribution | 21.0 | 1.3 | 03/4/99 | 06/30/02 |
| 12. | Irrigation Dam Safety | 26.6 | 1.3 | 06/24/99 | 03/31/05 |
| 13. | Transport | 40.0 | 0.0 | 06/08/00 | 31/12/04 |
| 14. | Social Investment Fund II | 20.0 | 0.5 | 05/11/00 | 12/31/05 |
| 15. | Judicial Reform | 11.4 | 0.0 | 09/14/00 | 12/30/04 |
| | Completed Projects: | 302.5 | 300.9 | | |
| 16. | Institution Building | 12.0 | 10.7 | 03/30/93 | 11/30/97 |
| 17. | Earthquake Rehabilitation | 28.0 | 29.7 | 02/01/94 | 06/30/97 |
| 18. | Power Maintenance | 13.7 | 13.2 | 12/08/94 | 06/30/99 |
| 19. | Economic Rehabilitation | 60.0 | 64.3 | 02/28/95 | 06/30/96 |
| 20. | SAC | 60.0 | 58.5 | 02/29/96 | 12/31/97 |
| 21. | SAC II | 60.0 | 58.6 | 08/26/97 | 06/30/99 |
| 22. | SATAC I | 3.8 | 2.7 | 02/29/96 | 06/30/00 |
| 23. | SAC III | 65.0 | 63.4 | 12/22/98 | 06/30/01 |

European Bank for Reconstruction and Development (EBRD)

As of mid-2000, the EBRD had signed three government guaranteed projects in Armenia. In March 1993 the EBRD approved a ECU 52.4 million loan for construction on the Hrazdan thermal power plant, aimed at the eventual closure of Armenia's nuclear plant in Medzamor. The government is contemplating the privatization of Hrazdan as the completion of this plant, which has been estimated recently to cost a further US\$120 million, is constrained by limited budgetary resources. The EBRD has an arrangement for funding of technical assistance for the Hrazdan privatization prospectus and continues to advise on the privatization process. In November 1994, an ECU 18.9 million loan to build an air cargo terminal in Zvartnots Airport as signed. A Wholesale Food Market Project loan was agreed in early 1996 for EC 13 million, including ECU 3 million as a line of credit for on-lending to food producers. However, the project encountered serious difficulties, which slowed down implementation, with disbursements amounting to under ECU 1 million by mid-1998. The EBRD and the government agreed to cancel the outstanding amount of the loan and to reconsider the project once a temporary market operates at full capacity.

Currently, EBRD is actively supporting the pending privatization of the electricity distribution system. If the privatization of the system is carried out in a manner that complies with international standards, EBRD is committed to take an equity position of up to 20 percent (for a maximum of US\$20 million) in the privatized companies. Furthermore, EBRD is considering the possibility of investing in equity and providing financing to the privatized Armentel for the expansion and modernization of the national telecommunications network. It has extended a loan to the Arak Brandy factory which was recently sold to the French Pernod company. A small multi-bank onlending facility was activated in early 2000; should the initial experience prove positive, EBRD is committed to further expand lending under this facility.

Armenia: Fund Technical Assistance Missions, 1998-2000^{1/}

| Subject | Type of Mission | Timing | Counterpart |
|---|---|--|---------------------------------------|
| Fiscal Affairs Department | | | |
| Development of Treasury | Resident Advisor | From September 1998 | MFE |
| Tax Policy | Expert Team Visit | March 1 – 12, 1999 | MFE and Ministry of Nature Protection |
| Tax Administration Mission | Technical Assistance | Feb. 28 – March 13, 2000 | MFE and Ministry of State Revenue |
| Tax Policy and Administration | Visit of an Armenian Delegation in Washington, DC | August 7 – 11, 2000 | MFE and Ministry of State Revenue |
| Monetary and Exchange Affairs Department | | | |
| Monetary and Foreign Exchange Operations | Long-Term Expert | November 1997 – November 1998 | CBA |
| Bank Supervision | Short-Term Expert | Periodic Visits 1998 – 1999 | CBA |
| Monetary and Foreign Exchange Operations | Technical Assistance | January 20 – February 3, 1998 | CBA |
| Monetary Policy and OPS/BKG Sector Issues | Technical Assistance | November 09 – November 13, 1998 | CBA |
| Monetary Operations and Bank Supervision | Technical Assistance | February 21 – March 05, 1999 | CBA |
| Monetary Operations | Short-Term Expert | Periodic Visits 1999 - 2000 | CBA |
| Bank Supervision | Long-Term Expert | Since April 2000 | CBA |
| Monetary Policy Research | Short-Term Expert | April 28 – May 04, 2000 | CBA |
| Financial Sector Assessment Program | Financial Sector Assessment Program | September 5 – September 22, 2000 and January 24 – January 26, 2001 | CBA |
| Statistics Department | | | |
| Multisector | Technical Assistance | October 26 – November 11, 1998 | MFE, CBA, Ministry of Statistics |
| National Accounts Statistics | Technical Assistance | August 3-16, 1999 | Ministry of Statistics |
| Balance of Payments Statistics | Technical Assistance | September 7 – October 4, 1999 | Ministry of Statistics |
| Data Dissemination Standards | Technical Assistance | August 29 – September 11, 2000 | National Statistics Service |

1/ For Technical Assistance missions prior to 1998, see EBS/98/213.

Armenia: Statistical Issues

The overall quality, timeliness and coverage of macroeconomic statistics in Armenia have improved significantly over the past few years, in part owing especially to technical assistance from MAE, FAD and STA. Since September 1997, an Armenia country page has been added to the IFS. However, further improvement is needed in the real and external sectors areas in order to enhance the design and monitoring of economic policies. Table 1 shows the availability of core statistical data, and the authorities' publication policy.

National accounts and price statistics

The Ministry of Statistics (now National Statistics Service) has already made significant changes to the national accounts methodology to bring it more in line with international practice. Good progress has been made in developing estimates of quarterly GDP at 1996 prices, which have already been published. Basic data collection procedures have also been improved, with national accounts adopting the concept of gross value based on accrued sales valued at transaction prices. However, progress has been slow in collecting data by discrete time periods and national accounts data at constant prices are still derived by comparable prices instead of the producer price index, which suffers from inadequate coverage. With STA assistance, the consumer price index program is in place and CPI data are current. With respect to wage data, coverage is still limited to the public sector.

Fiscal statistics

Fiscal data have problems with respect to both timeliness and quality. Revenue and cash expenditure data for the republican budget are available on a daily basis, with a lag of one to two days. Reporting of arrears has been improved by introducing regular reports from line ministries on outstanding obligations due but not yet paid. However, there have been delays in providing these reports to the treasury. In addition, the treasury has only limited possibilities to audit the reports. The treasury is in the process of implementing measures designed to improve this situation. Expenditures are reported in line with GFS standards. There remain significant shortcomings in the timeliness and quality of data on the transactions of local governments.

Money and banking statistics

Money and banking statistics are provided on a timely basis. Data on CBA accounts are available daily, with a one day lag, while the monetary survey is provided weekly with a one week lag. The CBA provides monetary statistics on exchange rates and interest rates with a very short lag. A new chart of accounts, relying on the IAS, was introduced in January 1998 and since then the balance sheets of the Monetary Authority and of the Deposit Money Banks follow IAS methodology. Some improvement is however needed in the area of interest rates, in order to decompose data on commercial operations from data on special operations done at a non-commercial interest rates.

External Sector statistics

The coverage of external sector data has improved in recent years. The trade statistics are provided on a timely basis, and directions of trade statistics as well as trade data by type of commodity are available with a few weeks lag. Information on the remaining items of the balance of payments is adequate in terms of coverage, and timeliness, as information is available quarterly with a lag of about two months.

Table 2. Armenia: Core Statistical Indicators

| | Exchange Rates | International Reserves | Central Bank Balance Sheet | Monetary Survey | Interest Rates | Consumer Price Index | Exports/ Imports | Balance of payments | Central Government Balance | GDP | External Debt |
|----------------------------|----------------|------------------------|----------------------------|-----------------|-----------------|----------------------|------------------|---------------------|----------------------------|---------------|---------------|
| Date of Latest Observation | 02/08/01 | 02/08/01 | 02/08/01 ¹ | 02/02/01 | January 2001 | January 2001 | December 2000 | Q3 2000 | December 2000 | December 2000 | December 2000 |
| Date Received | 02/12/01 | 02/12/01 | 02/12/01 | 02/06/00 | 02/12/01 | 01/28/01 | 01/20/01 | 01/20/01 | 01/16/01 | 01/11/01 | 01/20/01 |
| Frequency of Data | Daily | Daily | Daily | Weekly | 2-3 times/ week | Monthly | Monthly | Quarterly | Monthly | Quarterly | Quarterly |
| Frequency of reporting | Weekly | Weekly | Weekly | Weekly | Weekly | Monthly | Monthly | Quarterly | Monthly | Quarterly | Quarterly |
| Source of Update | CBA | CBA | CBA | CBA | CBA | NSS | NSS | NSS | MFE | NSS | MFE |
| Mode of Reporting | Email | Email | Email | Email | Email | Fax | Email | Email | Fax | Fax | Fax |
| Confidentiality | Public | - | Public | - | Public | Public | Public | Public | Public | Public | - |
| Frequency of Publication | Daily | Quarterly | Quarterly | Monthly | Monthly | Monthly | Monthly | Annually | Monthly | Quarterly | Annually |

1/ Summary of key aggregates. In general, summary information on key central bank aggregates is available at short notice upon request.

Abbreviations: CBA — Central Bank of Armenia, MFE — Ministry of Finance and Economy, NSS — National Statistics Service

Armenia—Medium Term Balance of Payments and External Debt Outlook

1. The staff's medium term balance of payments and external debt projections extend through 2010. For the PRGF-supported program period (2001-03) the projections take into account ongoing foreign investment projects in tourism, and in the mining, aluminum processing, and diamond industries, which will significantly increase Armenia's capacity to export. Only existing project commitments are incorporated into conservative external budgetary disbursement projections, but external grant inflows are projected to increase sharply in 2001 and 2002 owing to the implementation of major new projects financed by the Lincy Foundation (an NGO based in the United States financed by a member of the Armenian diaspora).

2. For the 2004-10 period, and in the absence of major external shocks or policy slippages, the expectation is that the economy will continue to expand rapidly, led by exports and financed mainly by buoyant FDI inflows predicated in part on the current low level of foreign investments in Armenia (FDI inflows did not commence in earnest until 1998). In an environment of continued price stability (no more than 3 percent annual inflation) investments are expected to remain at around 21-22 percent of GDP; nevertheless, economic growth is expected to slow down to 5 percent annually as the efficiency gains from the privatization process taper off. In addition, the projections incorporate the following specific assumptions:

- The real effective exchange rate remains constant at the end-2000 level;
- Merchandise exports will expand by 8½ percent annually (about 6½ percent in real terms);
- Underlying merchandise imports (total imports less humanitarian imports and imports of uncut diamonds) will expand by 5½ percent annually reflecting an elasticity of underlying import growth with respect to domestic demand of 0.8;
- Non-merchandise trade-related service items will grow in line with the growth of GDP;
- Workers' remittances and private transfers will grow in line with projected growth of GDP in Russia;
- Official transfers will remain constant in real terms;
- The externally financed fiscal deficit will remain at 2.0 percent of GDP;
- IDA investment credit disbursements will remain at \$45 million annually;
- Non-IDA disbursements are assumed to be repaid in 2011-20 and carry a rate of interest of 2.0 percent;

- The residual financing gap is assumed to be financed at a 5.0 percent rate of interest and to be repaid in 2011-20; and
- Gross reserves will remain at the equivalent of 3½ months of imports.¹

3. Public sector external debt is projected to roughly double over the coming decade, increasing from \$862 million in 2000 to \$1.8 billion in 2010. The average grant element is projected to fall from 38 percent in 2000 to 32 percent in 2010 as the higher share of the non-concessional financing gap debt more than offsets the increasingly more concessional regular budgetary debt. Consequently, PV debt is projected to increase from \$535 million in 2000 to \$1.2 billion in 2010.² Relative to exports (fiscal revenue), the PV debt ratio will fall from 135 percent (179 percent) to 116 percent (146 percent) over this period.³

4. As noted in paragraph 51, the medium term projections are subject to a high degree of uncertainty. First, while the outlook does not assume a resolution of the Nagorno-Karabakh issue and a reopening of regional trade routes, it is assumed that domestic political stability is maintained and that there are no major external trade shocks, but this assumption may not turn out to be valid. Second, significant progress toward addressing the financing gaps in the quasi-fiscal sectors is required for the government credibly to avoid a further buildup of external debt, which in turn will require politically difficult decisions. Third, the export base is narrow and volatile and the outlook, especially for tourism, is subject to a high degree of uncertainty.

5. It is difficult to quantify the possible effects of a less benign environment, but the 10 percent decrease in export earnings in 1997, following the loss of a major diamond contract, and the 9 percent decrease (in U.S. dollar terms) in fiscal revenues in 2000, following the political upheaval at the end of 1999, provide some indications of the magnitude of a possible future negative shock. In this perspective, the baseline projections are robust in that substantially higher shocks could be absorbed without rendering the external debt unsustainable. For instance, exports would have to fall by more than 60 percent from 2002 to 2003 in the baseline scenario in order for the PV debt/export ratio to exceed 150 percent in 2003.

¹ If the cumulative financing gap of \$358 million in 2004-10 were to remain unfilled, by 2010 gross reserves would be 1.1 months of imports and the PV debt/export ratio would be 83 percent.

² In, “Republic of Armenia, Georgia, Kyrgyz Republic, Republic of Moldova, and Republic of Tajikistan—External Debt and Fiscal Sustainability—Background Paper” (SM/01/36 Supplement 1), the PV of debt in 2010 was also projected at around \$1.2 billion.

³ Assuming that state budget revenues remain at 19.0 percent of GDP from 2006 onwards.

6. The medium term projections are, however, substantially more sensitive to a permanent reduction in the assumed rate of growth of exports. An alternative downside risk scenario illustrates this well. This scenario assumes that FDI will be less buoyant, which in turn will affect export performance and economic growth. In the downside risk scenario (Table 12), FDI is assumed to average \$115 million annually over the 2002-10 period (about 1 percent of GDP lower than in the baseline scenario), and real merchandise export and real GDP growth are projected at 2½ and 2 percentage points lower, respectively, than in the baseline scenario. In this scenario, the current account position improves less and by 2010 the current account deficit is 9½ percent of GDP. In consequence, there would be no improvement in the PV debt/export ratio in the early part of the decade and in the second half of the decade the ratio would increase sharply and would exceed 150 percent from 2007 onwards.

7. In these circumstances of deteriorating debt indicators, creditors might not extend new credits as they might consider it unlikely that such credits would be repaid in full, and a different strategy may be required for external debt. For illustrative purposes, two hypothetical Paris Club rescheduling agreements at the end of 2007 (when the PV debt/export ratio would exceed 150 percent for the first time) are presented. The first, along the lines recently extended to Georgia, would not ensure that the PV debt/export ratio would fall back below 150 percent as the eligible debt service that could be consolidated in 2008-09 is not very large (Table 13). The same result would obtain, in the initial years, with a Paris Club rescheduling on Naples terms; in this case however, if a stock of debt operation were applied by end-2010, the PV debt/export ratio would fall to 123 percent, closer to the level projected in the baseline scenario.

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

April 26, 2001

Dear Mr. Köhler:

We are committed to moving ahead with an ambitious and far-reaching macroeconomic and structural reform program in the 2001-2003 period, which will build upon past reform efforts that have been financially supported by the IMF and the World Bank since 1994. Following the decline in output in the early 1990s, significant progress was made on macroeconomic stability and restoration of growth under the government's economic reform program during 1996-1999, supported by arrangements under the IMF's Enhanced Structural Adjustment Facility (ESAF) and by considerable World Bank assistance. At the same time, and despite the economic growth performance during this period, there has been very little progress in reducing poverty and income inequality, as reflected in the Interim Poverty Reduction Strategy Paper (IPRSP).

The Armenian economy weakened following the political assassinations in October 1999. The resulting political uncertainty led to a very significant deterioration in the fiscal position and a temporary slowdown in the real economy which only began to be reversed as the political situation stabilized in the course of 2000. In the fiscal area, there was a very substantial and rapid run-up in budgetary expenditure arrears beginning in the fourth quarter of 1999, reflecting the effects of the political situation on external financing and tax receipts. The government has already taken measures to improve tax revenues and there are clear signs of a revenue recovery starting in June 2000. In the real sector, the economy contracted in the fourth quarter of 1999 but real GDP began to recover starting in the second quarter of 2000, and growth accelerated in the remainder of 2000, despite a summer drought affecting a portion of agriculture.

The attached Memorandum of Economic and Financial Policies outlines our key macroeconomic objectives and policies for 2001 to 2003, which are designed to address these challenges, and objectives and policies for the first year of the program. At the center of the program is a sizeable fiscal adjustment that will be supported by structural reforms, in particular efforts to improve tax administration and expenditure control, and to improve governance. The memorandum also describes our initiatives to strengthen the banking system. The IPRSP, which was prepared by the government after extensive discussions with representatives of civil society and international institutions, lays out our broader structural reform efforts aimed at poverty reduction and economic growth.

In support of our economic adjustment and reform program, Armenia requests a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 69 million (75 percent of quota).

We are confident that the policies and measures described in the attached memorandum are adequate to achieve the objectives of the program. However, the government and the Central Bank of Armenia stand ready to take any other measures that may become appropriate for this purpose. In the period of the PRGF arrangement, the government and the Central Bank of Armenia will regularly consult with the IMF concerning additional measures that may become appropriate and will provide the IMF with such information as the IMF requests in connection with the progress of Armenia in implementing the policies and reaching the objectives of the program supported by the PRGF arrangement.

After the period of the arrangement, and while Armenia has outstanding financial obligations to the IMF from loans and earlier arrangements, the government will consult with the IMF on Armenia's economic and financial policies from time to time, at the initiative of the government or at the request of the Managing Director. Armenia will conduct with the IMF the first semi-annual review of its program before September 30, 2001, as described in the attached memorandum.

Sincerely yours,

/s/
Andranik Margaryan
Prime Minister
Republic of Armenia

/s/
Vartan Khachatryan
Minister of Finance and Economy

/s/
Tigran S. Sargsyan
Chairman of the Central Bank

Republic of Armenia

Memorandum of Economic and Financial Policies for 2001-2003

I. INTRODUCTION

1. We are committed to moving ahead with an ambitious and far-reaching macroeconomic and structural reform program in the 2001-2003 period, which will build upon past reform efforts that have been financially supported by the IMF and the World Bank since 1994. Following the decline in output in the early 1990s, significant progress was made on macroeconomic stability and restoration of growth under the government's economic reform program during 1996-1999, supported by arrangements under the IMF's Enhanced Structural Adjustment Facility (ESAF) and by considerable World Bank assistance. Period average CPI inflation declined from 175 percent in 1995, prior to the start of the ESAF, to 0.7 percent in 1999. Real growth, driven by construction and services, averaged around 5 percent over the program period, despite the effects of a drought and the impact of the Russian economic crisis. At the same time, however, despite the economic growth performance during this period, there has been very little progress in reducing poverty and income inequality, as reflected in the Interim Poverty Reduction Strategy Paper (IPRSP).
2. Non-inflationary monetary and fiscal policies contributed to this strong macroeconomic performance. The non-inflationary fiscal stance was facilitated by abundant official external financing. Inflation remained low in 1998-1999, even though program projections for broad money growth were exceeded in almost every quarter since late 1996, as money demand continued to respond more strongly than anticipated to the stabilization policies pursued. Nevertheless, there was a worrisome lack of progress in increasing exports, which contributed to the very rapid growth in external debt ratios (the external debt/export ratio increased from 127 percent at end-1995 to 223 percent at end-1999). In addition, real interest rates remained high, and there were frequent budgetary revenue shortfalls and problems with expenditure control.
3. Substantial progress was made in structural reforms during the period of the ESAF arrangements. Progress was achieved on banking system reform, establishment of a treasury, strengthening of the social safety net, and revising tax laws. Considerable reforms were also carried out in the quasi-fiscal sectors (including the energy, irrigation, and drinking water and sewage sectors)—improving collections and production efficiency, beginning the process of eliminating the culture of non-payment, improving the transparency of and budgeting for quasi-fiscal energy subsidies, and initiating the privatization of the sector.
4. The Armenian economy weakened following the political assassinations in October 1999. The resulting political uncertainty led to a very significant deterioration in the fiscal position and a temporary slowdown in the real economy which only began to be reversed as the political situation stabilized in the course of 2000. In the fiscal area, there was a very substantial and rapid run-up in budgetary expenditure arrears beginning in the fourth quarter of 1999, reflecting the effects of an unstable political situation on external financing and tax

receipts. The government has already taken measures to improve tax revenues and there are clear signs of a revenue recovery starting in June 2000. In the real sector, the economy contracted in the fourth quarter of 1999 but real GDP began to recover starting in the second quarter of 2000, and growth accelerated in the remainder of 2000, despite a summer drought affecting a portion of agriculture. Although consumer prices rose by almost 3½ percent in the last two months of the year, cumulative inflation for 2000 as a whole was only 0.4 percent.

II. THE MEDIUM-TERM STRATEGY

5. To address Armenia's remaining external and fiscal vulnerabilities, and to ensure a sustained resumption of economic growth as the cornerstone for efforts to reduce poverty, the government and the Central Bank of Armenia (CBA) have adopted a comprehensive and ambitious macroeconomic and structural adjustment program for the period January 2001-December 2003. Under this program, developed in collaboration with the staffs of the IMF and the World Bank, we intend to strengthen public finances to eliminate the outstanding stock of budgetary arrears, maintain a rate of monetary growth consistent with continued price stability, progressively eliminate financing gaps in the quasi-fiscal sectors, further improve regulation of the banking sector, and improve governance through increased transparency and reduced corruption. The envisaged reforms are consistent with the IPRSP, which sets out the main elements of the broader program aimed at achieving sustained, rapid growth and poverty reduction. The program will be modified appropriately once the Poverty Reduction Strategy Paper (PRSP) has been finalized.

Macroeconomic Objectives and Policies

6. Our medium-term strategy will be to implement appropriate monetary and fiscal policies, as well as structural reform and governance measures, in order to enhance Armenia's growth prospects. Macroeconomic policies will need to focus initially on raising budgetary revenues and clearing arrears, and on reducing the fiscal deficit gradually over time, while pursuing a monetary policy consistent with price stability. Major initiatives to implement structural reforms and strengthen governance will be essential for improving the overall business environment, encouraging more investment (including foreign direct investment), and stimulating export growth. These policies should also help reduce the external debt burden over time.

7. Armenia's growth is projected to average around 6 percent per annum during 2001-2003 and be broadly based, while annual inflation should be held to about 3 percent. Fiscal policy under the program will focus on a gradual decline in the deficit which would be in line with the need to slow the growth of Armenia's external debt. On the basis of present commitments of external financing, the fiscal deficit (accrual basis) is currently projected to decline, from about 6½ percent of GDP in 2000, to 3 percent in 2003. This deficit reduction, combined with net private investment that is around 7½-8 percent in both 2000 and 2003, would make possible a reduction of the current account deficit from 14½ percent in 2000 to 10½ percent in 2003.

Fiscal Policy

8. Fiscal policy will focus on: (i) gradually reducing the deficit and eliminating the stock of arrears; (ii) maintaining an appropriate balance between current and capital expenditures while reducing non-productive expenditure; (iii) rationalization of social expenditures and possibly increasing them; and (iv) achieving ambitious but realistic tax revenue targets.

9. Reliance on external financing is expected to decline over the program period, and it is our intention to avoid contracting any new non-concessional external debt obligations. We intend to continue our efforts to improve coordination of monetary and fiscal policies and the functioning of the treasury bill market, which should lead to a decline in interest rates on treasury bills over the medium term. In view of the modest stock of domestic debt, there may be some scope for increasing reliance on the issuance of government securities, although the scope for such financing is limited given the need to avoid crowding out of the private sector. The prohibition on net inter-quarter direct financing of the budget by the CBA has proven to be useful in contributing to macroeconomic stabilization, and it will continue.

10. Strengthening of tax collections will come largely from improved tax and customs administration, and through improved governance including increased transparency and reduced corruption. The government has already achieved progress in the reform of the tax system, in particular, the abolition of nuisance excise taxes, broadening the tax base (removal of exemptions under the VAT, personal and corporate income taxes, and mandatory social insurance contributions), and rationalization of tax rates. Additional measures will include the elimination of remaining tax exemptions and the unification of widely varying excise taxes on similar products, which currently provide opportunities for tax evasion or avoidance. Over the program period, as the administrative capacity for VAT refunds improves and interest rates decline, we will make every effort to extend collection of the VAT to the border for all eligible goods.

11. Improving expenditure efficiency will require a number of steps, including to: (i) improve and consolidate development of the treasury system; (ii) improve the internal audit function of the Ministry of Finance and Economy (MFE) and the line ministries; (iii) strengthen the government's capacity to assess potential public investment projects; (iv) improve the management of state debt (including both external and domestic debt); and (v) refine the Medium Term Expenditure Framework (MTEF) and integrate it into future budget preparations. The key goal of expenditure control will be the prevention of new expenditure arrears. To this end, we intend to implement measures to improve the procedures for recording and timely monitoring of expenditure arrears of the general government.

12. A key element of the MTEF will be the prudent utilization of privatization proceeds. Any expenditure financed by privatization proceeds will be done in the context of the medium term strategy that was prepared prior to the submission of the 2000 budget. We intend to review this strategy periodically as needed, in consultation with the IMF and World Bank staff, especially in connection with the annual budget submissions to the parliament. In reviewing such plans, explicit consideration will be given to identifying ways in which these funds would assist in the program to reduce poverty. We shall continue to follow the

principle that the bulk of proceeds in the Special Privatization Account (SPA) should be used for well thought out capital expenditures (one-off revenue should not be used to finance current expenditure) and the retirement of non-concessional external debt (given the high external debt burden). Any reduction in the present value of the stock of non-concessional external debt arising from debt rescheduling agreements could be used to reduce the amount to be devoted for the retirement of such debt. We will consult with the World Bank staff regarding the list of capital projects to be financed using SPA proceeds.

13. We are currently negotiating a possible restructuring of Armenia's debt to Russia (part of which is in arrears), and we remain hopeful that the prospective agreement with Russia—which might take the form of a debt/equity swap—will lead to a substantial reduction in the present value of Armenia's external debt. The government will submit to the parliament draft amendments to the 2001 budget law which will enable the government to repay external arrears to Russia by drawing down the SPA.

14. The nuclear power plant may soon need to finance the purchase of additional fuels and other necessary inputs. This purchase will be made either by drawing on an existing line of credit from Russia, for which the available balance is \$11.6 million, or by the government contracting or guaranteeing the contracting of a new non-concessional loan instead of drawing on the existing line of credit. Should the latter approach be followed, the government will not subsequently draw down the credit line's available balance and will—in the context of any debt restructuring agreement with Russia—request that the credit line be closed.

Monetary, Exchange Rate, and Trade Policies

15. Building on its success in maintaining low inflation during 1998-2000, the main objective of the CBA will be to implement a monetary policy consistent with its obligation under the law to maintain price stability. This objective will be accomplished through adherence to an indicative reserve money corridor, which will serve as the nominal anchor for monetary policy. The CBA will continue to maintain a flexible exchange rate policy and will only intervene in the foreign exchange market to smooth short-term exchange rate fluctuations. Given the CBA's reluctance to allow the exchange rate immediately to adjust fully to exchange market pressures, movements of reserve money toward the edges of the corridor will provide the CBA with a signal of the need to reassess its short-term credit and foreign exchange market policies. In the event that reserve money moves outside the corridor, the CBA will consult promptly with the IMF staff regarding the appropriate policy response.

16. The government will continue to coordinate closely with the CBA in order to smooth budgetary expenditures as much as possible in the event of bulky inflows of official external financing, or short-term bridging operations—which would only take place under extraordinary circumstances—involving the SPA. Any bridging operation would be coordinated in such a way between the MFE and the CBA that the reserve money corridor would not be breached. In this connection, and in light of the delay in the first disbursement under the SAC IV by several weeks, we have decided to borrow up to dram 5 billion from

the SPA temporarily, which will be repaid on receipt of the first SAC IV disbursement. Moreover, we recognize that continued independence of the CBA is essential for ensuring that monetary policy is conducted in a manner that is consistent with price stability.

17. Armenia maintains a liberal trading system with no nontariff barriers (for trade protection purposes) and no export taxes. Most imports enter the country duty-free, while goods subject to import duties are assessed a uniform 10 percent import duty. The payments system is also very liberal with no current account restrictions and only a few minor capital account restrictions (most of which are imposed for prudential reasons). The government will maintain this liberal trade and payments system, which has served Armenia well, and strive to integrate further the Armenian economy into the world economy. In the very near future the government expects to adopt the remaining regulatory and legal requirements for WTO admission with the hope of completing Armenia's accession to the WTO in 2001. Furthermore, the government will redouble its efforts to attract foreign direct investment through a strengthened public relations campaign abroad and an improved business environment at home.

18. During the period of the program, we will not: (i) impose or intensify restrictions on payments or transfers for current international transactions; (ii) introduce multiple currency practices; (iii) conclude bilateral payments agreements that are inconsistent with Article VIII of the IMF's Articles; or (iv) impose or intensify import restrictions for balance of payments reasons.

Balance of Payments and External Financing

19. The trade balance deficit (goods and services) is expected to narrow significantly from 27 percent of GDP in 2000 to 20½ percent of GDP in 2003 as exports will benefit from buoyant foreign direct investments into the diamond cutting, base metal, and tourism industries, while import demand is expected to remain subdued as new enterprises emerge and newly privatized industries improve business practices and gain a higher share of the domestic market. Part of the lower trade balance deficit is expected to be offset by higher outflows of profit remittances and lower official transfers; nevertheless, the external current account deficit is programmed to narrow by about 4 percentage points of GDP (in line with a targeted increase in public sector savings of a similar magnitude) to around 10½ percent of GDP by 2003. Over the program period, foreign direct investments are expected to provide the bulk of external financing as the government—cognizant of the need to limit the further build up of external indebtedness—will target net external budgetary financing of nearly 2½ percent of GDP in 2003, down from nearly 4½ percent in 2001, but somewhat higher than the figure of 1½ percent in 2000.

Quasi-fiscal Sectors

20. We intend to implement a reform strategy designed to eliminate the culture of non-payment, particularly in the quasi-fiscal sectors (defined as energy, irrigation, water and sewage companies, district heating, and the Nairit chemical company). To complete the task of improving the viability of the quasi-fiscal sectors, it will be essential to take further measures, to be designed in consultation with the World Bank staff, to make these sectors progressively more self-reliant, through reduced losses, improved revenues, and if necessary higher tariffs. By the end of the program period, we are committed to either eliminating the financial gaps of these sectors or covering any remaining financial gaps by budget support.

21. In the energy sector, privatization of the energy distribution companies (EDCs) to internationally reputable companies on the basis of competitive tenders will be essential to promote the efficient and least cost operation of the companies. In addition, we intend to strengthen the legal and regulatory framework; promote the successful development of competitive electricity markets; and attract private investment in the non-privatized parts of the power sector. We intend to attain full cost-recovery operation in the electricity transmission sector; ensure continuous assessment of the financial condition of the borrowing entities; and set financial performance targets to help achieve financial viability of the sector.

22. It will also be important to improve the financial performance of the other quasi-fiscal sectors, especially since a part of the financial difficulties of the energy sector are due to non-payment of energy bills by the other quasi-fiscal sectors. In the irrigation sector, we aim to reduce energy usage in irrigation pumping stations and gradually increase tariffs. For Yerevan Water and Sewage Company, we have already recruited an international water operator to manage the company under a four year performance contract. Measures to be taken by the operator under the management contract are extensive, and will provide incentives for improved performance. For Armenia Water and Sewage Company, we intend to ensure that reforms do not affect access of the poor to high quality water; improve the company's cash flow through the reform of billing and collection; and further improve the company's accounting practices. We also intend to promote a new water sector law modeled on the electricity and telecommunications laws, clarifying rights and obligations of all sector stakeholders and ensuring clear and predictable "rules of the game." For district heating, we intend to develop the legal framework and assess a wide spectrum of economically and socially feasible heating options in Armenia, with a view to eliminating the fiscal deficit arising from district heating. In 2001, in pursuit of these objectives we are committed to develop an urban heating strategy with assistance from the World Bank. Moreover, we intend to treat the Nairit company as a commercial enterprise, which must be viable to remain in operation.

23. The accumulated debts of these sectors to the energy sector, and the corresponding debts of the energy sector to others, are a reflection of inadequate tariffs and administrative policies which discouraged financial discipline and in some cases encouraged theft. We will ensure that these debts are rescheduled on commercial terms.

24. Privatization is an essential step for ensuring the financial viability of the energy sector and to avoid a further debt build up. The gas distribution network is already largely privatized and, as elaborated further below, the electricity distribution network will be privatized in early 2001. Following the successful privatization of the EDCs, we intend to work out a strategy for restructuring energy sector debt with World Bank assistance. We aim to move ahead with the privatization of other elements of the energy sector, in a fully transparent manner, during the program period.

Structural Reforms and Governance

25. In addition to the structural fiscal and quasi-fiscal reforms described previously, progress in a number of structural areas will be critical to the success of our reform program. This will include significant progress in completing the privatization process; measures to reduce corruption and improve the quality and transparency of governance (in particular, strengthening the external audit between the different bodies of the Republic of Armenia); legal, judicial, and institutional reforms; and banking sector reforms. These efforts will be supported by the World Bank. The government has established a working group that is currently preparing a framework to define government functions. This includes an analysis of the appropriate choice of government responsibilities consistent with the government's capacities as well as questions of decentralization and delegation of authority.

26. We intend to enhance the financial monitoring of state-owned enterprises, including through publishing quarterly reports about their financial operations, and complete the privatization program in the next few years. We intend to privatize those remaining state-owned enterprises that can be sold, while moving quickly to make final decisions about how to handle companies that cannot be sold regardless of price. In view of the non-payments problem in the private sector, we intend to put a high priority on improving bankruptcy procedures (the application of which would lead either to the rehabilitation or liquidation of an enterprise). In this regard, we intend to advance the reform of the judicial system, in consultation with the World Bank staff, to ensure that it is adequate to support a market-oriented economy, as well as to enhance the capacity to implement bankruptcy procedures.

27. Strengthening of public sector institutions, in particular implementing civil service reform, will be a key part of our efforts to improve governance and reduce corruption. In this regard, we have asked the international community to assist us in developing a strategy for combating corruption. This strategy will focus on prevention, enforcement, and public education and information. We intend to continue past efforts to increase public awareness of the utilization of grants by requiring detailed reports, to the parliament and the public, and we intend in the future to require similar detailed reports on the outcome of privatization efforts.

28. Further efforts to enhance the ability of the CBA to supervise the banking system are important since a more efficient system of financial intermediation, with greater public confidence in commercial banks, will be an integral component of the strategy to increase domestic saving and investment. Restructuring and privatization of the Savings Bank, the only remaining state-owned bank, in consultation with the World Bank staff, will be a key

step in the process of restructuring the banking sector. It will also be important to maintain the current practice of government noninterference with the operations of commercial banks or the enforcement by the CBA of prudential regulations. We will continue to review the procedures for enforcing these regulations, to see if further strengthening is needed, and continue to strengthen banking supervision. The CBA intends to increase minimum capital requirements progressively for existing banks to the same level as new banks (\$5 million) by mid-2005. Finally, we will take steps to strengthen the powers of the CBA in bank bankruptcy and reorganization cases. Our efforts to strengthen the banking sector will be guided by the recommendations of the recent joint IMF/World Bank Financial Sector Assessment Program (FSAP) mission.

Poverty Reduction

29. Central to the new program will be a major effort to reduce poverty. As described in the IPRSP, the key to poverty alleviation, and to reversing the pattern of increasing income inequality, will be economic growth, because without such growth Armenia will not have the resources to reduce poverty significantly. Accordingly, one component of our anti-poverty strategy will consist of measures to enhance economic growth prospects that will have the greatest impact on reducing poverty. A second major component of our anti-poverty program will be our efforts to fight corruption and reform the civil service.

30. A third component will involve social protection. Further improvements in social assistance will require reductions in the number of recipients of family allowances, with the savings used to finance increased minimum or social pensions, as well as community development programs. We intend to improve the targeting of the allocation mechanism for family allowances and strengthen the administrative capacity for monitoring and evaluation. Moreover, we intend to avoid making new social commitments that could be unsustainable in the medium term.

31. A fourth component of the anti-poverty program will be a revision of the pension system. The medium term goal is to strengthen the public pension system to provide security for old age pensioners while reducing the cost to the budget. In this regard, we will prepare a strategy for pension reform which provides a basis for such reforms. A fifth component will involve shifting government expenditure toward the poor (particularly in the education and health areas). A final component of the anti-poverty strategy will be labor market policies, where there is a need to increase unemployment benefits, streamline the legal framework, and liberalize employment regulations and remove various labor regulations that tend to delay the recovery in formal employment.

III. THE PROGRAM FOR 2001

Macroeconomic Framework

32. Real GDP is expected to increase by at least 6.5 percent in 2001, reflecting the continuation of economic recovery and the effects of large expected private inflows from the Armenian diaspora, as well as higher tourism related to the celebration of the 1,700 year

anniversary of Armenia's adoption of Christianity as its state religion. Inflation has been projected at 3.5 percent (end-period) and our monetary policy is aimed at achieving this, but the inflation and other macroeconomic projections may be reconsidered during the year, depending on developments.

Fiscal Policy

33. Given the dramatic build up in state budget and pension expenditure arrears starting in late 1999, related to the deterioration in budgetary tax revenues as well as shortfalls in external budgetary financing due to delays in EDC privatization, a significant adjustment effort is essential in 2001. We have already made a substantial adjustment in 2000, as evidenced by the upward trend in state budget tax revenues since June 2000, and the extent of adjustment during 2001, based on the budget approved by the parliament, will be even more substantial. In the 2001 state budget, which became law on December 31, 2000, tax revenue is projected to reach 15.1 percent of GDP in 2001 which, while still below the 1999 level, represents an increase (0.3 percent of GDP) over revenue in 2000. State budget expenditure, equivalent to 21.2 percent of 2001 GDP, represents a reduction (excluding capital expenditure and repair financed by SPA funds) of 0.9 percent of GDP compared to 2000, and would be 4.1 percent of GDP lower than in 1999. The overall state budget deficit (on an accrual basis) is projected to fall from 6.4 percent of GDP in 2000 to 4.0 percent in 2001. (However, if an agreement on rescheduling Georgia's debt to Armenia is reached, this will create an additional budgetary financing gap of 0.2 percent of GDP.)

34. In clearing budgetary expenditure arrears, the government is focusing its efforts on reducing socially significant arrears, such as family allowances, pensions, and wages. During the fourth quarter of 2000, dram 6 billion of arrears in these areas were cleared in net terms by arranging a short-term bridging loan from the SPA. To the extent that further domestic arrears clearance in 2001 will be feasible, the government will maintain the same priorities.

35. Pension arrears have been reduced to less than 1½ months. Although the SFSI's revenues are back loaded within 2001, we will nevertheless ensure that its stock of arrears does not increase in the first quarter of 2001. It will clear at least dram 1.0 billion in arrears in the second quarter of 2001, and by end-2001 will have eliminated all arrears.

36. Under the state budget, only about dram 17.2 billion of arrears (1.5 percent of GDP) could be cleared in 2001 in the absence of further debt relief and donor assistance. Given our track record in implementing this comprehensive and ambitious adjustment program, we expect additional financing will be obtained from a Consultative Group (CG) meeting which the World Bank plans to hold in the summer of 2001. However, if there is a residual financing gap even after these additional though uncertain sources of external financing, as is likely, we would need to carry over some amount of arrears into 2002.

37. In approving the budget, the parliament also enacted a comprehensive tax policy package. The package includes a broadening of the tax base (exemptions have been abolished including under the VAT and from the personal income tax, enterprise profits tax, and social contributions) and various structural measures to improve the efficiency of the tax system. It

provides for extension of the VAT to the border from 30 percent of imported goods to 50 percent (based on 1999 trade data). The rate structure of the combined personal income tax/social security tax has been rationalized by replacing the highly dispersed marginal rates under the old regime with a combined flat rate.

38. The staff of the Ministry of State Revenues (MSR) will undergo a comprehensive performance review by end-May 2001. In parallel, the MSR has developed a job specific training program in cooperation with USAID, which will be implemented by end-December 2001. To enhance enforcement, the MSR will develop a plan, in coordination with the Ministry of Justice, to accelerate seizure and bankruptcy procedures by May 15, 2001. Under amendments to the Law on Taxes that took effect on January 1, 2001, tax and SFSI bodies are now required to initiate bankruptcy proceedings for any delinquent taxpayer or contributor within 183 days, which eliminates the scope for discretion and the associated opportunities for abuse. In addition, we will begin to publish lists of the names of delinquent taxpayers, on a quarterly basis, by May 8, 2001. To enhance the collection of non-tax revenues, the government will issue a decree that defines the responsibilities of the different state agencies in the collection process by May 1, 2001.

39. We will also take further measures to improve collections of mandatory social insurance contributions. Regarding customs, we will base our reform efforts on the implementation of the findings of the diagnostic workshop held in March 2000. We have set up an action plan (consisting, among other things, of the reform of the import and export processes, risk assessment, and intelligence activities), in cooperation with USAID and DFID, and will ensure its timely implementation.

40. We also intend to implement measures to enhance expenditure control. In this regard, we intend to complete a public expenditure review, in cooperation with the World Bank, by end-June 2002. We have submitted a draft treasury law to the parliament, and the government will make every effort to ensure its enactment by the parliament by end-June 2001. We plan to introduce commitment control procedures, on a pilot basis, in a few major ministries and departments, by end-June 2001. These procedures will be implemented in all other ministries/departments/state-governing territorial bodies by end-December 2001. We will also introduce a system of registering payments in the treasury on the basis of accruals by end-December 2001, which will help to improve the reliability of expenditure arrears reporting. Lastly, we already require local governments to report their cash expenditures on a monthly basis. Improving the internal audit procedures in the line ministries, the departments, and state-governing territorial bodies is a long-term goal. As a first step, we intend to approve the legal, procedural, and organizational basis for internal audit by end-December 2001. Thereafter, we propose to implement internal audit in all of the line ministries during 2002.

41. In line with the basic principle on the use of SPA proceeds (see paragraph 12), and with a view to limiting the use of such proceeds for capital expenditures in any year to broadly one-half of the amount in the SPA at the beginning of that year, in 2001 54 percent of this balance (after adjusting for repayment of the \$15 million in bridge financing in late 2000) will be committed to capital expenditures (the corresponding figure in 2000 was

52 percent). In addition, at least 25 percent of the initial balance (after adjusting for repayment of the bridge financing) will be set aside for the retirement of non-concessional external debt, with the proviso that any reduction in the present value of the stock of debt arising from debt rescheduling agreements could be used to reduce the amount of the set-aside.

Monetary, Exchange Rate, and Banking Sector Policies

42. The monetary program for 2001 is designed to maintain monetary growth at a level consistent with price stability. Given the 33 percent growth in reserve money in the second half of 2000 related to foreign inflows and spending of SPA money (on capital expenditures and to reduce budgetary expenditure arrears), we believe it is essential to bring the rate of reserve money growth down very significantly in 2001, especially in the first half. If inflation developments during the first half are higher than envisaged, the CBA will consult promptly with the IMF staff with a view to a possible further tightening of the monetary program.

43. Dram broad money is expected to remain flat in 2001 given the extraordinarily rapid growth in the monetary aggregates in the second half of 2000. The projected growth of broad money (12 percent) is based on the expectation of continuing strong growth in foreign currency deposits and an increase in reserve money of 2 percent. The 2001 program will target the dram equivalent of a \$6 million (end-year to end-year) increase in the net official international reserve position of the CBA, which together with disbursements under the PRGF will enable the central bank to maintain import coverage of gross reserves of over 3½ months of imports.

44. The CBA intends to strengthen its prudential regulations to enhance further the soundness of the banking system. The CBA and the government intend to issue and implement a loan classification system, which is in accordance with international best practices, and takes into account the capacity of borrowers to service their loans, by end-June 2001. The CBA and the government also intend to introduce a new “watch” category to the loan classification system and to provision for loans in this category by a greater amount than for standard loans, by end-June 2001. The CBA will further develop valuation methodologies with respect to loans and collateral and introduce new provision rules that are consistent with international best practices, and more closely tailored to the risks prevailing in the Armenian economy, by end-December 2001. The CBA has already issued guidelines for the measurement and management of foreign exchange, interest rate, and liquidity risk by commercial banks, and intends to issue guidelines for credit risk by end-December 2001. Minimum capital requirements for existing banks, presently \$1 million, will be increased to \$1.3 million by end-June 2001, \$1.5 million by end-June 2002, \$2 million by end-June 2003, and to the same level as new banks (\$5 million) by end-June 2005. The CBA has also decided to establish a credit bureau, among the banks, to fill the gap in credit information about companies, by end-February 2002.

45. In order to strengthen the CBA’s ability to deal effectively with problem banks (including by giving the CBA power to change the management of insolvent banks and banks that are solvent but fail to comply with prudential requirements), the CBA has submitted a

new draft Law on Bankruptcy of Banks to the government, and the government will submit a draft to the parliament by end-June 2001, with a view to obtaining parliamentary approval of the law by end-October 2001. The new law would enhance the ability of the CBA to deal adequately with insolvent banks. In particular, it should be drafted in a manner that would enable the central bank to undertake swift action in bank bankruptcy cases. The government will submit draft amendments to the parliament of the CBA Law and/or the Law on Banks and Banking Activity by end-June 2001, and make every effort to ensure parliamentary approval of these amendments by end-December 2001, in order to enhance the CBA's authority to require implementation of remedial action, including decisions to terminate a bank license or initiate the bankruptcy of a bank, and to give the CBA the authority to confirm any changes in bank ownership. The CBA and the government will take the necessary steps to strengthen penalty provisions, if necessary by incorporating these changes into law.

46. The government is firmly committed to maintaining the independence of the central bank, and will not enact or support any legislation or legislative initiative that may infringe upon the independence of the central bank, in terms of management, functions, or operations. Should a draft Law on Statutes be proposed that could possibly infringe upon the independence of the central bank, the government will propose that the draft classify CBA Board resolutions as legal statutes and not as acts of a state agency. The government will submit a draft law, or draft amendments to existing laws, to provide for appropriately regulated non-bank financial institutions, and bank reorganizations, to the parliament by end-December 2001. Also, the government will review and submit amendments to the Securities Market Regulation Law to the parliament by end-June 2001, with a view to adoption by end-December 2001, to ensure that the activity of domestic banks in the government securities market is not regulated by this law, and that banks can engage in dealing and brokerage activities without special licensing from the Securities Commission.

Balance of Payments and External Financing

47. Notwithstanding the significant narrowing of external imbalances in recent years, the balance of payments remains vulnerable. In 2001, higher economic growth and investments are likely to boost imports, thus limiting the scope for a further narrowing of the external current account deficit. Even though foreign direct investment is expected to remain buoyant—in part because of the planned privatization of the EDCs and other investments into the energy sector—the capital account surplus is not expected to finance the current account deficit fully.

48. An external financing gap of \$96 million is projected for 2001, which reflects an overall balance of payments deficit of \$45 million, a targeted reserve build-up of \$23 million (so as to achieve gross reserves equivalent to over 3½ months of imports), IMF repayments of \$10 million, and \$19 million of arrears clearance to Russia. The financing gap is expected to be filled in part by first-year disbursements under the PRGF arrangement (\$26 million) and the World Bank's SAC IV (\$50 million). To fill the residual financing gap of \$20 million, additional donor support would also be needed, and as noted above the World Bank plans to hold a CG meeting in the summer of 2001.

Quasi-fiscal Sectors

49. In the energy sector, we intend to send final agreed tender documents to potential bidders in the competitive tender for privatizing the EDCs, conducted under the World Bank supported program, by July 9, 2001. Moreover, we intend to improve the transparency and monitoring of the financial performance of the quasi-fiscal sectors under the program. In this regard, we have already included the projected financing gaps for the key quasi-fiscal sectors (energy, irrigation, and water and sewage companies) in the message of the government accompanying the 2001 budget approved by the parliament. As a first step toward incorporating explicit financial targets for the quasi-fiscal sectors into our program, and on the basis of quarterly projections, we have established semiannual floors for the primary balance of the energy sector for 2001. While the data are not presently available to specify semiannual financial targets for the other key quasi-fiscal sectors (irrigation and water and sewage companies), we intend to develop a mechanism for monitoring the financial performance of these sectors on a semiannual basis by end-December 2001, starting with Yerevan Water and Sewage Company by end-June 2001. In the meantime, we have established annual floors for 2001, for the primary balances of these quasi-fiscal sectors. We will also work to produce annual cash flows for district heating and the company Nairit that are adequate for the purpose of setting financial targets.

50. In addition, concerning the energy sector, the government has already issued a decree that obliges the MSR, the Ministry of Energy, and the MFE to use the same methodology for the determination of tax liabilities (including penalties and fines). Moreover, we will issue a decree that prohibits state-owned enterprises from supplying goods and services to (or on behalf of) the power sectors, without written agreements on the goods and services to be supplied, their prices, and terms of payment (deadlines, interest on credit, and penalties on late payments) by end-May 2001. We intend to issue a detailed report to the parliament and the IMF staff on the terms of the 1998 gas-for-equity swap, including how this deal was reflected in the accounts of the state budget and the balance sheets of participating companies, by end-June 2001.

Governance

51. We are firmly committed to following through on our efforts to improve governance and reduce corruption. Efforts to combat corruption will be coordinated by the Prime Minister's recently established anti-corruption commission, which has been charged with elaborating a major program of actions in this area. As an important first step in our efforts to fight corruption, we have submitted a revised draft law on financial disclosure of public officials to the parliament, taking into account the extensive comments already received from IMF staff, and will make every effort to ensure parliamentary approval of this law by end-June 2001. In parallel, we intend to achieve enactment of a new civil service law, which has been developed in close cooperation with the World Bank staff. To ensure progress in the program to define government functions, the working group (see paragraph 25) will submit a concept paper to the government and to the public by end-June 2001.

52. To improve reporting of fiscal data to the public, by end-June 2001 we will start to publish monthly comprehensive reports (including revenues, expenditures, financing, receivables, and payables) on budget execution and accounts on a pilot basis, and based on the results of the pilot we intend to institute the reporting for all ministries by end-December 2001. These reports will contain detailed information on the use of external grants and loans, privatization transactions and the use of privatization proceeds, the financial condition of major state-owned enterprises (quarterly reports only; we will refine the list of such enterprises by end-June 2001), budget execution relative to the approved budget, and the status of tax and expenditure arrears. In addition, all ministries, departments, and state-governing territorial bodies will provide annual reports on their performance. Finally, we have hired an external auditor—through international tender—for the use of SPA proceeds.

53. Moreover, we intend to implement a number of measures related to improvements in tax administration, and other structural fiscal measures, which are linked to improved transparency and governance. In particular, our program envisages the implementation of a comprehensive audit program in cooperation with USAID. As a first step, we will put in place a fully operational system of VAT cross-checks, based on the receipts collected through audits. By end-May, we will complete the regulatory framework (i.e., the government decree providing the data format), with a view to having in place a fully operational system of VAT cross-checks by end-June 2001. By end-June 2001, the comprehensive automated audit system will be operational in all Yerevan offices. To support the audit program, we will develop rules for the collection of information and the application of indirect audit methods. By end-December 2001, we will extend the automated system to all tax offices.

Prior Actions

54. We have taken or will take the following prior actions before the IMF Executive Board considers our request for an arrangement under the PRGF:

- Replenish in the first quarter of 2001 the SPA by the full amount borrowed from it in late 2000;
- Meet cumulative state budget tax revenue targets for the relevant periods (dram 21.0 billion for January-February, dram 35.5 billion for January-March, and dram 50.0 billion for January-April, 2001);
- Ensure no increase in the stock of state budget arrears after end-December 2000;
- Ensure no increase in the stock of SFSI arrears after end-December 2000;
- Clear/restructure all external arrears;
- Conform to the monetary program for the relevant periods;

- Submit to the parliament a draft treasury law, prepared in consultation with the IMF staff;
- The government will have signed a contract with an external auditor—hired through international tender—for the use of SPA proceeds; and
- Submit to the parliament a revised draft law on financial disclosure of public officials, prepared in consultation with the IMF staff.

Program Monitoring and Reporting Requirements

55. Program monitoring will be carried out on the basis of semiannual quantitative performance criteria and quantitative benchmarks, structural performance criteria, and structural benchmarks, for the period January 1, 2001 to December 31, 2003, with semiannual reviews based on performance as of end-June and end-December of each program year. Quantitative performance criteria have been set for June 30 and December 31, 2001, and quantitative benchmarks have been set for September 30, 2001. The quantitative performance criteria include: (i) a ceiling on the net domestic assets of the CBA; (ii) a ceiling on net domestic banking system credit to the central government; (iii) a ceiling on state budget arrears; (iv) a ceiling on SFSI arrears; (v) a floor on state budget tax revenues; (vi) a ceiling on the overall cash deficit of the state budget; (vii) a floor on the primary balance of the energy sector; (viii) a ceiling on net disbursements of short-term external debt; (ix) a ceiling on contracting and guaranteeing of new non-concessional medium- and long-term external debt longer than one year (with a sub-ceiling on debt of 1-5 year maturities); (x) a ceiling on external arrears (continuous performance criterion); and (xi) a floor on net official international reserves. An indicative floor and ceiling have also been set on reserve money for June 30, September 30, and December 31, 2001. Quantitative performance criteria and benchmarks, and indicative targets, are shown in the attached Table 1. Adoption by the parliament and signing by the president by end-June 2001 of a law on financial disclosure of public officials—that would: (i) require public officials to report their incomes and assets in accordance with the procedures established by that law; and (ii) imposes liability for failure to make the required disclosure—will be a structural performance criterion under the program. Structural benchmarks during the first program year are summarized in the attached Table 2. Details on the definition and monitoring (and adjustors) of quantitative performance criteria and indicative targets are set in the Technical Memorandum of Understanding (attachment I to this Memorandum). All data necessary for the effective monitoring of the program, which are specified in the Technical Memorandum of Understanding, will be reported in a timely manner to the IMF by the government, the CBA, and the National Statistical Service (NSS).

56. We believe that the policies detailed above are adequate to achieve the objectives of the program, but we remain prepared to take any additional measures that may be necessary for this purpose.

Table 1. Armenia: Quantitative Performance Criteria and Indicative Targets, 2001

| | 2000 | | 2001 | | | |
|--|-------------------------------|------------|--------------|---------|---------|---------|
| | Dec. | Mar. | Jun. 1/ | Sep. 2/ | Dec. 1/ | |
| | Prel. | Program 2/ | Prel. Actual | Program | | |
| Quantitative performance criteria: | | | | | | |
| | (in millions of drams) | | | | | |
| Net domestic assets of the CBA | -3,970 | -1,711 | -4,575 | -2,819 | -3,389 | -5,955 |
| Net domestic banking system credit to state budget | 9,373 | 10,399 | 5,691 | 10,839 | 11,171 | 12,073 |
| State budget stock of arrears 3/ | 44,353 | 44,003 | ... | 34,422 | 27,115 | 27,115 |
| SFSI stock of arrears | 4,356 | 4,356 | ... | 3,356 | 1,456 | 0 |
| State budget tax revenues (Floor) 4/ 5/ | 152,357 | 35,480 | 35,640 | 77,992 | 124,637 | 173,304 |
| State budget overall cash deficit 4/ 6/ | 40,820 | -1,341 | ... | 25,997 | 49,696 | 63,507 |
| Primary balance of the energy sector (Floor) 4/ | 167 | ... | ... | 900 | ... | -200 |
| | (in millions of U.S. dollars) | | | | | |
| Net disbursements of short-term external debt 7/ | 0 | 0 | 0 | 0 | 0 | 0 |
| Contracting and guaranteeing of new nonconcessional medium- and long-term external debt longer than one year 4/ 8/ | 0 | 11.6 | 0 | 11.6 | 11.6 | 11.6 |
| Of which: debt of 1-5 year maturities | 0 | 11.6 | 0 | 11.6 | 11.6 | 11.6 |
| External arrears (continuous criterion) | 19 | 24 | 24 | 0 | 0 | 0 |
| Net official international reserves | 138.3 | 117.1 | 119.5 | 126.4 | 133.9 | 144.5 |
| Indicative Targets: | | | | | | |
| | (in millions of drams) | | | | | |
| Reserve money | | | | | | |
| Maximum | ... | 64,222 | ... | 68,289 | 71,973 | 75,302 |
| Minimum | ... | 61,704 | ... | 65,611 | 69,151 | 72,349 |
| Actual | 72,390 | ... | 61,430 | ... | ... | ... |

Sources: Armenian authorities; and Fund staff estimates.

1/ Performance criteria.

2/ Benchmarks.

3/ The ceiling will be adjusted downwards by the full amount of (i) 2001 debt service to Russia, if rescheduled or otherwise restructured; and (ii) higher-than-programmed grants. The ceiling will be adjusted upwards by the full amount of any foregone repayment in the event of rescheduling agreement with Georgia.

4/ Targets are cumulative during the year.

5/ Programmed cumulative tax revenue target for January-April, 2001 is dram 50.0 billion.

6/ The ceiling will be adjusted upwards by the amount of 2001 principal payments to Russia that need not be paid in the context of a possible debt rescheduling or other restructuring agreement with Russia, and by the amount of any nonprogrammed foreign-financed project disbursements.

7/ Excluding normal import-related credit and sales of treasury bills to nonresidents.

8/ The ceiling will be adjusted downwards by the full amount of disbursements under the existing \$20.57 million line of credit from Russia.

Table 2. Structural Performance Criteria and Benchmarks, 2001

I. STRUCTURAL PERFORMANCE CRITERIA

End-June 2001

- Adoption by the parliament and signing by the president of a law on financial disclosure of public officials that would: (i) require public officials to report their income and assets in accordance with the procedures established by that law; and (ii) impose liability for failure to make the required disclosure.

II. STRUCTURAL BENCHMARKS

End-June 2001

- Parliamentary approval of a treasury law.
- The comprehensive automated audit system will be operational in all Yerevan offices. (To support the audit program, rules for the collection of information and the application of indirect audit methods will be developed.)
- The government will submit a new draft Law on Bankruptcy of Banks to the parliament. The government will also submit draft amendments to the parliament of the CBA Law and/or the Law on Banks and Banking Activity.

End-October 2001

- Parliamentary approval of a new Law on Bankruptcy of Banks.

End-December 2001

- The automated audit system will be extended to all tax offices.
- Parliamentary approval of amendments of the CBA Law and/or the Law on Banks and Banking Activity.

Republic of Armenia

Technical Memorandum of Understanding

Armenia's performance under the PRGF-supported program will be assessed by the IMF on the basis of the observance of quarterly quantitative performance criteria and indicative targets as well as on compliance with structural performance criteria and benchmarks. This Technical Memorandum of Understanding (TMU), including attached tables, sets out and defines the performance criteria (and adjustors) and indicative targets as well as the monitoring and reporting requirements. It also sets out and defines the prior actions.

I. QUANTITATIVE TARGETS

1. Quantitative targets for 2001 are presented in Table 1 and defined below. Benchmarks are set for end-March and end-September and performance criteria for end-June and end-December. Other concepts needed for the proper definition of the quantitative targets are also defined.

Reserve money

2. The reserve money targets are indicative only and include both a floor and a ceiling. Reserve money of the Central Bank of Armenia (CBA) is defined as the sum of currency issue, required and excess reserves including on foreign currency deposits, and current and time deposit accounts of certain resident agents. Thus defined, the outstanding stock of reserve money amounted to dram 72,390 million on December 31, 2000.

3. The target for reserve money will be subject to a daily corridor consisting of upper and lower limits on the reserve money path. The width of the corridor in 2001 (plus or minus 2.0 percent) has been established based on the quarterly average standard deviation of excess reserves held by banks in percent of quarterly average reserve money during the period 1996-2000. Whenever reserve money breaches the corridor, the CBA will consult promptly with IMF staff regarding the appropriate policy response.

Net official international reserves

4. The program targets a minimum level of net official international reserves (NIR) of the CBA. The stock of such reserves will be calculated as the difference between total gross international reserves and total official reserve liabilities.

5. Total gross official international reserves shall be defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral or in swaps), holdings of SDRs, any reserve position in the IMF, and holdings of convertible currencies (i.e., those listed in Table 2) in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). Gross reserves held in the form of securities are marked to market. Gross reserves are reported net of the value of the balance on the government's Special

Privatization Account (SPA). Capital subscriptions in foreign financial institutions and illiquid foreign assets are also excluded.

6. There is no reporting on financial derivatives and other off balance sheet positions as the CBA does not currently trade in such financial instruments. However, if the CBA decides to commence such trading it will promptly notify the IMF staff to establish proper reporting requirements in this regard.

7. Official reserve liabilities shall be defined as outstanding liabilities to the IMF, and convertible currency (i.e., those listed in Table 2) liabilities of the CBA to nonresidents with an original maturity of up to and including one year.

8. NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the exchange rates as of December 31, 2000 as established by the CBA (Table 2). Thus defined, NIR was US\$138.3 million on December 31, 2000.

Net domestic assets of the CBA

9. The program targets a maximum level of net domestic assets (NDA) of the CBA. NDA of the CBA is defined as reserve money less NIR, where the dram-equivalent value of NIR is calculated using the end-2000 official exchange rate of dram 552.18 per U.S. dollar. Thus defined, the outstanding stock of the CBA's NDA amounted to minus dram 3,970 million on December 31, 2000.

10. NDA is composed of: (1) net credit to the general government; (2) outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money, exclusive of accrued interest; and, as a residual (3) other items (net).

Government

11. Unless otherwise noted, government is meant to include the central government (the budget of which will henceforth be referred to as the "state budget"). The State Fund for Social Insurance (SFSI), whose overall cash balance must be zero on an annual basis, will be monitored by a separate performance criterion covering the stock of SFSI arrears. Local governments—which are not allowed to borrow either domestically or externally—are excluded from the definition of government as there are long lags in the reporting of the activities of these entities.

Kreditanstalt fur Wiederaufbau SME onlending facility to commercial banks

12. An onlending facility credit from the Kreditanstalt fur Wiederaufbau (KfW) to commercial banks is channeled through the CBA. For program purposes, disbursements under this credit are recorded in the central government's accounts as foreign-financed

onlending. In the monetary accounts the CBA's liability to KfW is included in other items net.

Banking system and commercial banking system

13. The commercial banking system is the consolidation of all banks licensed by the CBA to conduct banking business. The banking system is the consolidation of the CBA and the commercial banking system.

Ceilings on domestic banking system net credit to central government

14. Net credit from the CBA to the central government includes the CBA's holdings of treasury bills and treasury bonds less central government deposits (including deposits of donor-financed project implementation units and balances of proceeds from the sale of humanitarian assistance). Treasury bonds are valued at the purchase price and treasury bills are valued at the purchase price plus the implicit accrued interest. Except for treasury bills, accrued interest is excluded from net credit. The CBA does not extend direct credit to the central government. The source of the data to be used is specified in paragraph 33.

15. Net credit from commercial banks includes: (1) gross credit from banks to the central government less central government deposits with banks (excluding accrued interest); and (2) banks' holdings of treasury bonds (valued at the purchase price and excluding accrued interest) and treasury bills (valued at the purchase price plus the implicit accrued interest).

16. Accordingly, net credit of the banking system to the central government is the sum of net credit from the CBA and net credit from commercial banks. Thus defined, net domestic banking system credit to the central government was dram 9,373 million on December 31, 2000.

Ceilings on the contracting and guaranteeing of new nonconcessional external debt by the government and by the CBA

17. External debt limits apply to new medium- and long-term external debt¹ with original maturities of more than one year, which are contracted or guaranteed by the government (as

¹ The term "debt" shall have the meaning set forth in Section 9(a) of the Guidelines on performance criteria on external debt, as modified by the Executive Board Decision No. 12274-(00/85) of August 24, 2000, and shall include all current (not contingent) liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the obligor to make one or more payments in the form of assets (including currency) or services at some future point(s) in time to discharge the principal and/or interest liabilities incurred under the contract. In particular, all instruments that share the characteristics of debt enumerated above (including loans, suppliers' credits, and leases) will be included in the performance criterion on external debt.

defined above) or by the CBA, with a sublimit on such debt with maturities of more than one year up to and including five years. In addition, there are limits on disbursements of short-term external debt contracted or guaranteed by the government or the CBA; all obligations with original maturities of up to one year fall under this limit, except normal import-related credits. The outstanding stock of short-term external debt on December 31, 2000 was zero.

18. The program ceilings on the contracting and guaranteeing of new nonconcessional medium- and long-term debt, by the government or the CBA, will apply to all forms of external debt, as defined in paragraph 17 of the TMU, with maturity greater than 1 year. The only liabilities excluded from the limits are sales of treasury bills or treasury bonds to nonresidents, provided the sales go through the regular auction mechanism and involve no exchange rate guarantees; and concessional loans. For program purposes, a loan is considered concessional if the grant element is at least 35 percent calculated using a discount factor based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the loan maturity.² The average of the CIRRs over the last ten years will be used for loans with a maturity of at least 15 years and the average of the CIRRs for the preceding six months will be used for shorter maturities. For the purpose of monitoring compliance with the targets, all agreements concluded in respect of rescheduling or refinancing of existing debt shall be excluded from the limits. Transactions subject to these ceilings shall be valued in the contracted currencies and converted into U.S. dollars at the average monthly market exchange rate in the month when the borrowing commitment was contracted.

Ceilings on external arrears

19. External arrears of the central government or the CBA will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of loans contracted or guaranteed by the government or the CBA since Armenia's independence, unpaid penalties or interest charges associated with these arrears, and overdue payments owed by the government or the CBA on imports received subsequent to independence. Thus defined, external arrears at end-December 2000 were \$19.0 million.

Limits on the state budget balance

20. The state budget balance during a given period is defined from the financing side on a cash basis as the sum of domestic banking system net financing, domestic non-bank net financing, and external net financing.

² The margins are: 0.75 percent for repayment periods of less than 15 years, 1 percent for 15-19 years, 1.15 percent for 20-29 years, and 1.25 percent for 30 years or more.

21. Domestic banking system net financing is measured as the change during the period of net domestic banking system credit to the state budget. The source of the data to be used is specified in paragraph 33.

22. Domestic non-bank net financing is measured as the sum of: (1) the change during the period of outstanding treasury bills and bonds to non-banks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);³ and (2) any other disbursement or transaction (other than proceeds from privatizations which are deposited into the SPA) that increases non-banks' claims on the central government, less amortizations made by the central government to private resident non-bank agents. These data will be provided by the Ministry of Finance and Economy (MFE) in consultation with the CBA.

23. External net financing is measured as total debt-increasing disbursements from non-residents to the central government less total amortizations from the central government to non-residents. All foreign-currency denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

Privatization proceeds

24. Proceeds stemming from the selling of enterprises in the context of the government's annual privatization program (i.e., enterprises listed in the government's list of enterprises to be privatized in accordance with the law on privatization) are deposited into the SPA. The account is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. However, as noted above, these proceeds are not included in the definition of the monetary accounts of the banking system. Any withdrawal from the SPA (including accrued interest) will be accounted for as privatization proceeds used to finance the state budget (as defined above).

25. Proceeds from other privatizations are included in the regular budgetary accounts as capital revenue. These proceeds are either deposited in a privatization account, held at the CBA and included in the definition of net credit to the central government, or spent for general budgetary purposes.

Tax revenues of the state budget and the SFSI

26. Tax revenue is defined in accordance with *Government Finance Statistics* (GFS) 1986, section IV.A.1. The MFE will report total tax revenue to the IMF, on a monthly basis and within seven days of the end of each month, using the following categories: VAT, excises, enterprise profit tax, personal income tax, land tax, customs duties, presumptive income tax, property tax, and other taxes (including environmental taxes).

³ Domestic non-bank holdings of treasury bills and treasury bonds are defined as total outstanding treasury bills and bonds less holdings by the banking system and the SFSI.

Central government and SFSI arrears

27. The program targets a maximum level of the stock of central government arrears. It also targets a maximum level of the stock of SFSI arrears. For program purposes, arrears are defined as follows. With respect to wages, pension payments, family allowances, amortization, and interest payments, the stock of arrears is defined as all unpaid claims outstanding as of the end of the month. For all other expenditure categories, arrears are defined as the stock of unpaid claims, as verified by the recipient of the goods and services, which has been outstanding for more than 30 days as of the end of the month. The reports on the arrears (in the format of Table 3) will be compiled monthly by the MFE for the central government and the SFSI separately, and reported by the MFE to the IMF within 45 days of the end of each month.

Energy sector cash flows

28. The government will provide a detailed quarterly cash flow for the energy sector. The energy sector is defined to consist of the following companies: (1) Hrazdan thermal power plant; (2) Yerevan thermal power plant; (3) Metsamor nuclear power plant; (4) Sevan-Hrazdan Cascade hydro-power plant; (5) Vorotan hydro-power plants system; (6) High Voltage Electricity Network; (7) Armenergo; (8) Yerevan Electricity Network; (9) Northern Electricity Network; (10) Southern Electricity Network; (11) Central Electricity Network; (12) Armgazprom; and (13) Armtourtrade. The cash flow of the energy sector consists of the consolidation of the cash flows of these enterprises. Four of the companies are scheduled to be privatized in 2001 and starting in the quarter following a privatization of a company, this company will be omitted from the definition of the energy sector. The cash flow information—to follow the format of the attached sample Table 4⁴—will be provided to the IMF no later than 28 days after the end of each quarter.

29. The program will target the primary balance of the energy sector, where the primary balance is defined as current revenues less total expenditures excluding all interest payments and capital expenditures related to foreign-financed projects, i.e., foreign-financed and co-financed capital expenditures.

II. REPORTING REQUIREMENTS

30. The government, the CBA, and the National Statistical Service (NSS) will provide the IMF with all necessary economic and financial statistical data to monitor economic developments and program performance including, but not necessarily limited to, the following specific information. Unless otherwise indicated, the requested information will be in accordance with the definitions elaborated in the previous section.

⁴ Table 4 is in summary form. A more comprehensive table will be provided in the form of an Excel workbook (the format of which has been agreed with IMF staff).

The balance sheet of the CBA

31. The CBA has provided the IMF staff the chart of accounts and it will notify the staff of any revisions thereto.

32. Weekly (summary⁵) and monthly end-of-period (by chart of account) data on the balance sheet of the CBA will be reported to the IMF by the CBA within seven days of the end of the reporting period. The information will clearly provide the basis for calculating the following items: NIR, NDA of the CBA, net credit from the CBA to government (including separate lines for the central government, SFSL, and local governments), net credit provided to commercial banks (by type of credit), and any other financing provided to the rest of the economy.

The balance sheet of the banking system

33. Monthly banking system data, in the form of a monetary survey, as well as the consolidated balance sheet of the commercial banking system (by chart of accounts), will be reported to the IMF by the CBA within 21 days of the end of each month. The information will clearly provide the basis for calculating the following items: net foreign assets (NFA) and NDA of the banking system, net credit to government (including separate lines for the central government, SFSL, and local governments), and other financing provided to the rest of the economy.

34. Dram broad money of the banking system is defined as the total of currency outside banks, plus banking system deposits of resident households and enterprises in drams, excluding accrued interest. Thus defined, dram broad money does not include deposits of the central government, SFSL, or local governments. Accrued interest on deposits held with commercial banks will be recorded in other items net.

35. Broad money is defined as dram broad money and foreign currency deposits of resident households and enterprises in the banking system.

Treasury bill and coupon bond financing

36. The CBA will provide monthly data to the IMF within seven days of the end of each month on the amount of treasury bill and coupon bond holdings by the following categories of holders: the CBA, resident banks, resident non-banks, and nonresidents.

⁵ As defined in CBA Resolution No. 201 (December 6, 1999).

International reserves

37. The CBA will provide monthly data (by chart of accounts) within 14 days of the end of each month on both gross and net official international reserves. These data will be provided in two variants: (1) at program exchange rates; and (2) at actual official exchange rates.

Nontax and capital revenue

38. The MFE will report on a monthly basis non-tax revenues, capital revenue, cash grants and proceeds from the sales of humanitarian assistance. This information will be reported within seven days of the end of each month.

External debt

39. The MFE, in collaboration with the CBA, will provide information on the disbursements and outstanding stock of short-term external debt; on contracting and guaranteeing and the outstanding stocks of medium-and long-term external debt of the government and of the CBA; and any stock of outstanding arrears on external debt service payments within 21 days of the end of each month. In addition, the MFE will report the total amount of outstanding government guarantees and external arrears with the same reporting frequency.

Tax arrears

40. The Ministry of State Revenues will report on an end-of-month basis the amount of outstanding tax arrears, by the end of the following month.

Budgetary sector employment

41. The MFE will provide quarterly updates on budgetary employment by ministries, and on average budgetary sector wages, within one month following the end of each quarter.

Budgetary and extra budgetary data

42. Quarterly data on budgetary execution will be reported to the IMF by the MFE and the SFSI within one month following the end of each quarter. All cash receipts, all cash expenditures (including debt-service payments), and external and domestic borrowing operations will be part of this report. Expenditure data will be provided according to both economic and functional classifications, consistent with GFS methodology. In addition, budgetary financing by the MFE will be reported by economic and functional classification on a monthly basis by the end of the following month.

Non-budgetary domestic arrears

43. The MFE will coordinate—in collaboration with the Ministry of Energy, the CBA, and the NSS—a report to the IMF on a monthly basis on the stock of arrears of the 50 largest enterprise debtors which are in arrears to the banking system, and energy arrears of households and enterprises. This information is to be provided within 28 days of the end of each month.

Balance of payments data

44. The NSS will provide: (1) on a monthly basis detailed export and import data within 28 days of the end of each month; and (2) on a quarterly basis a balance of payments within two months of the end of each quarter.

Energy sector payable and receivable debts

45. The MFE will provide monthly reports on the end-of-month stock of accounts payables and accounts receivables of the consolidated energy sector (defined in paragraph 28) with a lag of no more than 28 days.

Privatization proceeds and use of privatization proceeds for budgetary support

46. The CBA will provide to the IMF information on: (1) the balance on the SPA at the end of each month; and (2) all gross additions and gross withdrawals on a daily basis during each month. The information will be provided on a monthly basis no later than seven days after the end of each month.

Other financial sector information

47. The CBA will provide information on the foreign exchange market (including the official, buying, and selling exchange rates, inter-bank turnover, and the volume of CBA sales and purchases) and interest rates by maturities (including the refinance rate, the inter-bank rate and volumes, the treasury bill and coupon bond yields and volumes by maturity, and bank deposit and lending rates by maturity). The CBA will also provide data on commercial banks' prudential ratios (including liquid asset ratios, capital adequacy ratios, open foreign exchange limits, and percentage of classified loans by category). These data will be provided on a monthly basis within 21 days of the end of each month. In addition, the CBA will provide other data as specified in CBA Resolution No. 201 (December 6, 1999).

Real sector information

48. The NSS will notify the IMF of the monthly CPI by category by the fifth day of the following month, and convey quarterly GDP estimates within two months of the end of each quarter.

III. PRIOR ACTIONS

49. The program's prior actions in the structural policy area are deemed to have been complied with if the following conditions have been met:

- Replenishment in the first quarter of 2001 of the SPA by the full amount borrowed from it in late 2000;
- The CBA, as instructed by the government, has transferred funds sufficient to clear all external payments arrears that have not been restructured.
- A draft treasury law, prepared in consultation with IMF staff, has been submitted by the government to the parliament;
- The government has signed a contract with an external auditor regarding the use of SPA proceeds, hired through international tender, and the government has provided the IMF staff with a copy of the tender documents;
- A revised draft law on financial disclosure of public officials, prepared in consultation with the IMF staff, has been submitted by the government to the parliament.

50. Compliance with the program's quantitative prior actions will be verified through the regular reporting procedures.

IV. STRUCTURAL PERFORMANCE CRITERION

51. Adoption by the parliament and signing by the president by end-June 2001 of a law on financial disclosure of public officials that would: (i) require public officials to report their income and assets in accordance with the procedures established by that law; and (ii) impose liability for failure to make the required disclosure.

V. PROGRAM ADJUSTORS

52. The ceiling on central government arrears will be adjusted: (1) downward by the full amount of the share of 2001 debt service to Russia (dram 2,514 million in the first quarter of 2001, dram 5,008 million (cumulatively) in the first through the second quarter, dram 7,465 million in the first through third quarters, and dram 9,920 million in the first through fourth quarters) not to be serviced in the context of a possible debt rescheduling agreement; (2) upward by the full amount of any foregone repayment in the context of a possible debt rescheduling agreement with Georgia (zero in the first quarter of 2001, dram 1,078 million in the first through the second quarter, dram 1,078 million in the first through third quarters, and dram 2,156 million in the first through fourth quarters); and (3) downward by the full amount of higher than programmed external grants (dram 4,753 million in the first quarter of 2001, dram 6,943 million in the first through the

second quarter, dram 9,668 million in the first through third quarters, and dram 14,393 in the first through fourth quarters).

53. The central government's budgetary cash deficit will be adjusted: (1) upward by the full amount of 2001 principal payments to Russia (dram 1,742 million in the first quarter, dram 3,484 million in the first through the second quarter, dram 5,226 million in the first through third quarters, and dram 6,970 million in the first through fourth quarters) that need not be paid in the context of a possible debt rescheduling or other restructuring agreement with Russia; and (2) upward (downward) by the amount of higher (lower) than programmed foreign-financed project disbursements. Adjustment lending by the World Bank is not included in the adjustor.

Table 1. Armenia: Quantitative Performance Criteria and Indicative Targets, 2001

| | 2000 | | 2001 | | |
|---|-------------------------------|------------|--------------|---------|---------|
| | Dec. | Mar. | Jun. 1/ | Sep. 2/ | Dec. 1/ |
| | Prel. | Program 2/ | Prel. Actual | Program | |
| Quantitative performance criteria: | | | | | |
| | (in millions of drams) | | | | |
| Net domestic assets of the CBA | | | | | |
| Net domestic banking system credit to state budget | | | | | |
| State budget stock of arrears 3/ | | | | | |
| SFSI stock of arrears | | | | | |
| State budget tax revenues (Floor) 4/ 5/ | | | | | |
| State budget overall cash deficit 4/ 6/ | | | | | |
| Primary balance of the energy sector (Floor) 4/ | | | | | |
| | (in millions of U.S. dollars) | | | | |
| Net disbursements of short-term external debt 7/ | | | | | |
| Contracting and guaranteeing of new nonconcessional medium- and long-term external debt longer than one year 4/ 8/ <i>Of which</i> : debt of 1-5 year maturities | | | | | |
| External arrears (continuous criterion) | | | | | |
| Net official international reserves | | | | | |
| Indicative Targets: | | | | | |
| | (in millions of drams) | | | | |
| Reserve money | | | | | |
| Maximum | | | | | |
| Minimum | | | | | |
| Actual | | | | | |

Sources: Armenian authorities; and Fund staff estimates.

1/ Performance criteria.

2/ Benchmarks.

3/ The ceiling will be adjusted downwards by the full amount of (i) 2001 debt service to Russia, if rescheduled or otherwise restructured; and (ii) higher-than-programmed grants. The ceiling will be adjusted upwards by the full amount of any foregone repayment in the event of rescheduling agreement with Georgia.

4/ Targets are cumulative during the year.

5/ Programmed cumulative tax revenue target for January-April, 2001 is dram 50.0 billion.

6/ The ceiling will be adjusted upwards by the amount of 2001 principal payments to Russia that need not be paid in the context of a possible debt rescheduling or other restructuring agreement with Russia, and by the amount of any nonprogrammed foreign-financed project disbursements.

7/ Excluding normal import-related credit and sales of treasury bills to nonresidents.

8/ The ceiling will be adjusted downwards by the full amount of disbursements under the existing \$20.57 million line of credit from Russia.

Table 2. Armenia: Official Exchange Rates of the CBA
(As of December 31, 2000)

| Currency unit | Drams per currency unit | Dollars per currency unit |
|-------------------|----------------------------|------------------------------|
| Australian dollar | 305.91 | 0.5540 |
| Canadian dollar | 368.07 | 0.6666 |
| Swiss franc | 337.32 | 0.6109 |
| Danish krone | 68.85 | 0.1247 |
| Euro 1/ | 513.80 | 0.9305 |
| Pound sterling | 821.20 | 1.4872 |
| Greck drachma | 1.51 | 0.0027 |
| Japanese yen | 4.81 | 0.0087 |
| Norwegian krone | 62.40 | 0.1130 |
| Swedish krone | 58.18 | 0.1054 |
| U.S. dollar | 552.18 | 1.0000 |
| SDR | 719.44 | 1.3029 |
| Gold 2/ | 4689.58 ^a | 8.4928 |

Sources: Armenian authorities; and Fund staff estimates.

1/ Values of the currencies of the EU-member countries which have adopted the euro are calculated using the appropriate fixed conversion rates as established by the Council of the EU.

2/ Per gram.

Table 3. Armenia: Arrears of the State Budget and the SFSI
(In millions of dram; end of period)

| | Pre-1999 | 1999 | 2000 | Reporting period A | Reporting period B | Reporting period C |
|------------------------------|----------|------|------|-----------------------|-----------------------|-----------------------|
| Total expenditures | | | | | | |
| Current expenditures | | | | | | |
| Wages | | | | | | |
| Subsidies | | | | | | |
| Interest payments | | | | | | |
| Domestic | | | | | | |
| External | | | | | | |
| Transfers | | | | | | |
| Family allowances | | | | | | |
| Pension contributions | | | | | | |
| Contribution to pension fund | | | | | | |
| Other | | | | | | |
| Goods and services | | | | | | |
| Health | | | | | | |
| Education | | | | | | |
| Other | | | | | | |
| Capital expenditures | | | | | | |
| Net lending | | | | | | |
| Amortization arrears | | | | | | |
| Arrears of the SFSI | | | | | | |
| o/w pension arrears | | | | | | |

Source: Armenian Ministry of Finance and Economy.

Table 4. Armenia: Cash Flow of the Consolidated Energy Sector
(In millions of dram)

| |
|--|
| Revenues |
| Electricity revenues collected |
| Revenues collected for Thermal Energy Supply |
| Noncore activities |
| Expenditures |
| Inputs |
| Imported gas |
| Nuclear fuel |
| O&M costs |
| Net payment of taxes accrued |
| Other current expenditures |
| Interest payments |
| Capital expenditures |
| Primary balance 1/ |
| Current balance |
| Balance |
| Financing available |
| Domestic sources |
| Banks |
| Budgetary loans |
| Nonbank loans |
| Tax arrears |
| Pay for shares in ArmRusgas acquired earlier |
| Production reserves |
| Pre-payment for electricity |
| Collection of old arrears |
| External sources |
| Government subsidies on external loans |
| ArmRosGasProm gas, debt for equity swap |
| Errors and omissions |
| Financing gap |
| In millions of U.S. dollars |
| In percent of GDP |
| Balance (in percent of GDP) |
| Primary balance (in percent of GDP) |
| Current balance (in percent of GDP) |

Sources: Armenian authorities; and Fund staff estimates.

1/ The primary balance is defined as current revenues minus total expenditures excluding all interest payments and capital expenditures related to foreign financed projects.

Statement by the IMF Staff Representative
May 21, 2001

1. The following information has become available since the staff report (SM/01/61; 4/30/01) was issued. This information does not change the thrust of the staff appraisal.
2. Economic developments continue to be generally encouraging. Real GDP grew by 12.3 percent in the first quarter of 2001, compared to the first quarter of 2000. Inflation was minus 0.1 percent in April, or 3.6 percent cumulatively for the first four months of 2001. The trade balance was strong in the first quarter, with merchandise exports growing by 30 percent over the first quarter of 2000, and merchandise imports declining by 10 percent. Reserve money remained within the corridor in April and the dram was relatively stable in U.S. dollar terms.
3. Regarding fiscal performance, total revenue and grants in the first quarter of 2001 were slightly higher than envisaged as buoyant nontax revenues (fuelled by higher-than-programmed profit remittances from the Central Bank of Armenia) more than offset a shortfall in grant inflows (related to slower than programmed monetization of commodity grants). These higher revenues were unfortunately reflected in higher than programmed expenditures in the first quarter (dram 1.7 billion, or 4 percent). The staff is concerned about expenditure control and will stay in close contact with the authorities in the immediate period ahead, not only to better understand the reasons for the overspending and help address any identified shortcomings in budget implementation, but also to provide assurances that the authorities will possess the capacity to carry through with their intention to reduce expenditure commitments in June, should this prove necessary.
4. The required documentation under the safeguards framework is currently under review by the staff. The central bank publishes its financial statements in the Annual Report and they are audited by an international external auditor. As part of the safeguards framework staff will ascertain whether the external audit meets internationally accepted standards. The full Stage One safeguards assessment is expected to be completed by the time of the first review of the program.
5. All of the prior actions have been implemented, except for: (i) the cumulative state budget tax revenue target for January-April 2001; and (ii) the requirement that there be no increase in the stock of state budget arrears after end-December 2000. The authorities settled their external payment arrears of \$2.1 million to Turkmenistan on May 18. The reason why the authorities did not settle these arrears at least five working days prior to the Board meeting was that there was a good possibility they would receive a comfort letter from the Turkmen authorities which would allow Armenia to settle this payment through the provision of goods at a later date. As this did not come, the authorities settled the arrears through a cash payment.

6. With regard to the first of these two prior actions, April tax revenues (at dram 10.5 billion) fell around 30 percent short of the target agreed with the staff. Consequently, the January-April cumulative tax revenue target was missed by some 8 percent. Revenues from the VAT and excises make up roughly two-thirds of tax revenue in Armenia, and this is where the main shortfalls have occurred. In April, net VAT collections were about 30 percent below the average monthly level for the first quarter. About one-third of this decline appears to be due mainly to lower collections from the energy sector—which the authorities indicate has run up some 0.4 percent of GDP in tax arrears since the beginning of the year—as well as a continuing decline in registered imports of, and thus VAT collected on, gasoline. Roughly, the other two-thirds of the decline in VAT revenues appears to be due to a sharp increase in VAT refunds on exports in April, which reflect requests for refunds by two large companies in early April. Excise collections in April continued to fall for the second straight month. The authorities attribute most of this decline to increased underreporting and smuggling of imported gasoline.

7. The authorities have indicated, in a letter to Management from the Prime Minister, that they have taken actions to deal with what appear to be the major sources of the revenue shortfall, and on this basis remain firmly committed to achieving the state budget tax revenue target for end-June 2001 as specified in the program. Specifically, the Prime Minister instructed the Ministry of State Revenues to take tougher administrative measures related to customs control and smuggling of imported gasoline. As a result, the volume of gasoline imports during the first 11 days of May rose sharply to a level higher than that for the entire month of April. Secondly, the Prime Minister referred in his letter to specific measures which were taken and decided on at a special meeting of the Board of the Ministry of Energy in which he participated, intended to ensure that the state-owned energy companies step up their tax payments in May and June.

8. In addition, the letter states that the Prime Minister is committed to (i) reduce expenditure commitments in June by an amount—should the May revenue outturn be lower than the authorities now project—necessary to keep the stock of domestic expenditure arrears in line with the program; and (ii) submit an amended budget to the parliament should the government decide, in consultation with Fund staff, that in light of actual revenue performance in the first half, further expenditure cuts would be needed to achieve the arrears clearance in the second half of the year specified in the program.

9. With regard to the second prior action, compared to a small programmed decline in the stock of state budget arrears in the first quarter of 2001, arrears increased by dram 3.0 billion. (Since the issuance of the staff report, the staff has learned that a small amount of state budget arrears—less than 0.02 percent of GDP—were accumulated in the first two months of 2001.) According to the Ministry of Finance and Economy, the government kept a roughly equivalent amount on deposit in the central bank as a contingency in the context of ongoing discussions with a major creditor. While this is technically a violation of the staff's understandings with the authorities, it should be recognized that they could have made the payment and avoided the accumulation of arrears and would have complied with the program target. In that sense, the deviation from the target was unfortunate but reversible.

10. The indications given above concerning the recent shortfall in tax revenues and expenditure slippage increase the risks to the program by making more difficult the achievement of the program's fiscal targets for June, 2001. However, the authorities have provided assurances that they will meet these targets. Therefore, based on the authorities' assurances, and despite their having not observed two prior actions, the staff continues to recommend Executive Board approval of Armenia's request for an arrangement under the Poverty Reduction and Growth Facility.

11. An assessment of structural conditionality streamlining is provided in the attached Box 1.

Box 1. Armenia—Structural Conditionality Streamlining Assessment

1. Coverage of Structural Conditionality in the Current Program

Structural conditionality in the program, listed in paras 54-55 of the MEFP and the attached Tables 1 and 2 (EBS/01/61, 4/30/01, pp. 84-87), focuses on improving public sector governance, strengthening treasury management and tax administration, and bank bankruptcy legislation. The financial performance of the energy sector is addressed by a quantitative performance criterion. Strengthening the performance of the budget and of the energy sector, and dealing with problem banks, are central to the effort to reestablish macroeconomic stability.

2. Status of Structural Conditionality from Earlier Programs

The status of structural performance criteria and benchmarks for end-March and end-June 1999 was presented in EBS/99/181, 9/20/99, Table 2, p. 9. Energy sector reform, which was not implemented, will be covered under the proposed World Bank SAC IV, which includes board presentation and tranche release conditions related to energy sector privatization. The structural conditions for the remainder of 1999, which covered the areas of tax administration, treasury management, the banking sector, and the social safety net, were observed.

3. Structural Areas Covered by Bank Lending and Conditionality

The proposed SAC IV includes board presentation and/or tranche release conditions related to the energy sector and other privatization, improved targeting of poverty allowances, and pension reform. It also includes a number of issues related to public administrative reform, primarily those aimed at improvements in the business environment, as well as improvements in the legal framework for private sector development, further rationalization of the health and education sectors, and measures to develop land markets. The Country Assistance Strategy envisages a separate public sector reform project, preparation of which is scheduled to commence this fall.

4. Other Relevant Structural Conditions Not Included in Current Program

The proposed program does not include energy sector reform measures per se, even though these were in the 1999 program supported under the third annual ESAF arrangement (EBS/98/213, Supplement 1, 12/8/98, pp. 14-15). As noted above, the proposed program includes a quantitative performance criterion on the primary balance of the energy sector, to be monitored in close cooperation with the Bank staff, while the Bank staff will handle structural reform issues in the energy sector in the context of conditions under SAC IV. Measures in the areas of privatization, civil service reform, and the social safety net were included in the 1999 ESAF-supported program but are not included in the proposed program. These areas are important but not critical to the program's macroeconomic objectives, are outside of the Fund's core areas, and will be covered under the World Bank SAC IV and its other lending programs (see EBS/01/61, footnote 19, p. 30).

NEWS  **BRIEF**

FOR IMMEDIATE RELEASE

News Brief No. 01/45
FOR IMMEDIATE RELEASE
May 24, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Approves US\$87 Million PRGF Credit to Armenia

The Executive Board of the International Monetary Fund (IMF) has given its final approval of the three-year loan of SDR 69 million (about US\$87 million) under the Poverty Reduction and Growth Facility (PRGF) for Armenia to support the government's economic program. This final approval will make the first disbursement of SDR 10 million (about US\$13 million) available immediately.

The approval by the IMF Executive Board was contingent on a decision by the World Bank Executive Board on May 22 ([see Press Release No. 01/25](#)), which concluded that the Interim Poverty Reduction Strategy Paper (I-PRSP) submitted by the Republic of Armenia provides a sound basis for the development of a fully participatory PRSP and for World Bank concessional financial assistance.



Press Release No. 01/25
FOR IMMEDIATE RELEASE
May 21, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves in Principle US\$87 Million PRGF Credit to Armenia

The Executive Board of the International Monetary Fund (IMF) today approved in principle a three-year loan of SDR 69 million (about US\$87 million) under the Poverty Reduction and Growth Facility (PRGF)¹ to support the government's economic program.

A final decision by the IMF Executive Board is pending discussion of Armenia's Interim Poverty Reduction Strategy Paper (I-PRSP) by the World Bank Executive Board, which is expected to take place on May 22, 2001. The first disbursement of SDR 10 million (about US\$13 million) under the new PRGF-supported program will become available when the final decision is made by the IMF Executive Board.

Following the Executive Board's discussion, Eduardo Aninat, Deputy Managing Director and Acting Chairman, stated:

"Armenia's comprehensive and ambitious macroeconomic and structural reform program in the 2001-03 period is a continuation of efforts to ensure sustained and rapid economic growth as the cornerstone of efforts to reduce poverty.

"The Armenian authorities' medium-term strategy to pursue high and sustained growth through an improvement in the overall business climate, with competitive markets guiding the allocation

¹ On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It was intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for the Republic of Armenia, pending the completion of a PRSP, a preliminary framework has been set out in an I-PRSP, and a participatory process is underway. It is understood that all policy undertakings in the I-PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement. PRGF loans carry an annual interest rate of 0.5%, and are repayable over 10 years with a 5½-year grace period in principal payments.

of resources, is appropriate. The success of this strategy depends on consolidating and sustaining macroeconomic stability, and proceeding decisively with the next stage of structural, legal, and institutional reforms. The authorities' program is expected to promote domestic savings and private investment, maintain the official international reserve position, and reduce the external debt burden over time.

“To attain the authorities' medium-term growth and poverty reduction objectives, the program contains measures to strengthen the public finances so as to eliminate the outstanding stock of budgetary arrears, maintain a rate of monetary growth consistent with continued price stability, progressively eliminate losses by state-owned enterprises, and further improve regulation of the banking sector. The program also emphasizes improved governance through increasing transparency and reducing corruption, which is essential to ensure that an acceleration in economic growth will succeed in reducing poverty. The envisaged reforms are consistent with the Interim Poverty Reduction Strategy Paper and will be appropriately modified once the Poverty Reduction Strategy Paper has been finalized,” Mr. Aninat said.

Program Summary

Real GDP growth in Armenia exceeded 6 percent during the first nine months of 1999, but following the political assassinations in October 1999, the economic situation deteriorated in late 1999 and early 2000. In the second quarter of 2000, economic growth resumed, while price stability was ensured.

The new three-year economic program focuses on policies that would enable Armenia to reduce its remaining fiscal vulnerabilities and ensure sustained and rapid economic growth as the cornerstone for its efforts to reduce poverty. The envisaged policies are consistent with the I-PRSP, which sets out the main elements of the authorities' broader program aimed at achieving these goals.

The program anticipates that structural measures and improvements in governance, together with an improvement in the fiscal position and an appropriate monetary policy, should lead to increased private investment (including foreign direct investment) and sustained, rapid economic growth and poverty reduction.

Under the program, real GDP growth is projected to average around 6 percent during 2001-03, annual inflation will be held to 3 percent, and the gross official reserve position of the Central Bank of Armenia will be maintained at around 3½ months of imports. The external position is expected to strengthen due to foreign direct investment in the export sector, production by new or newly privatized firms of goods that are competitive with imports, and anticipated private inflows.

In 2001, real GDP and inflation are projected to be broadly in line with the medium-term targets under the program. The overall state budget deficit is targeted to fall to 4.0 percent of GDP in 2001 (on an accrual basis) from 6.4 percent in 2000. Revenue and grants are projected to increase by 0.7 percent of GDP in 2001 compared with 2000, and total expenditure is projected to fall by 1.6 percent of GDP. This deficit reduction, combined with a projected increase in net private investment of about 2 percentage points of GDP in 2001 (mainly because of major new investments financed by the Armenian diaspora), would keep the current account deficit under control.

Selected reforms are included in the program in the structural and governance areas that are essential to ensure macroeconomic stability, to establish an improved environment for private investment and growth, and to reduce poverty. In particular, the authorities intend to improve tax administration and expenditure control, progressively eliminate financing gaps in the quasi-fiscal sectors, further improve regulation of the banking sector, and improve governance and reduce corruption by increasing transparency and accountability.

A major effort to reduce poverty is central to the authorities' program, given the sharp increase in poverty in the 1990s and the associated increase in income inequality. In the authorities'

I-PRSP, prepared in collaboration with the IMF and World Bank staffs, their strategy consists mainly of: measures to enhance economic growth prospects, since the key to poverty alleviation will be economic growth; measures to fight corruption and to reform the civil service; improved targeting of the allocation of family allowances and strengthened administrative capacity for monitoring and evaluation; pension reform; shifting of government expenditures toward the poor (particularly in the health and education sectors); and measures to strengthen labor market policies.

The Republic of Armenia became a member of the IMF on May 28, 1992. Armenia's quota² is SDR 92 million (about US\$116 million), and its outstanding use of IMF credit currently totals SDR 133 million (about US\$168 million).

² A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Republic of Armenia : Selected Economic Indicators, 1998-2003

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|-------|-------|-------|-------|-------|-------|
| 1. Gross Domestic product | | | | | | |
| Real GDP growth (percent change) | 7.3 | 3.3 | 6.0 | 6.5 | 6.0 | 6.0 |
| Nominal GDP (in billions of dram) | 959 | 988 | 1,032 | 1,149 | 1,254 | 1,369 |
| Nominal GDP (in millions of U.S. dollars) | 1,899 | 1,847 | 1,915 | 2,089 | 2,280 | 2,489 |
| 2. Inflation (CPI, percent change) | | | | | | |
| End-of-period | -1.2 | 2.1 | 0.4 | 3.5 | 3.0 | 3.0 |
| Year-on-year | 8.7 | 0.7 | -0.8 | 4.5 | 3.0 | 3.0 |
| (In percent of GDP) | | | | | | |
| 3. Central government | | | | | | |
| Revenue and grants | 17.1 | 19.3 | 16.5 | 17.2 | 17.6 | 18.0 |
| Expenditure | 21.9 | 26.5 | 22.8 | 21.2 | 20.2 | 20.9 |
| Balance (accrual) | -4.8 | -7.2 | -6.4 | -4.0 | -2.5 | -3.0 |
| 4. Monetary indicators | | | | | | |
| Reserve money (percent change) | 6.5 | 0.0 | 34.4 | 2.0 | ... | ... |
| Broad money (percent change) | 36.0 | 13.6 | 38.7 | 12.0 | ... | ... |
| Broad money velocity (end of period) | 10.0 | 9.1 | 6.9 | 6.8 | ... | ... |
| (Dram per U.S. dollar) | | | | | | |
| 5. Exchange rates | | | | | | |
| Period average | 505 | 535 | 540 | ... | ... | ... |
| End-of-period | 522 | 524 | 552 | ... | ... | ... |
| 6. External indicators (In millions of U.S. dollars, unless noted otherwise) | | | | | | |
| Current account balance (excl. official transfers) | -515 | -401 | -382 | -394 | -375 | -361 |
| In percent of GDP | -27.1 | -21.7 | -19.9 | -18.9 | -16.4 | -14.5 |
| Total external debt | 787 | 855 | 862 | 968 | 1,048 | 1,105 |
| In percent of GDP | 41.4 | 46.3 | 45.1 | 46.3 | 46.0 | 44.4 |
| Gross international reserves | 298 | 305 | 314 | 336 | 344 | 347 |
| In months of imports of GNFS | 3.9 | 3.8 | 3.6 | 3.7 | 3.6 | 3.5 |

Source: Armenian authorities; and IMF staff estimates.



INTERNATIONAL MONETARY FUND

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IMF Concludes 2001 Article IV Consultation with the Republic of Armenia

On May 21, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Armenia.¹

Background

The economic situation has improved since mid-2000 following the deterioration in late 1999 and early 2000. Real GDP began to recover in the second quarter and increased by 6.0 percent for 2000 as a whole, despite a severe drought affecting part of agriculture during the summer. Growth was led by industry, construction, and trade and services. Inflation remained low in 1999 and 2000 owing to a variety of factors, including generally non-inflationary monetary and fiscal policy during the period. Cumulative inflation for 2000 as a whole was only 0.4 percent.

Fiscal policy was characterized by a very substantial run-up in budgetary expenditure arrears in late 1999 and the first half of 2000, reflecting shortfalls in tax revenues and delays in disbursements of external budgetary financing related to policy slippages. The authorities increased revenue collections in the second half of 2000 relative to the budget as the political situation stabilized, economic activity recovered, and tax administration improved. Moreover, the World Bank disbursed the fourth tranche under its SAC III loan to Armenia in December 2000. The government also reduced budgetary expenditure commitments in the fourth quarter equal to 2.6 percent of quarterly GDP, and cleared socially significant arrears (such as family allowances, pensions, and wages), using proceeds borrowed from the Special Privatization

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Account (SPA), amounting to 2.3 percent of quarterly GDP. State budgetary expenditure arrears decreased slightly in the second half of 2000, to 4.3 percent of GDP at end-2000.

While monetary aggregates grew substantially during 1999 and 2000, inflation was low, suggesting a rapid growth in real money demand. In particular, reserve money growth was moderate in the first half of 2000, but exceeded the upper limit of the Central Bank of Armenia's (CBA) indicative reserve money corridor starting in July. In the fourth quarter, however, reserve money increased by 25 percent, because the net foreign assets of the CBA increased due to official inflows and spending of proceeds from the SPA on capital expenditures and—through the bridging operation—on clearance of arrears. Reserve money was brought down significantly in the first quarter of 2001. Armenia's currency, the dram, remained broadly stable during the 1999-2000 period.

The external current account improved significantly, with the deficit falling from 21.2 percent of GDP in 1998 to 14.6 percent in 2000, reflecting a reduced trade deficit. The capital account surplus decreased from around US\$400 million in 1998 to around US\$300 million in both 1999 and 2000, in the absence of major international privatizations which had boosted foreign direct investment in 1998. At end-2000, external debt amounted to US\$862 million, the equivalent of 45 percent of GDP or 196 percent of (current year) exports. In present value terms, external debt at end-2000 is estimated at US\$535 million, or the equivalent of 135 percent of exports, down from US\$549 million (154 percent of exports) in 1999.

The authorities have made progress in reforming the energy sector, which remains a considerable financial drain on the budget and the rest of the economy, through taking steps to privatize the energy distribution companies (EDCs). In August 2000, the government adopted the EDC Privatization Law, which allows the privatization of the four EDCs through an international tender. The authorities have made good progress in the tender process for privatizing the EDCs.

Executive Board Assessment

Executive Directors commended the authorities for implementing macroeconomic policies following the political turbulence of late 1999 and early 2000 that have succeeded in maintaining low inflation and slowing the build-up in expenditure arrears. Directors welcomed the authorities' determination to maintain a rate of monetary growth consistent with continued price stability, tighten fiscal policy to eliminate the outstanding stock of budgetary arrears in 2002 and lower the external debt burden over time, progressively eliminate financing gaps in the quasi-fiscal sectors, further improve regulation of the banking sector, and improve governance and reduce corruption through increased transparency and accountability. All these policies were viewed as essential to laying the foundation for sustained economic growth and poverty reduction.

Directors noted that the authorities had made a good start in the process of fiscal consolidation by strengthening tax collections and cutting expenditures in the second half of 2000, and that the approved state budget for 2001 entails a further adjustment in revenues and expenditures. However, Directors stressed the need for stronger revenue-enhancing measures, while

cautioning against excessive cuts in social spending. They strongly recommended that attention be paid to the effectiveness and transparency of social spending. Directors encouraged the authorities to enact swiftly the treasury law and to rationalize expenditure over the medium term in the context of the planned public expenditure review.

Following the rapid growth in monetary aggregates in the second half of 2000, Directors commended the CBA for bringing reserve money down in the first quarter of 2001. Directors welcomed the CBA's decision to continue to use an indicative path for reserve money to guide the day-to-day implementation of the monetary program, and urged the authorities to stand ready to tighten monetary policy, should inflation turn out to be higher than projected. Directors also underscored the importance of enhanced coordination of monetary and fiscal policies.

Directors considered the authorities' flexible exchange rate policy to be appropriate, noting that indicators of external competitiveness and recent macroeconomic performance suggested that Armenia weathered well the Russian currency crisis in 1998. They praised the authorities for maintaining a liberal trade and exchange system and for their pursuit of WTO membership.

While the Financial System Stability Assessment report pointed to a relatively healthy financial system, Directors noted that the underlying situation contains a number of weaknesses and vulnerabilities. They urged the authorities to tighten bank's accounting standards, prudential rules for loan classification and loss provisioning, and capital standards to build trust in the banks and reduce financial system vulnerability to macroeconomic shocks.

Directors welcomed the recent progress in reducing the external debt burden and the steps being taken by the authorities to eliminate external payments arrears. They stressed that a cautious approach to external borrowing must continue to be pursued and supported the authorities' intention to use privatization proceeds to improve the country's debt profile.

Directors stressed that successful implementation of the government's plans for financial rehabilitation of the quasi-fiscal sectors is necessary to ensure macroeconomic stabilization and should be accorded high priority. In this regard, they attached particular importance to the planned privatization of the energy distribution companies, and urged the authorities to move ahead with the tender process in a transparent manner.

Directors welcomed the progress made in implementing the General Data Dissemination Standard, and encouraged the authorities to further improve the quality and timeliness of economic statistics.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Armenia is also available.

Republic of Armenia: Selected Economic Indicators, 1998-2000

| | 1998 | 1999 | 2000 |
|---|-------|-------|-------|
| Real sector | | | |
| Nominal GDP (in billions of drams) | 959 | 988 | 1,032 |
| Real GDP growth (percent change) 1/ | 7.3 | 3.3 | 6.0 |
| Nominal GDP (in millions of U.S. dollars) | 1,899 | 1,847 | 1,915 |
| Inflation (In percent) 2/ | | | |
| Period average 1/ | 8.7 | 0.7 | -0.8 |
| End-of-period 3/ | -1.2 | 2.1 | 0.4 |
| Exchange rates (drams/U.S. dollar) 2/ | | | |
| Period average | 505 | 535 | 540 |
| End-of-period | 522 | 524 | 552 |
| State budget (in percent of GDP) | | | |
| Revenue and grants | 17.1 | 19.3 | 16.5 |
| <i>of which: tax revenue</i> | 13.6 | 16.1 | 14.8 |
| Expenditure | 21.9 | 26.5 | 22.8 |
| <i>of which: current expenditure</i> | 16.3 | 19.2 | 17.5 |
| Cash deficit /3 | -4.7 | -5.5 | -4.0 |
| Accrual deficit | -4.8 | -7.2 | -6.4 |
| Change in arrears | 0.5 | 2.0 | 1.9 |
| Measures/Gap | 0.0 | 0.0 | 0.0 |
| Statistical discrepancy | -0.4 | -0.2 | 0.5 |
| Monetary indicators 2/ | | | |
| Reserve money (end-of-period growth rate, in percent) | 6.5 | 0.0 | 34.4 |
| Broad money (end-of-period growth rate, in percent) | 36.0 | 13.6 | 38.7 |
| Broad money velocity 6/ | 10.0 | 9.1 | 6.9 |
| External indicators | | | |
| Current account balance 7/ | | | |
| (in millions of U.S. dollars) | -515 | -401 | -382 |
| (in percent of GDP) | -27.1 | -21.7 | -19.9 |
| Total external debt | | | |
| (in millions of U.S. dollars) | 787 | 855 | 862 |
| (in percent of GDP) | 41.4 | 46.3 | 45.1 |
| External debt service (in percent of exports of goods and services) | 19.0 | 14.3 | 10.7 |
| Gross official international reserves (in millions of dollars) | 298 | 305 | 314 |
| (in months of next year's imports of goods and services) | 3.9 | 3.8 | 3.6 |

Sources: Armenian authorities; and IMF staff estimates

1/ With respect to the same period in the previous year

2/ Figures for Q1 2001 are preliminary actuals

3/ Inflation during the previous 12 months

4/ Deficit as measured by financing

5/ Change in percent of reserve money at the beginning of the period

6/ Based on GDP for the period, seasonally unadjusted for quarterly figures

7/ Excludes official transfers